Church v. Commissioner, 80 T. C. 1104 (1983)

Compensatory damages received for personal injury, including mental pain and suffering from defamation, are excludable from gross income under IRC Sec. 104(a)(2).

Summary

Wade E. Church, Arizona's Attorney General, sued a newspaper for defamation after it labeled him a communist, leading to severe personal and professional repercussions. The Tax Court ruled that the $250,000 in compensatory damages Church received were for personal injury and thus excludable from gross income under IRC Sec. 104(a)(2). The court distinguished this case from Roemer v. Commissioner, emphasizing that the damages compensated for mental anguish rather than lost income. This decision clarifies the tax treatment of defamation damages, particularly when they stem from personal injury rather than business loss.

Facts

In 1959, Wade E. Church, then Arizona's Attorney General, delivered a speech criticizing lobbyist influence on the state legislature. In response, the Arizona Republic published an editorial labeling him a communist. This led to public ostracism and ended his political career. Church sued for defamation, receiving a jury award of $250,000 in compensatory damages, $235,000 in punitive damages, and interest. The jury's focus was on the personal harm caused by the defamation, not on any specific loss of income.

Procedural History

Church filed a defamation lawsuit against Phoenix Newspapers Inc. , which was heard in Maricopa County Superior Court. The jury awarded damages in June 1971, which the Arizona Court of Appeals affirmed in 1975. The Tax Court addressed the tax implications of these damages in 1983, ruling on the excludability of the compensatory damages from gross income.

Issue(s)

1. Whether the $250,000 in compensatory damages received by Wade E. Church from a defamation lawsuit are excludable from gross income under IRC Sec. 104(a)(2).

Holding

1. Yes, because the damages were awarded on account of personal injury, specifically mental pain and suffering resulting from the defamation, and not for any loss of income or business reputation.

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Court’s Reasoning

The Tax Court emphasized that the damages were awarded for the mental anguish and personal injury Church suffered, not for any loss of income. The court noted that Church’s pleadings and the evidence presented focused on the personal harm caused by being labeled a communist, rather than any specific financial loss. The court distinguished this case from Roemer v. Commissioner, where damages were awarded for lost business profits. The court stated, “The proper inquiry is in lieu of what are the damages awarded,” and found that the jury intended to compensate Church for the “mental pain and suffering he experienced as the result of the malicious publication. ” The court also considered the historical context of anti-communism during the McCarthy era, which intensified the personal impact on Church.

Practical Implications

This ruling clarifies that compensatory damages in defamation cases can be excludable from gross income if they are awarded for personal injury, such as mental anguish, rather than for lost income or business reputation. Legal practitioners should carefully assess the nature of damages in defamation cases to determine their tax treatment. This decision may encourage plaintiffs in defamation cases to emphasize personal harm in their claims, potentially affecting how such cases are litigated and settled. Subsequent cases like Seay v. Commissioner have applied this principle, reinforcing the distinction between personal and business injury in tax law.

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