Burford v. United States, 642 F. Supp. 635 (N. D. Ala. 1986)

Section 104(a)(2) of the Internal Revenue Code excludes both compensatory and punitive damages received on account of personal injuries from gross income.

Summary

In Burford v. United States, the court addressed whether punitive damages awarded in a wrongful death action were excludable from gross income under section 104(a)(2). The plaintiff received damages following a wrongful death lawsuit, which included punitive damages. The court held that the broad language of section 104(a)(2), which excludes “any damages received on account of personal injuries,” encompasses both compensatory and punitive damages. The decision emphasized the plain meaning of the statute, rejecting the IRS’s position that punitive damages should be taxable.

Facts

The plaintiff received damages from a wrongful death lawsuit, which included both compensatory and punitive damages. The IRS argued that punitive damages should be included in gross income, while the plaintiff contended that section 104(a)(2) excluded all damages received on account of personal injuries, including punitive damages.

Procedural History

The case was initially filed in the United States District Court for the Northern District of Alabama. The court addressed the issue of whether punitive damages should be excluded from gross income under section 104(a)(2). The court’s decision was based on the interpretation of the statutory language and rejected the IRS’s position as stated in Revenue Ruling 84-108.

Issue(s)

1. Whether section 104(a)(2) of the Internal Revenue Code excludes punitive damages received on account of personal injuries from gross income.

Holding

1. Yes, because the plain meaning of “any damages received on account of personal injuries” under section 104(a)(2) includes both compensatory and punitive damages.

Court’s Reasoning

The court’s decision hinged on the interpretation of the statutory language of section 104(a)(2). The court noted that Congress, aware of punitive damages when enacting the predecessor to section 104(a)(2), chose not to limit the exclusion to compensatory damages. The court rejected the IRS's position in Revenue Ruling 84-108, which argued that punitive damages were not awarded "on account of" personal injury. The court emphasized that punitive damages result from both personal injury and the defendant's culpability, and thus are received "on account of" personal injury. The court also cited Burford v. United States, which held that section 104(a)(2) excluded an award in a wrongful death action, including punitive damages, from gross income.

Practical Implications

This decision clarifies that punitive damages received on account of personal injuries are excludable from gross income under section 104(a)(2). Attorneys should advise clients that all damages, including punitive, from personal injury lawsuits are not taxable. This ruling may influence how damages are structured in settlements and how tax liabilities are calculated. It also serves as a precedent for future cases involving the tax treatment of punitive damages, potentially affecting the IRS's approach to similar cases. Subsequent cases, such as Rickel v. Commissioner, have further reinforced this interpretation, emphasizing the importance of the nature of the claim in determining taxability.

