

## ***Bent v. Commissioner, 87 T. C. 245 (1986)***

Settlement payments for violations of constitutional rights under 42 U. S. C. § 1983 are excludable from gross income as damages received on account of personal injuries.

### **Summary**

Bent, a school teacher, sued the Marshallton-McKean School District after his employment was terminated, alleging violations of his First Amendment rights. The Chancery Court found the district liable for abridging Bent's freedom of speech and awarded monetary damages. The case was settled for \$24,000. The Tax Court ruled that this settlement payment was excludable from Bent's gross income under section 104(a)(2) of the Internal Revenue Code as damages for personal injuries resulting from a constitutional rights violation. However, Bent's \$8,000 legal fee payment was not deductible because it was allocable to the tax-exempt settlement.

### **Facts**

James E. Bent was employed as a secondary school teacher at McKean High School starting in 1970. He was active in the teachers' association and made public criticisms of the school administration. In 1973, his contract was not renewed, leading Bent to file a lawsuit alleging violations of his First Amendment rights and other claims. The Chancery Court found the school district liable for violating Bent's free speech rights but limited relief to monetary damages. The case was settled for \$24,000, which Bent did not report as income on his 1977 tax return, and he claimed a deduction for \$8,000 in legal fees.

### **Procedural History**

Bent's case was initially tried in the Delaware Court of Chancery, which found liability for the First Amendment violation but deferred on the amount of damages. After negotiations, the case was settled for \$24,000. Bent then faced a tax deficiency notice from the IRS, leading to a case before the U. S. Tax Court. The Tax Court determined the tax treatment of the settlement payment and legal fees.

### **Issue(s)**

1. Whether the \$24,000 settlement payment received by Bent is excludable from gross income under section 104(a)(2) of the Internal Revenue Code.
2. Whether Bent is entitled to a deduction for the \$8,000 paid as legal fees if the settlement payment is excludable.

### **Holding**

1. Yes, because the payment was made on account of a violation of Bent's First Amendment rights under 42 U. S. C. § 1983, which constitutes a personal injury and

is thus excludable under section 104(a)(2).

2. No, because the legal fees are allocable to the tax-exempt settlement payment and are therefore not deductible under section 265 of the Internal Revenue Code.

### **Court's Reasoning**

The Tax Court applied section 104(a)(2) of the Internal Revenue Code, which excludes from gross income damages received on account of personal injuries. The court found that Bent's settlement was based on the Chancery Court's ruling that his First Amendment rights were violated, a claim under 42 U. S. C. § 1983, which the court characterized as a "species of tort liability" and a personal injury action. The court cited Supreme Court precedent in *Wilson v. Garcia*, which established that § 1983 claims are best characterized as personal injury actions. The court rejected the IRS's argument that the settlement was for contractual issues, focusing instead on the constitutional rights violation. Regarding the legal fees, the court applied section 265, which disallows deductions for expenses allocable to tax-exempt income.

### **Practical Implications**

This decision clarifies that settlement payments for violations of constitutional rights under § 1983 can be excluded from gross income as damages for personal injuries. Legal practitioners should note this when advising clients on the tax treatment of such settlements. However, the non-deductibility of legal fees related to these settlements may affect the net benefit to the plaintiff. This ruling influences how similar cases involving constitutional rights are analyzed for tax purposes and may affect settlement negotiations. Subsequent cases have applied this ruling, such as in situations where damages for emotional distress or other non-physical injuries are at issue.