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Taxing Wrongful Conviction Money Is Wrong

Our justice system is complex, and sometimes gross injustices occur. Undoing them does not always happen, and even when it does, it takes time. Few of us can imagine what it would be like to be convicted and imprisoned for crimes we did not commit. And while taxes seem far removed from this topic, they are not.

A few years ago, Congressmen [Sam Johnson](#) (R-TX) and [John Larson](#) (D-CT) tried to get legislative tax relief for innocent people who are wrongfully convicted. Their bill failed but they haven't given up. Now, they have [re-introduced](#) the [Wrongful Convictions Tax Relief Act](#). The bill would amend the tax code to say that:

“In the case of any wrongfully incarcerated individual, gross income shall not include any civil damages, restitution, or other monetary award (including compensatory or statutory damages and restitution imposed in a criminal matter) relating to the incarceration of such individual for the covered offense for which such individual was convicted.”

They correctly point out that there is a gap in the tax law. Fortunately, one can read feel-good stories about wrongfully convicted people who are subsequently freed. But what happens then? Sometimes they seek financial redress in one of a number of different ways. Sometimes they get it, but how is it taxed? It depends.



El Reno Federal Correctional Institution in El Reno, Oklahoma (Photo credit: SAUL LOEB/AFP/Getty Images)

The tax issues have been surprisingly cloudy. In the 1950s and 1960s, the IRS ruled prisoners of war, civilian internees and holocaust survivors received tax-free money for their loss of liberty. In 2007, the IRS “obsoleted” these rulings suggesting the landscape had changed. The IRS now asks whether a wrongfully jailed person was physically injured/sick while unlawfully jailed.

If so, the damages are tax free, just like more garden variety personal physical injury recoveries. What if an exoneree isn’t physically injured? In IRS [Chief Counsel Advice 201045023](#), the IRS said a recovery was exempt, but the IRS sidestepped whether being unlawfully incarcerated is *itself* tax-free. The Tax Court and [Sixth Circuit](#) in [Stadnyk](#) suggest that persons who aren’t physically injured may be taxed. That’s [why the Stadnyk case is a lemon](#).

There are usually significant physical injuries and sickness but not always. Besides, what about the money just for being locked up? What if an exoneree gets \$50,000 for physical injuries and \$450,000 for being unlawfully behind bars?

It may be difficult or even impossible to separate out all of the multiple levels of horror, all the losses that can never be made up. But in many cases, the loss of physical freedom and civil rights is at the root of the need for reparations.

The loss of physical freedom should be tax-free in its own right. Many exonerated individuals experience severe hardship acclimating to society, finding jobs, housing and reconnecting with family. The [Wrongful Convictions Tax Relief Act](#) proposes to allow exonerees to keep their awards tax-free.

The debate over these recoveries has focused (probably incorrectly) on the factual question whether the wrongfully jailed person experienced physical injuries or physical sickness while unlawfully incarcerated. If so, the damages are tax free, just like more garden variety personal physical injury recoveries. If not, taxable.

More and more prisoners are being [exonerated based on DNA](#) or other evidence. Under statute, by lawsuit or even by legislative grant, exonerees may receive compensation for their years behind bars. In fact, are you ready for some shocking figures?

Since the first DNA exoneration in 1989, wrongfully convicted persons have served thousands of years in prisons before being exonerated. The average exoneree has served more than ten years in prison. Although a few get lucky and get out quickly, some spend multiple decades behind bars. Whether you look at an individual case or at the averages, the numbers are astounding.

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