Threlkeld v. Commissioner, 92 T. C. 1302 (1989)

Damages received for injury to professional reputation in a malicious prosecution claim are excludable from gross income as compensation for personal injuries under section 104(a)(2).

Summary

In Threlkeld v. Commissioner, the Tax Court ruled that damages received for injury to professional reputation in a settlement of a malicious prosecution claim are excludable from gross income under section 104(a)(2). The case involved a taxpayer who received $21,500 as part of a settlement agreement for malicious prosecution, specifically allocated for damage to his professional reputation. The court overturned its prior distinction between personal and professional reputation, finding no justification for such a distinction in tort actions. The decision was based on the nature of the claim under Tennessee law, which treats malicious prosecution as a personal injury, and the court's interpretation that section 104(a)(2) covers all personal injuries, physical or nonphysical.

Facts

The taxpayer, Threlkeld, filed a lawsuit against J. B. Williams for malicious prosecution after Williams unsuccessfully sued Threlkeld for fraud in a real estate transaction. The original suit against Threlkeld was dismissed, and he subsequently sued Williams for malicious prosecution, alleging damage to his professional reputation among other injuries. In 1980, Threlkeld settled the malicious prosecution claim with Williams, receiving $300,000, of which $21,500 was specifically allocated for damage to his professional reputation. Threlkeld did not report this amount as income on his 1980 tax return, leading to a dispute with the IRS over whether this portion of the settlement was excludable from gross income under section 104(a)(2).

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Threlkeld's federal income taxes for 1979 and 1980, asserting that the $21,500 received for damage to professional reputation was taxable. After concessions by both parties, the sole issue before the Tax Court was the tax treatment of the $21,500 received in 1980. The Tax Court reviewed prior case law and its own precedents, ultimately deciding to overrule its previous distinction between personal and professional reputation in tort actions for purposes of section 104(a)(2).

Issue(s)

1. Whether damages received for injury to professional reputation in a malicious prosecution claim are excludable from gross income under section 104(a)(2).

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the court determined that the distinction between personal and professional reputation should not be maintained for the purpose of section 104(a)(2), and that damages for malicious prosecution are considered compensation for personal injuries under Tennessee law.

Court’s Reasoning

The court’s decision to overrule the distinction between personal and professional reputation was based on several factors. Firstly, the court noted that no Court of Appeals had upheld this distinction, and the Ninth Circuit in Roemer v. Commissioner had rejected it. The court emphasized that the focus should be on the nature of the injury, not its consequences, and that all personal injuries, whether physical or nonphysical, should be treated similarly under section 104(a)(2). The court analyzed the nature of malicious prosecution under Tennessee law, finding it to be a personal injury tort. The court also considered the legislative history and purpose of section 104(a)(2), concluding that it was meant to exclude damages received for any invasion of rights inherent to a person. The court’s decision was supported by a majority of judges, with no dissenting opinions recorded.

Practical Implications

This decision has significant implications for the tax treatment of damages received in tort actions. It clarifies that damages for injury to professional reputation in the context of personal injury torts like malicious prosecution are excludable from gross income. This ruling may encourage taxpayers to challenge the taxability of similar damages and could lead to changes in how settlement agreements are structured and reported for tax purposes. It also underscores the importance of state law classifications of torts in determining federal tax treatment. Subsequent cases have cited Threlkeld in support of the broader interpretation of “personal injuries” under section 104(a)(2), further solidifying its impact on tax law regarding tort recoveries.

© 2025 SCOTUSreports.com. All rights reserved.