

MEMORANDUM:

To: Congressional Structured Settlements Caucus Members
From: Eric Vaughn
RE: PTSD Issue: Money Damages Recovered on Account of Post-Traumatic Stress Disorder Should Be Excluded from Gross Income Under IRC Section 104(a)(2)
Date: May 15, 2022

PTSD Issue: Twenty Members on the House Ways and Means Committee have written to Treasury Secretary Yellen and IRS Commissioner to request the Internal Revenue Service (IRS) issue a revenue ruling clarifying that Post-Traumatic Stress Disorder (PTSD) and its related damages are physical injuries or sickness and excludable under Section 104(a)(2) of the Internal Revenue Code.

PTSD was not recognized as a mental disorder by the American Psychiatric Association until 1980 but has been recognized as an illness affecting soldiers since the Civil War. Not limited to soldiers, it affects men, women and children, soldiers and civilians alike, and left untreated, can result in permanent physical and cognitive disabilities and even death.

Under the current Tax Code, Section 104(a)(2) only provides tax exempt recoveries to victims of physical injuries or sickness. In order to distinguish physical injuries from purely emotional distress type injuries, Congress amended Section 104(a)(2) of the Internal Revenue Code to require that for tax exemption, injuries or sickness must be physical in nature. The IRS later interpreted this to require the demonstration of some sort of observable harm. At the time, medical science was not sufficiently advanced to identify the structural damage done to the brain by PTSD. This remains the standard today.

Today, medical science and diagnostic technology are far more advanced than they were a quarter century ago and we now know that PTSD is not merely an outward manifestation of emotional distress, but rather, an illness that causes physical damage to the brain's limbic system. MRI's and neuroimaging studies have shown significant trauma to the cognitive and emotional regions of the brain in those who suffer from PTSD. A vast amount of current medical literature demonstrates the affect that PTSD has on the neuroanatomy and structures of the brain to someone who has been clinically diagnosed with PTSD.

It is consistent with the intent of Congress and the IRS that a physical injury like PTSD be exempt from taxation in order to make a victim with a physical injury or illness whole.

Background: Whether damages paid to an individual claimant on account of post-traumatic stress disorder (PTSD) are excludable from gross income under section 104(a)(2) of the Internal Revenue Code (Code).

Post-traumatic stress disorder (“PTSD”) should be classified as a physical sickness under Section 104(a)(2) of the Internal Revenue Code of 1986, as amended so that the money damages recovered by an individual on account of PTSD are not subject to federal income tax. Much like a traumatic brain injury caused by a car accident or trauma suffered by a newborn baby during birth, the trauma that results in PTSD is linked to a panoply of discernible physical neurological changes that medical science is just beginning to understand.

- Originally dismissed as “shell shock,” PTSD was not recognized as a mental disorder by the American Psychiatric Association until 1980, and it was not until the mid-1990s that medical researchers began studying the anatomical and physiological effects that PTSD exerts on the brain and other organ systems.
- There is now a broad consensus that PTSD is far more than a symptom of the emotional distress that lingers but eventually dissipates after an unpleasant or traumatic event; to the contrary, it is a sign of something far more serious—the alteration of neuroanatomy and brain function that, if left unaddressed, may result in permanent physical and cognitive disabilities and even death.

Section 104 of the Internal Revenue Code: If you are physically injured in military service or as a private citizen, payments you receive to compensate you for your injuries are tax-free. If you receive payments for an injury that is not physical or has no outward signs such as bruises or broken bones, the rules are less clear. PTSD can aggravate other problems and lead to joblessness, homelessness and suicide. A compensatory payment for physical injuries or physical sickness is tax-free under Section 104. However, payments for punitive damages and interest are taxed.

- Section 104(a)(1): First responders and health care workers who suffer PTSD in the course and scope of their employment currently receive the damages for PTSD tax free under Section 104(a)(1). Under IRC 104(a)(1) gross income does not include amounts received under Workmen's Compensation acts as compensation for personal injuries or sickness
- Section 104(a)(2): Requires an injury be "physical," Section 104(a)(1) states: the case types described in the white paper focus as Section 104(a)(2) requires that an injury be "physical."
- Section 104 (a)(4): Gross income does not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980.

- Section 104 (a)(5): Gross income does not include amounts received by an individual as disability income attributable to injuries incurred as a direct result of a terrorist or military action
- Section 104(a)(6): Gross income does not include monetary compensation for surviving dependents of public safety officers who died as a result of a personal injury sustained in the line of duty