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When Have They Paid Enough - The Taxability of Compensation Payments Made to Wrongfully Incarcerated Individuals

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WHEN HAVE THEY PAID ENOUGH?
THE TAXABILITY OF COMPENSATION
PAYMENTS MADE TO WRONGFULLY
INCARCERATED INDIVIDUALS

Erin Tyler Brewster*

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I. INTRODUCTION

On July 22, 2010, Cornelius Dupree (Dupree) was released from
prison and placed on parole.1 Eight days later, DNA test results
confirmed that Dupree served thirty years in the Texas prison

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The author would like to thank her husband for his unwavering patience, support, and
love.

1. Houston Man To Be Declared Innocent After Serving 30 Years For a Dallas Rape
project.org/Content/Houston_Man_To_Be_Declared_Innocent_After_Serving_30_Years_
For_a_Dallas_Rape_and_Robbery_He_Didnt_Commit.php.

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system for crimes he did not commit. In the state of Texas, Dupree has served more time in prison than any other innocent individual cleared by DNA evidence.

Dupree's nightmare began in December 1979, when a female, who was robbed and raped at gunpoint by two men on November 23, 1979, misidentified nineteen-year-old Dupree and friend Anthony Massingill (Massingill) as the perpetrators of the crime. At a trial four months following the attack, Dupree and Massingill were again identified as the attackers. Although maintaining his innocence throughout his trial, Dupree was found guilty of aggravated robbery and assault with a deadly weapon. As a result, Dupree was sentenced to seventy-five years in prison.

The tragedy of wrongful conviction and incarceration is twofold: 1) the person responsible for the crime remains on the streets, potentially harming others in society, and 2) an innocent person is, all at once, stripped of his freedom and thrust into the notorious violence and terror of the prison system. While the true perpetrator of the crime for which Dupree was convicted and sentenced may never be found, Dupree has at least been granted his freedom. And Dupree is more fortunate than others in his position; for the thirty years he spent behind bars Dupree is eligible under Texas statute for compensation of $80,000 per year of incarceration, plus additional amounts for educational and reintegration assistance.

After thirty years of incarceration, Dupree stands to receive approximately $2.4 million from the state of Texas—that is—before taxes. The question of whether this amount qualifies as gross income, and thus is subject to federal income tax, remains unclear. The taxability of such payment ultimately hinges on whether the compensation is paid on ac-

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2. Id.
3. Id.
4. Id. An astounding 75% of the erroneous convictions that have been cleared with DNA technology are the result of misidentifications. Id.
5. Id.
6. Id. The prosecutor did not prosecute Dupree for the rape charges since a conviction would not have added to his sentence. Id.
7. Id.
count of personal physical injury or physical illness. While this determination seems simple enough, it is an area fraught with uncertainty, particularly in defining what is, or is not, “physical.”

Part II of this Comment highlights the disheartening realities of erroneous convictions in the United States, including the measures that have been taken at both the federal and state levels to identify cases in which DNA evidence may lead to exoneration and, once identified, freeing and compensating those individuals who have spent time in prison for crimes they did not commit. Part III addresses the definition of gross income for federal income tax purposes and the current requirement that compensation be paid on account of some sort of “physical” harm in order to be excluded from gross income. Finally, Part IV explores how the classification of payments made to wrongfully incarcerated individuals directly dictates their taxability and why such payments should not be subject to federal income taxation.

II. RIGHTING A WRONG: THE INNOCENCE PROJECT AND COMPENSATING THE WRONGFULLY INCARCERATED

A. AN INNOCENCE PROJECT

Individuals in the United States have been wrongfully accused, convicted, and incarcerated due to a variety of factors, including: eyewitness misidentification, false confessions (whether coerced or obtained from a young or developmentally disabled individual), incorrect snitch testimony (often offered for preferential treatment or deals entered into with the prosecution), prosecutorial misconduct, and improper forensic evidence. On average, a wrongfully incarcerated individual is convicted at the age of twenty-seven and spends thirteen years in prison. In aggregate, wrongfully incarcerated individuals have served approximately 3,524 years in prison.

Long before the passage of the Justice for All Act of 2004, signed into law by former President George W. Bush on October 30, 2004, a breakthrough in DNA testing introduced a scientific means to prove actual innocence of individuals who had been wrongfully incarcerated for crimes they did not commit. Where blood typing had traditionally been the primary means of identifying or excluding suspects, the “DNA fingerprint

13. Id.
14. Id.
17. BARRY SCHECK ET AL., WHEN JUSTICE GOES WRONG AND HOW TO MAKE IT RIGHT: ACTUAL INNOCENCE 52 (2003).
test” allowed for a more refined means of determining whether or not an individual had committed a crime.\textsuperscript{18} Unfortunately, the “DNA fingerprint test” was only possible in instances where an ample supply of DNA existed, a rarity at most crime scenes.\textsuperscript{19} With Kary Mullis’s remarkable 1983 revelation, the polymerase chain reaction, DNA testing was made possible on much smaller amounts of genetic material,\textsuperscript{20} resulting in an increase of cases where DNA testing was made possible.

The Innocence Project almost exclusively handles cases in which DNA evidence is available to prove an individual’s innocence.\textsuperscript{21} Since the first DNA exoneration in 1989, 273 individuals across thirty-four states have been exonerated through DNA evidence.\textsuperscript{22} Of those 273 individuals, seventeen spent time on death row.\textsuperscript{23} Of the individuals exonerated by post-conviction DNA testing, approximately half have been financially compensated for their wrongful incarceration.\textsuperscript{24}

\section*{B. The Federal Statute}

The Justice for All Act of 2004 included the Innocence Protection Act of 2004 (the Act), which established federal post-conviction DNA testing, granted incentives for states to consider claims of actual innocence, developed grants to improve capital representation and prosecution in state cases, increased compensation in federal cases, and contained congressional encouragement for state compensation statutes.\textsuperscript{25} More specifically, the Act allowed an individual to file a motion for DNA testing of evidence if: 1) the applicant asserted, under penalty of perjury, his or her innocence of the federal offense or of a separate federal offense if the evidence was admitted in a federal death sentencing hearing and being found not guilty of the federal offense would lead to a lesser sentence or new sentencing hearing, 2) the DNA evidence was secured in connection with the investigation or prosecution of the federal offense, 3) the evidence to be tested had not already been subjected to DNA testing and the applicant did not waive his or her right to DNA testing after the enactment of the Innocence Protection Act of 2004, 4) the government had possession of the evidence to be tested at the time the motion was filed and met specified chain of custody requirements, and 5) the requested DNA testing was reasonable and consistent with scientific and forensic practices.\textsuperscript{26} Additionally, an individual must present a defense that is not incompatible with any affirmative defenses previously offered at trial and

\begin{itemize}
\item \textsuperscript{18} Id. at 45.
\item \textsuperscript{19} Id. at 46.
\item \textsuperscript{20} Id. at 49.
\item \textsuperscript{22} Facts on Post-Conviction DNA Exonerations, supra note 8.
\item \textsuperscript{23} Id.
\item \textsuperscript{24} Id.
\item \textsuperscript{26} Id. § 411.
\end{itemize}
that, if proved, would demonstrate his actual innocence.\textsuperscript{27} An individual may similarly file a motion for DNA testing in the case of a state offense if the individual is able to show that no adequate remedy exists under state law to authorize DNA testing and the individual has exhausted all existing remedies under state law in requesting DNA testing.\textsuperscript{28}

Under the Innocence Protection Act of 2004, if the DNA test shows that the incarcerated individual was not the source of the DNA evidence at issue, such individual may be entitled to either a new trial or re-sentencing.\textsuperscript{29} The individual may file a motion for a new trial or re-sentencing which shall be granted by the court if the DNA test results, when examined with all the evidence in the case (whether or not previously introduced at trial), “establish by compelling evidence that a new trial would result in an acquittal.”\textsuperscript{30} The acquittal may be of either the federal offense for which the individual has been incarcerated or another federal or state offense that was admitted in a federal death sentencing hearing, the exoneration of which would result in a reduced sentence.\textsuperscript{31}

The Innocence Protection Act of 2004 enacted other, additional protections to assist in exonerating innocent individuals from faulty prosecution and incarceration. Accordingly, the government must maintain biological evidence obtained during an investigation or prosecution of a federal offense for which an individual is incarcerated.\textsuperscript{32} The Act also established generous grant programs to assist states in managing the costs of post-conviction DNA testing,\textsuperscript{33} provided that states meet certain requirements and allow for post-conviction DNA testing under a state statute, rule, regulation, or practice comparable to 18 U.S.C. § 3600(a) that sufficiently resolves claims of actual innocence.\textsuperscript{34} The Act also provided grants to states for creating or improving systems to heighten “the quality of legal representation provided to indigent defendants” who had been charged with offenses subject to capital punishment.\textsuperscript{35} Grants were similarly provided to aid state and local prosecutors in litigating such capital punishment cases, including training programs, legal reform, assessment of prosecutorial performance, and a systematic review of state death penalty cases to determine cases for which post-conviction DNA analysis might be suitable.\textsuperscript{36}

Perhaps most significant to the discussion at hand, the Innocence Protection Act of 2004 increased the amount of federal compensation granted to wrongfully incarcerated individuals and encouraged states to

\textsuperscript{27} Id.
\textsuperscript{28} Id.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Id.
\textsuperscript{33} Id. § 412. The Kirk Bloodsworth Post-Conviction DNA Testing Grant Program appropriated $5,000,000 per year for the years 2005 through 2009 for such purpose. Id.
\textsuperscript{34} Id. § 413.
\textsuperscript{35} Id. § 421.
\textsuperscript{36} Id. § 422.
develop and enact their own compensation statutes in state death penalty cases. The Act increased federal compensation to $50,000 per year of wrongful incarceration or, in the case of a wrongfully incarcerated individual who served time on death row, $100,000 per year. The Act explicitly stated Congress's intent regarding the states: "It is the sense of Congress that States should provide reasonable compensation to any person found to have been unjustly convicted of an offense against the State and sentenced to death." Thus, the Innocence Protection Act of 2004 bolstered federal compensation to the wrongfully incarcerated and provided clear congressional intent for states to follow suit.

C. State Compensation Statutes

While the federal government, the District of Columbia, and twenty-seven states have compensation statutes for wrongfully incarcerated individuals, each jurisdiction differs in its terms and measures of compensation. Although the federal and state statutes differ in eligibility, methods of payment, timing, and exceptions, the basis (remuneration for physical injury, lost wages, educational assistance) for each jurisdiction's compensation system is the focus of a taxability discussion. A brief survey of the twenty-eight jurisdictions in the United States with compensation statutes shows the wide variance that exists between the type and amount of compensation afforded in each jurisdiction.

ALABAMA

Wrongfully incarcerated individuals are entitled to receive $50,000 per year of wrongful incarceration. The Alabama Committee on Compensation for Wrongful Incarceration has the discretion to propose (in the form of a bill to the state legislature) that an additional amount be awarded "if circumstances warrant such a supplemental award."

CALIFORNIA

Compensation to wrongfully incarcerated individuals is limited to $100 per day of incarceration and requires a showing that the individual sustained pecuniary damages as a result of wrongful conviction and incarceration. The statute specifies that the payment does not constitute gross income for California state income tax purposes.

CONNECTICUT

A wrongfully incarcerated individual may file a claim against the state, providing evidence of damages arising from "loss of liberty and enjoyment of life, loss of earnings, loss of earning capacity, loss of familial rela-

37. Id. § 431–32.
38. Id. § 431.
39. Id. § 432.
40. Compensating the Wrongly Convicted, supra note 8.
41. See discussion infra Part III.
43. Id. § 29-2-159(b).
45. Id.
tionships, loss of reputation, physical pain and suffering, mental pain and suffering and attorney's fees and other expenses arising from or related to such person's arrest, prosecution, conviction and incarceration." In determining the amount of compensation payable to an individual, the Connecticut Claims Commissioner must also consider damages incurred by such individual. Additionally, compensation may include payments for employment assistance, tuition for any state institution of higher education, and reintegration into society.

DISTRICT OF COLUMBIA

A wrongfully incarcerated individual may bring a claim against the District of Columbia; the amount of compensation to be awarded is under the judge's discretion. Punitive damages are explicitly excluded from any compensation awarded.

FLORIDA

Wrongfully incarcerated individuals are entitled to $50,000 per year of incarceration plus reimbursement of any court costs, fines, penalties, or reasonable attorney's fees incurred by the wrongfully incarcerated individual. Remuneration for these amounts may not exceed $2,000,000. Wrongfully incarcerated individuals are also entitled (separate from the $2,000,000 cap) to a tuition and fee waiver for up to 120 credit hours at a career center, community college, or state university.

ILLINOIS

The amount of compensation is at the discretion of the Illinois Court of Claims, with maximum awards (adjusted annually in accordance with changes in the Consumer Price Index For All Urban Consumers) set by the statute. Additionally, the state provides job search and placement services to wrongfully incarcerated individuals.

IOWA

Compensation available to wrongfully incarcerated individuals is limited to attorney's and other related fees incurred in connection with the individual's wrongful conviction and post-conviction relief. Compensation also includes $50 per day of wrongful incarceration plus the value of lost wages (set at a maximum of $25,000 per year) directly related to the individual's erroneous conviction and incarceration.

46. CONN. GEN. STAT. § 54-102uu(b)-(c) (West 2009).
47. Id. § 54-102uu(d).
48. Id. § 54-102uu(e).
50. Id. § 2-423.
51. FLA. STAT. ANN. § 961.06(1)(a), (c), (d) (West Supp. 2010).
52. Id. § 961.06(1) (flush language).
53. Id. § 961.06(1)(b).
54. 705 ILL. COMP. STAT. ANN. 505 / 8(c) (West 2007). The maximum compensation amounts currently set by statute are as follows: $85,350 for five years imprisonment or less, $170,000 for imprisonment between five and fourteen years, and $199,150 for imprisonment greater than fourteen years. Id. at 505 / 8(c) (West Supp. 2011).
55. 20 ILL. COMP. STAT. ANN. 1015 / 2 (West Supp. 2010).
56. IOWA CODE ANN. § 663A.1(a) (West 2003).
57. Id. § 663A.1(b)-(c).
LOUISIANA

Compensation is set at $15,000 per year, with an aggregate maximum award set at $150,000.58 At the discretion of the court, additional compensation (up to $40,000) may be granted for “loss of life opportunities” including one year of job-skills training, medical and counseling services, and Louisiana state public education or community college tuition.59

MAINE

Damages for wrongful incarceration are limited to $300,000, and punitive damages are specifically excluded by statute.60

MARYLAND

The Maryland Board of Works maintains the discretion to award a wrongfully convicted and incarcerated individual damages corresponding to the actual damages sustained by such individual.61 In addition, compensation may include an amount for financial or other counseling.62

MASSACHUSETTS

Total compensation is in the discretion of the judge or jury and is limited to $500,000.63 In awarding damages, the judge or jury may consider income the individual would have earned, circumstances surrounding the individual’s conviction, the length and conditions of incarceration, and any other factors necessary to compensate the individual.64 Damages may also be awarded for services to deal with physical or emotional issues directly related to incarceration.65 Furthermore, wrongfully incarcerated individuals may be entitled to a 50% reduction in tuition for any Massachusetts state or community college.66

MISSISSIPPI

A wrongfully convicted individual is entitled to $50,000 per year of erroneous incarceration, with a maximum recovery of $500,000.67 The statute explicitly excludes any compensation awarded to a wrongfully incarcerated individual from that person’s gross income for state income tax purposes.68

59. Id. § 572.8H(2)(a)-(c).
62. Id.
63. MASS. GEN. LAWS ANN. ch. 258D, § 5(A) (West Supp. 2010).
64. Id.
65. Id.
66. Id.
67. MISS. CODE ANN. § 11-44-7(2)(a) (West Supp. 2010). The statute provides legislative intent regarding wrongfully incarcerated individuals in a particularly earnest manner, stating that such persons “have been uniquely victimized, have distinct problems reentering society” and “[i]n light of the particular and substantial horror of being imprisoned for a crime one did not commit, the Legislature intends . . . that innocent people who are wrongfully convicted be able to receive monetary compensation.” Id. § 11-44-1.
68. Id. § 11-44-7(3)(c).
MISSOURI

Compensation is set at $50 per day of post-conviction incarceration for the crime for which the individual is found innocent.69

MONTANA

Wrongfully incarcerated individuals are entitled to receive educational assistance including tuition, fees, books, and room and board at any Montana community college, state university, or tribally-controlled community college.70

NEBRASKA

Compensation for wrongful incarceration is based on damages “found to proximately result from the wrongful conviction” and is limited to a maximum of $500,000.71

NEW HAMPSHIRE

Damages awarded to wrongfully incarcerated individuals are set at a maximum of $20,000.72

NEW JERSEY

Wrongfully convicted individuals are entitled to the greater of: 1) twice the amount of the individual's income prior to incarceration, or 2) $20,000 per year of wrongful incarceration.73 In addition, damages may include reasonable attorney's fees.74

NEW YORK

It is within the court's discretion to “award damages in such sum of money as the court determines will fairly and reasonably compensate” the wrongfully convicted and incarcerated individual.75

NORTH CAROLINA

A wrongfully incarcerated individual has a claim against the state for the pecuniary losses suffered as a result of wrongful incarceration.76 Compensation of $50,000 per year of wrongful incarceration may be awarded, not to exceed $750,000 in total.77 A wrongfully incarcerated individual may be further compensated for any “loss of life opportunities” in the form of job-skills training and tuition at any North Carolina public university or community college.78

71. Neb. Rev. Stat. § 29-4604(1), (4) (Supp. 2010). The Nebraska statute, much like the Mississippi statute, contains strong words of legislative intent. See supra note 67. Given that claimants have been “uniquely victimized, have distinct problems reentering society, and have difficulty achieving legal redress . . . such persons should have an avenue of redress.” Neb. Rev. Stat. § 29-4602. The statute goes further to acknowledge the “particular and substantial horror” of wrongful incarceration. Id.
74. Id. § 52:4C-5(b).
77. Id. § 148-84(a).
78. Id. § 148-84(c)(1)–(2).
OHIO

Compensation includes fines, court costs, and reasonable attorney's fees relating to the criminal proceedings against the wrongfully incarcerated individual, as well as $40,330 (adjusted annually by the state auditor based on the yearly average of the two prior years' consumer price index) per year of wrongful incarceration.\(^79\) An individual may also be awarded lost wages or income suffered as a direct result of wrongful imprisonment.\(^80\) While an individual may maintain a claim against the state for wrongful incarceration, the statute "does not affect any liability of the state or of its employees to a wrongfully imprisoned individual on a claim for relief that is not based on the fact of the wrongful imprisonment, including . . . a claim for relief that arises out of circumstances occurring during . . . confinement."\(^81\)

OKLAHOMA

Compensation is set at a maximum of $175,000, and punitive damages are specifically excluded by statute.\(^82\)

TENNESSEE

The Board of Claims considers factors such as physical and mental suffering and loss of earnings in determining the amount of compensation due to a wrongfully incarcerated individual, with a maximum award of $1,000,000.\(^83\)

TEXAS

Wrongfully incarcerated individuals are entitled to receive $80,000 per year of wrongful imprisonment in addition to amounts paid for child support owed by such individual (the claim for which arose out of their imprisonment), including any unpaid interest or arrearages that accrued during imprisonment.\(^84\) Such individuals may also receive an additional $25,000 per year spent on parole or as a registered sex offender.\(^85\) Additional compensation is available for tuition (up to 120 credit hours) and fees at a career center or public institution of higher education,\(^86\) as well as reentry and reintegration services.\(^87\)

UTAH

Compensation paid to wrongfully incarcerated individuals is set at the annual Utah nonagricultural payroll wage (based on the most recent data at the time of the individual's release) per year of erroneous incarceration, for a maximum of fifteen years.\(^88\)

\(^80\) Id. § 2743.48(E)(2)(c).
\(^81\) Id. § 2743.48(F)(3).
\(^85\) Id. § 103.052(b).
\(^86\) Id. §103.054.
\(^87\) Tex. Gov't Code § 501.091(b) (West Supp. 2010).
\(^88\) Utah Code Ann. § 78B-9-405(1)(a) (West 2010).
VERMONT

At the discretion of the trier of fact, compensation may be set between $30,000 and $60,000 per year of wrongful incarceration. The wrongfully incarcerated individual may also be entitled to lost wages, reasonable attorney's fees, costs related to criminal defense and proving innocence, up to ten years access to the Vermont Health Access Plan, reintegration expenses, and certain mental and physical health care expenses. With the exception of amounts awarded for attorney's fees, compensation awarded to a wrongfully incarcerated individual is exempt from Vermont state taxes.

VIRGINIA

Compensation paid to wrongfully incarcerated individuals is set at an amount equal to 90% of the Virginia per capita personal income (based on the annual report by the Bureau of Economic Analysis of the U.S. Department of Commerce) per year of erroneous incarceration, up to twenty years. In addition, up to $10,000 shall be available as compensation for tuition at a Virginia community college or technical training institution.

WEST VIRGINIA

At the discretion of the court, compensation awarded to a wrongfully convicted person shall be a sum that “the court determines will fairly and reasonably compensate him.”

WISCONSIN

Subject to the discretion of the claims board, a wrongfully incarcerated individual is entitled to compensation “which will equitably compensate” him, not to exceed $25,000 in total or a rate of compensation greater than $5,000 per year. The claims board may petition the legislature on a case-by-case basis for additional amounts if it does not feel the $25,000 allowed by the statute is adequate.

In the twenty-three states that do not have compensation statutes, wrongfully incarcerated individuals have limited means to remedy the years spent behind bars. While these individuals may be able to bring common law tort claims, constitutional claims under Section 1983 for deprivation of liberty, claims for violation of the Fourth Amendment.

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89. VT. STAT. ANN. tit. 13, § 5574(b) (West 2009).
90. Id. § 5574(b)(1)–(4).
91. Id. § 5574(c)(1).
92. VA. CODE ANN. § 8.01-195.11(A) (West 2007).
93. Id. § 8.01-195.11(C).
94. W. VA. CODE ANN. § 14-2-13a(g) (West 2009).
95. WIS. STAT. ANN. § 775.05(4) (West 2009).
96. Id.
right against illegal search and seizure, claims alleging violations of the Fifth Amendment right to due process of law, or seek individual, case-by-case state legislative remedies, such avenues have their own complications and difficult elements to establish.\textsuperscript{99} Even if recovery is obtained through one of these alternative routes, it will likely be based on something other than the direct, physical injury caused by wrongful incarceration.

III. DEFINING “PHYSICAL”: STADNYK AND CURRENT DEVELOPMENTS SURROUNDING THE TAXABILITY OF WRONGFUL INCARCERATION PAYMENTS

A. GROSS INCOME AND DAMAGES

Internal Revenue Code (Code) Section 61 broadly defines gross income as “all income from whatever source derived,” including a lengthy but non-exhaustive list of includible items.\textsuperscript{100} Accordingly, an item is generally included in gross income unless it has been specifically excluded under another section of the Code. The Supreme Court has clarified the sweeping definition of gross income as “instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion” and directed that Code Section 61 be given a “liberal construction . . . in recognition of the intention of Congress to tax all gains except those specifically exempted.”\textsuperscript{101} The Court added that “[t]he mere fact that the payments were extracted from the wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to the recipients.”\textsuperscript{102} Additionally, the mere fact that an award for damages is compensatory in nature does not exclude it from gross income.\textsuperscript{103} Thus, it reasonably follows that under the general definition of gross income, damages are includible in income (and, thus, subject to federal income tax).

\textsuperscript{99} Id.
\textsuperscript{100} I.R.C. § 61 (2006). The non-exclusive list includes: “(1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) Gross income derived from business; (3) Gains derived from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Alimony and separate maintenance payments; (9) Annuities; (10) Income from life insurance and endowment contracts; (11) Pensions; (12) Income from discharge of indebtedness; (13) Distributive share of partnership gross income; (14) Income in respect of a decedent; and (15) Income from an interest in an estate or trust.” Id.


\textsuperscript{102} Id.

\textsuperscript{103} Burke, 504 U.S. at 241 (With respect to back-pay settlement awards that were compensatory in nature, the Court held: “[t]here is no dispute that the settlement awards in this case would constitute gross income within the reach of § 61(a).”).
Internal Revenue Code Section 104 has historically offered an exclusion from gross income for five areas of compensation for physical injury or illness. Prior to 1996, Code Section 104(a)(2) provided an exclusion for “the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.” As part of the Small Business Job Protection Act of 1996, Congress amended Code Section 104(a)(2) to include the term “physical.” Thus the exclusion became limited to recoveries for “personal physical injuries or physical sickness.”

While “personal physical injury” has not been defined, the Internal Revenue Service (IRS) has indicated that it is akin to “harms such as bruises, cuts, swelling, and bleeding.” Hence, the 1996 amendment to Code Section 104(a)(2) legislatively overruled court decisions that excluded from gross income damages for nonphysical injuries. Furthermore, damages received under Code Section 104(a)(2) include amounts “received . . . through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.” Such exclusion from gross income does not include punitive damages, which therefore remain includible in gross income. Although Code Section 104(a)(2) provides an exclusion from gross income, it is significant to note that the Supreme Court has adhered to a “default rule of statutory interpretation that exclusions from income must be narrowly construed.”

The Supreme Court’s 1995 decision in Commissioner v. Schleier established a two-prong test applicable to Code Section 104(a)(2). Relying on the plain language of Code Section 104(a)(2) and the applicable Treasury Regulations, the Court recognized “two independent requirements

112. Comm’r v. Schleier, 515 U.S. 323, 328 (1995) (quoting Burke, 504 U.S. at 248 (Souter, J., concurring)). In Burke, the Court held that the back-pay awarded to plaintiffs pursuant to Title VII of the Civil Rights Act of 1964 (under which damages were limited to back wages) did not redress a tort-like claim. Burke, 504 U.S. at 241. Thus, given a lack of the “clear application of 26 U.S.C. § 104(a)(2) as interpreted by the Treasury regulation,” the award was not excludible under Code Section 104(a)(2). Id. at 248 (Souter, J., concurring).
113. Schleier, 515 U.S. at 336-37; see also Stadnyk v. Comm’r, 367 F. App’x 586, 591 (6th Cir. 2010); Hansen, 2009 WL 1139469, at *5.
that a taxpayer must meet before a recovery may be excluded under § 104(a)(2)."114 First, the underlying cause of action (ultimately resulting in recovery) must be "based upon a tort or tort type rights."115 Second, the recovery must be received "on account of personal injuries or sickness."116 Thus, a taxpayer must show that both requirements have been met before damages qualify for exclusion under Code Section 104(a)(2).117 Although the Schleier decision pre-dated Congress's 1996 amendment to Code Section 104(a)(2) under the Small Business Job Protection Act of 1996 (adding the term "physical"), courts have continued to analyze the application of Code Section 104(a)(2) under the same, two-pronged analysis.118 The only difference is that post-1996 decisions have an arguably added requirement due to the "physical" language added by the Small Business Job Protection Act of 1996.119

In determining whether damages have been awarded or a settlement has been made on account of either 1) a tort or tort-like right, or 2) personal physical injury or physical sickness, courts often look to the nature of the relief granted or the specifics of the settlement agreement.120 Take, for example, the Supreme Court's ruling in United States v. Burke, which held that because damages awarded under Title VII of the Civil Rights Act of 1964 were limited to back wages, such damages did not redress a tort-like right within the scope of Code Section 104(a)(2).121 Several years after its decision in Burke, the Court held that claims under the Age Discrimination in Employment Act (ADEA) did not qualify for exclusion under Code Section 104(a)(2), as "the ADEA provides no compensation 'for any of the other traditional harms associated with personal injury.'"122 The Tax Court has held that damages arising from claims against the U.S. Postal Service under an Equal Employment Opportunity Commission claim were not excludible since "none of the award was predicated on personal physical injury or physical sickness."123 Additionally, whether a settlement agreement indicates that any portion of the

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114. Schleier, 515 U.S. at 337.
115. Id.; see also Treas. Reg. § 1.104-1(c).
116. Schleier, 515 U.S. at 337; see also I.R.C. § 104(a)(2).
117. See Schleier, 515 U.S. at 337.
121. Burke, 504 U.S. at 241–42.
122. Schleier, 515 U.S. at 336. The Court noted "what the Burke Court recognized as the primary characteristic of an 'action based upon ... tort type rights': the availability of compensatory remedies." Id. at 335.
123. Sanford, 2008 WL 2491676, at *3. The Tax Court recognized that the emotional trauma suffered by the taxpayer "manifested itself in physical symptoms such as asthma, sleep deprivation, skin irritation, appetite loss, severe headaches, and depression." Id. However, these physical symptoms were not the basis of the award, which was instead predicated on "sexual harassment, discrimination based on sex, and the failure ... to take appropriate corrective action." Id.
award is paid on account of physical injury or physical illness may be indicative of whether courts will treat the payment as qualifying under Code Section 104(a)(2). According to the Tax Court, "[i]f the settlement agreement lacks express language stating what the amount paid pursuant to that agreement was to settle, the intent of the payor is critical to that determination." And while the belief of the payee as to the purpose of the payment may be pertinent to such inquiry, "the character of the settlement payment hinges ultimately on the dominant reason of the payor in making the payment." 

While punitive damages are rarely excluded from gross income, all damages resulting from an action that has its origin in a claim for physical injury or sickness may be excludible even if a portion of the damages do not directly compensate for a physical injury or sickness. For example, damages for loss of consortium arising from the physical injury or physical sickness of an individual's spouse are excludible from gross income under Code Section 104(a)(2). Additionally, damages awarded for emotional distress may only be excludible from gross income if attributable to a physical injury or physical sickness. Thus, damages awarded for emotional distress arising from claims such as discrimination or injury to reputation are not excludible from gross income.

Given that damages (with the exception of punitive damages) arising from a suit for physical injury or physical illness are treated as payments for physical injury or sickness, it naturally follows that loss of income resulting from physical injury or physical illness is treated similarly. Therefore, damages received in a suit for personal injury, including an amount allocable to lost wages as a result of the physical injury or physical illness, are excludible from gross income.

B. THE STADNYK APPROACH: FALSE IMPRISONMENT ISN'T "PHYSICAL"

In Stadnyk v. Commissioner, the Sixth Circuit recently addressed whether the physical restraint aspect of a claim for false imprisonment constitutes "physical injuries or physical sickness" for purposes of determining whether any damages resulting from such claim would be excluded from income under Code Section 104(a)(2). Petitioner, Mrs.

124. See Stadnyk, 367 F. App'x at 594.
126. Id.
127. See H.R. REP. NO. 104-737 (1996) (Conf. Rep.). Punitive damages received in a wrongful death action may be excluded from gross income if the applicable state law provides that the only available damages in such action are punitive damages. Id. at 300–01.
128. Id. at 301.
129. Id.
130. Id. The exclusion of such damages is limited to the amount of damages received not in excess of the amount paid for medical treatment for emotional distress. Id.
131. Id.
133. See Stadnyk v. Comm'r, 367 F. App'x 586, 592–94 (6th Cir. 2010).
Stadnyk, unsatisfied with her purchase of a vehicle, requested that Bank One place a stop payment order on her check. Rather than placing a hold on the check for a “dissatisfied purchase,” Bank One mistakenly classified the check as having insufficient funds and returned the check to the car dealership. The dealership filed a criminal complaint against Mrs. Stadnyk, ultimately resulting in her February 23, 1997, arrest by the Fayette County Sheriff's Department. Mrs. Stadnyk “was handcuffed, photographed, . . . confined to a holding area . . . searched via pat-down and use of an electric wand . . . required to undress . . . in the presence of officers, and put on an orange jumpsuit.” She was released on bail approximately eight hours after her arrest.

Consequent to her arrest, Mrs. Stadnyk filed a complaint alleging “malicious prosecution, abuse of process, false imprisonment, defamation, and outrageous conduct” against the dealership and Bank One. Although settlements were reached with both parties of the alleged complaint, Mrs. Stadnyk’s $49,000 settlement with Bank One attracted the attention of the Commissioner of Internal Revenue. The Commissioner assessed a $13,119 tax deficiency (plus a $2,624 accuracy-related penalty) against Mrs. Stadnyk for failure to report the $49,000 award on her 2002 Form 1040. With respect to the tax deficiency, the Tax Court held for the Commissioner, after which Mrs. Stadnyk filed a notice of appeal.

On appeal, the Sixth Circuit addressed whether the settlement qualified as gross income and, if so, whether it qualified for exclusion under Code Section 104(a)(2). In accordance with the Supreme Court’s broad construction of gross income, the Sixth Circuit found that the $49,000 settlement constituted gross income under Code Section 61(a). Thus, the Court recognized that the payment would only escape the reach of federal income taxation if the payment qualified under a specific exclusion.

Analyzing whether the $49,000 settlement payment made by Bank One to Mrs. Stadnyk qualified for exclusion under Code Section 104(a)(2), the Sixth Circuit relied on the two-prong test set forth by the Supreme Court.

134. Id. at 588.
135. Id.
136. Id.
137. Id.
138. Id.
139. Id.
140. Id. at 589.
141. Id.
142. Id.
143. See id. at 589–94.
144. See supra note 101 and accompanying text.
145. Stadnyk, 367 F. App’x at 590.
146. Id. at 590–91.
in *Commissioner v. Schleier.*

Given that Mrs. Stadnyk’s complaint alleged various tort claims, such as “malicious prosecution, abuse of process, false imprisonment, defamation, and outrageous conduct,” the court held that the first prong of the *Schleier* test was met: Mrs. Stadnyk’s underlying claim was based on tort or tort-like rights.

With respect to the second prong of the *Schleier* test, the statutory requirement that the damages be awarded on account of personal injury or illness, the Sixth Circuit held that such requirement was not met.

In determining that the settlement payment made to Mrs. Stadnyk was not awarded on account of personal injury or illness, the court first focused on the 1996 amendment to Code Section 104(a)(2), which “expressly limit[ed] the type of damages excludable from income to personal physical injuries or physical sickness.” Moreover, the court noted that during her deposition, Mrs. Stadnyk testified that she did not sustain any physical injury from her arrest. The court expressly rejected the argument that a false imprisonment claim necessarily includes physical restraint and that “damages received from false imprisonment arise from the person’s physical loss of their freedom and the mental suffering and humiliation that accompany this deprivation.” Accordingly, the court stated that “the mere fact that false imprisonment involves a physical act — restraining the victim’s freedom — does not mean that the victim is necessarily physically injured as a result of that physical act.”

The Sixth Circuit concluded by noting that since the settlement agreement with Bank One lacked any indication that damages were paid on account of any physical injury, Mrs. Stadnyk had failed to establish a causal connection between a physical injury and the settlement.

Accordingly, the damages awarded on account of Mrs. Stadnyk’s erroneous arrest and detention in the Jessamine County Jail did not qualify for an exclusion from gross income under Code Section 104(a)(2).

### C. Recent Legislative Proposals and Internal Revenue Guidance

Referred to the Senate Committee on Finance on December 6, 2007, the Wrongful Convictions Tax Relief Act of 2007 proposed an amendment to the Internal Revenue Code of 1986 (as amended), providing

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147. *Id.* at 591. The *Schleier* Court required that 1) the underlying claim be based on tort or tort-like right, and 2) that any damages awarded be on account of personal injury or illness. *Comm'r v. Schleier,* 515 U.S. 323, 337 (1995).


149. *Id.* at 594.

150. *Id.* at 592.

151. *Id.* According to her testimony, “nobody carrying out her arrest put their hands on her, grabbed her, jerked her around, bruised her, or hurt her.” *Id.* Given the lack of physical injury, the court found that Mrs. Stadnyk suffered emotional injuries. *Id.* at 593.

152. *Id.* at 593.

153. *Id.*

154. *Id.* at 594.

155. *Id.*
wrongfully incarcerated individuals full exclusion from gross income of any compensation related to their wrongful incarceration.\textsuperscript{156} The proposal also provided that such individuals would receive a maximum annual exclusion of $50,000 from gross income as well as a refundable tax credit for 50% payroll taxes paid on up to $50,000 employment and self employment income, combined.\textsuperscript{157} "Wrongfully incarcerated individuals" included individuals who had been convicted of a criminal offense and later found innocent or pardoned for such offense after serving a portion of the resulting prison sentence.\textsuperscript{158} The proposed legislation disqualified individuals with previous convictions punishable by more than one year of imprisonment.\textsuperscript{159} Additionally, the proposed legislation limited the tax benefits for qualifying individuals to the lesser of fifteen years or the number of years such individual was wrongfully incarcerated.\textsuperscript{160} The proposed legislation was not enacted;\textsuperscript{161} consequently, compensation paid to wrongfully incarcerated individuals presumably remained under the reach of gross income, as defined under Code Section 61,\textsuperscript{162} unless the payment could be specifically shown to cover "personal physical injuries or physical sickness" under Code Section 104(a)(2).\textsuperscript{163}

On September 29, 2010, a slightly modified version of the Wrongful Convictions Tax Relief Act of 2007 was referred to the Senate Committee on Finance.\textsuperscript{164} The 2010 proposal provided the same tax benefits to wrongfully incarcerated individuals as the 2007 proposal, but included one additional caveat: tax benefits granted by the amendment would be terminated upon conviction of a subsequent offense punishable by more than one year of imprisonment.\textsuperscript{165} As with the 2007 proposal, no action was taken on the Wrongful Convictions Tax Relief Act of 2010.\textsuperscript{166}

Similar legislation was proposed to the House Committee on Ways and Means on September 23, 2008,\textsuperscript{167} and again on March 3, 2010.\textsuperscript{168} The 2008 proposal, entitled the Wrongful Convictions Tax Relief Act of 2008,
was not enacted into law.\textsuperscript{169} The more recent 2010 proposal was identical to the Wrongful Convictions Tax Relief Act of 2010 referred to the Senate Committee on Finance.\textsuperscript{170} Like each of the other proposals made to the Senate and House of Representatives, no action was taken on the 2010 proposed legislation.\textsuperscript{171}

The most recent glimpse into how the Internal Revenue Service views payments made to wrongfully incarcerated individuals is included in an Office of Chief Counsel IRS memorandum dated November 4, 2010.\textsuperscript{172} The memorandum provides a specific fact pattern: an individual was wrongfully convicted of a crime and incarcerated for several years before being exonerated by the state.\textsuperscript{173} While incarcerated, the individual suffered physical injuries and sickness.\textsuperscript{174} Upon his exoneration, the individual received compensation under state legislation compensating individuals who were wrongfully incarcerated “for their injuries, sickness, and economic losses flowing from the physical injuries and physical sickness.”\textsuperscript{175} In short, the Office of Chief Counsel concluded that compensation paid to wrongfully incarcerated individuals for physical injuries and physical sickness, including amounts received for economic losses flowing from such physical injury or sickness, is excludible from gross income under Code Section 104(a)(2).\textsuperscript{176} This conclusion was tempered by two qualifications: 1) title, constructive receipt, or economic benefit of the corpus or assets used to fund future periodic payments may render a portion of future periodic payments taxable, and 2) punitive damages are included in gross income.\textsuperscript{177}

\section*{IV. CALL IT INJURY, CALL IT DISASTER}

As more and more individuals are exonerated after spending time in prison for crimes they did not commit, the question becomes whether the payments made to these individuals, such as those made to Cornelius Dupree (who could stand to owe the federal government approximately $840,000 in taxes),\textsuperscript{178} constitute gross income under Code Section 61(a), and if so, whether such payments qualify for exclusion under Code Section 104(a)(2). The “sweeping definition”\textsuperscript{179} of gross income, the Su-

\begin{itemize}
  \item \textsuperscript{170} See H.R. 4743.
  \item \textsuperscript{172} I.R.S. Chief Couns. Mem. 201045023 (Nov. 4, 2010).
  \item \textsuperscript{173} Id.
  \item \textsuperscript{174} Id.
  \item \textsuperscript{175} Id.
  \item \textsuperscript{176} Id.
  \item \textsuperscript{177} Id.
  \item \textsuperscript{178} Assuming Dupree is paid $80,000 for each of the thirty years he spent behind bars (resulting in a maximum payout of $2,400,000) subject to the top federal income tax rate for unmarried individuals of 35%. See I.R.C. § 1 (i)(2) (2006).
  \item \textsuperscript{179} See Comm’t v. Schleier, 515 U.S. 323, 327 (1995); United States v. Burke, 504 U.S. 229, 233 (1992); Stadnyk v. Comm’t, 367 F. App’x 586, 590 (6th Cir. 2010).\end{itemize}
preme Court's repeatedly narrow construction of exclusions from gross income,\textsuperscript{180} and the Sixth Circuit's recent holding in \textit{Stadnyk v. Commissioner}\textsuperscript{181} intersect to provide a resounding answer: payments made to wrongfully incarcerated individuals qualify as gross income without qualifying for exclusion under Code Section 104(a)(2).

But at what point have the wrongfully convicted and incarcerated individuals in our society paid enough? On average, wrongfully convicted individuals who have been exonerated by DNA evidence have been deprived of over a decade of their lives.\textsuperscript{182} Upon exoneration, they may, or may not, be compensated for their time in prison.\textsuperscript{183} The notion that those individuals fortunate enough to receive compensation payments will likely have to pay federal income tax on them demands a fresh look at either reclassifying such payments or offering a legislative, wholesale exemption so that wrongfully incarcerated individuals may fully recover for the years that have been stripped away.

A. Physical Injury Under Current Classification?

Although compensation payments made to wrongfully incarcerated individuals are likely taxable under the current construction of gross income, Code Section 104(a)(2) and the recent \textit{Stadnyk} discussion of false imprisonment show that fine distinctions exist, which may provide a narrow exclusion from federal income taxation. If such payments do not escape taxation under the current Internal Revenue Code and applicable Treasury Regulations, they should be reclassified or legislatively exempted to avoid taxation.

As a threshold matter, compensation payments made to wrongfully incarcerated individuals almost certainly qualify as gross income under Code Section 61(a). According to the Supreme Court's broad construction of Code Section 61(a),\textsuperscript{184} compensation payments made under either federal or state statutes easily fall within the purview of gross income: the payments constitute an increase of wealth recognized and controlled by the individual.\textsuperscript{185} Whether the payments are deemed to purely compensate wrongfully incarcerated individuals or, alternatively, contain a punitive element against state or federal misconduct,\textsuperscript{186} neither classification escapes the broad reach of gross income.\textsuperscript{187}

\textsuperscript{180} Schleier, 515 U.S. at 328 (citing Burke, 504 U.S. at 248 (Souter, J., concurring)).
\textsuperscript{181} See Stadnyk, 367 F. App'x at 592-94.
\textsuperscript{182} Facts on Post-Conviction DNA Exonerations, supra note 8.
\textsuperscript{183} Compensating the Wrongly Convicted, supra note 8.
\textsuperscript{184} Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 430-31 (1955); see also Schleier, 515 U.S. at 327; Burke, 504 U.S. at 233; Stadnyk, 367 F. App'x at 590.
\textsuperscript{185} Glenshaw Glass, 348 U.S. at 430-31.
\textsuperscript{186} Some jurisdictions specifically exclude punitive damages from any damages awarded to wrongfully incarcerated individuals. See D.C. CODE § 2-423 (2001); ME. REV. STAT. ANN. tit. 14, § 8242 (1), (3) (2003); OKLA. STAT. ANN. tit. 51, § 154(B)(4), (C) (West 2008).
\textsuperscript{187} Burke, 504 U.S. at 241; Glenshaw Glass, 348 U.S. at 431.
Thus, the next inquiry is whether compensation payments made to wrongfully incarcerated individuals fall within the exclusion offered by Code Section 104(a)(2). While the payments may be summarily defined as gross income, the application of Code Section 104(a)(2), the Sixth Circuit's decision in Stadnyk v. Commissioner, and the Schleier two-pronged test are riddled with distinctions that require deeper analysis. Since 1996, Code Section 104(a)(2) simply requires that damages paid on account of suit or settlement be made on account of "personal physical injuries or physical sickness." It appears deceptively simple that imprisonment contains an inherently "physical" aspect and thus would qualify for exclusion under Code Section 104(a)(2). If wrongful imprisonment merely qualified as "physical," the inquiry would end there. Since the compensation payments made to wrongfully incarcerated individuals would necessarily be on account of a "personal physical injury," all other damages associated with wrongful incarceration, such as amounts awarded to compensate for loss of earnings, loss of earnings capacity, loss of reputation, mental pain and suffering, and loss of life opportunities, would likewise be excludable under Code Section 104(a)(2).

Indeed, this is the approach suggested by the November 4, 2010, Office of Chief Counsel IRS memorandum dealing with compensation payments made to wrongfully incarcerated individuals. The exclusion of the payment in the Office of Chief Counsel memorandum was predicated on the fact that the payment flowed from physical injury or sickness. The particular facts of the memorandum leave open for debate whether payments that are not specifically predicated on personal physical injury or illness sustained during incarceration qualify for exclusion under Code Section 104(a)(2).

As evidenced by the Sixth Circuit's recent decision in Stadnyk v. Commissioner, defining what qualifies as "physical" may not be as straightforward as it appears. The court made it clear that in the case of a claim for false imprisonment, just because the claim involves physical restraint "does not mean that the victim is necessarily physically injured as a result of that physical act." The court specifically focused on the fact that Mrs. Stadnyk, a victim of false imprisonment in that case, did not sustain any outward physical injuries as a result of being physically arrested, physically removed from her home, and detained in the county jail. Compared to a claim for wrongful imprisonment, which likewise entails an arrest and physical detainment, Stadnyk suggests that unless some personal physical injury or physical illness is sustained as a direct result of

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191. Id. The facts of the memorandum specifically stated that the individual in question suffered physical injuries and sickness during his incarceration. Id.
192. See generally id.
193. Stadnyk v. Comm'r, 367 F. App'x 586, 593 (6th Cir. 2010).
194. Id.
being wrongfully incarcerated, the fact that wrongful incarceration is, in itself, "physical" is not sufficient to bring any resulting compensation payments under the protective reach of Code Section 104(a)(2).

A glaring difference between false imprisonment and wrongful incarceration likely distinguishes all wrongful incarceration cases from *Stadnyk v. Commissioner*: the pervasive theme of violence within the U.S. prison system.\(^195\) Conditions at some prisons have been reported as so bad that they violated the Eighth Amendment right against "cruel and unusual punishment."\(^196\) During 2004, the U.S. Justice Department reported over 8,000 incidents of rape and sexual abuse behind prison walls, in some instances instigated and encouraged by prison officers.\(^197\) Gang activity is rampant in the U.S. prison system, often facilitating "drug distribution, prostitution, and extortion" within the prison.\(^198\) While reported assaults among inmates have historically reached staggering numbers (in 2000, a reported 8,094 inmates needed medical care as a result of this kind of violence), there is ample evidence that excessive force and violence comes from prison guards as well.\(^199\) Suffice to say that extreme violence has a profound foothold in the U.S. prison system, a practical guarantee that most inmates suffer physical injury or illness as a direct result of their incarceration. This presumption stands in stark contrast to the facts in *Stadnyk*, in which there was evidence that "nobody carrying out her arrest or detention put their hands on her, grabbed her, jerked her around, bruised her, or hurt her."\(^200\) The distinction is undeniable; it is the difference between an absolute absence of physical harm in *Stadnyk* compared to the near certainty of years of sustained physical and sexual abuse suffered by inmates.

While prison violence is a near certainty, exonerated individuals would be required to prove to the Commissioner of Internal Revenue (presumably, on review) that they suffered actual personal physical harm during their incarceration. Furthermore, rather than showing that damages awarded for non-physical injury (loss of earnings, loss of earnings capacity, loss of reputation, mental pain and suffering, loss of life opportunities) were directly related to their wrongful incarceration, such individuals would seemingly have to show that damages for non-physical injury were a direct result of the physical injury they sustained while incarcerated. This argument quickly fails: to argue that an exonerated individual's loss of earnings capacity was directly related to a physical assault he sustained in prison does not muster the requisite causal relationship required for exclusion under Code Section 104(a)(2). So while wrong-

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196. Id. at 337. For example, conditions on Missouri State Penitentiary's death row were considered "cruel and unusual punishment." Id. The accommodations were located in a "rodent infested basement" with insufficient plumbing and ventilation systems. Id.
197. Id. at 338.
198. Id. at 344.
199. Id.
fully incarcerated individuals almost certainly sustain personal physical injury in prison, only the damages directly relating to such physical injury would be excluded from taxation, the approach seemingly adopted by the IRS Office of Chief Counsel.201

More subtle distinctions may be drawn when the Schleier two-pronged test is applied to determine the applicability of Code Section 104(a)(2).202 The first prong of the test, that the claim be “based upon tort or tort type right,”203 is easily satisfied since wrongful incarceration is similar to a claim for false imprisonment.204 The second prong of the test, that the award be received “on account of personal injuries or sickness,”205 may be satisfied if a wrongfully incarcerated individual can prove that he suffered personal physical injury or illness during his incarceration (and that the non-physical elements of his compensation payment are on account of such physical injury or illness).206 Just as courts have often looked to the nature of the relief awarded or the specifics of a settlement agreement to determine whether an award satisfies the Schleier two-pronged test,207 the federal and state statutes providing renumeration to wrongfully incarcerated individuals are useful in applying the Schleier test to these payments.

The variations among the federal and state statutes that provide compensation payments to wrongfully incarcerated individuals arguably result in a different application of the Schleier two-pronged test, depending on the jurisdiction. For example, in the few states that contain specific statutory language regarding physical injury or conditions,208 the award arguably arises (at least in part) from the personal physical injury sustained during incarceration. Thus, the award possibly qualifies for exclusion under Code Section 104(a)(2). More commonly, state statutes leave

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202. Comm’r v. Schleier, 515 U.S. 323, 336-37 (1995). While the two-pronged test in Schleier was developed prior to the 1996 amendment adding the word “physical” to Code Section 104(a)(2), the application of the test in this Comment incorporates the “physical” requirement. See supra notes 104–09 and accompanying text.
203. Schleier, 515 U.S. at 337.
204. Restatement (Second) of Torts § 35(1)(a)–(c) (1965). A successful claim for false imprisonment may be brought against an individual if the following are shown: “(a) he acts intending to confine the other or a third person within boundaries fixed by the actor, and (b) his act directly or indirectly results in such a confinement of the other, and (c) the other is conscious of the confinement or is harmed by it.”; see also Wood, supra note 98, at 279–81 (suggesting that wrongfully incarcerated individuals could seek redress through a tort claim for false imprisonment).
205. Schleier, 515 U.S. at 337.
206. See supra notes 120–26 and accompanying text.
it to the discretion of the appropriate party (i.e., court, committee, jury, etc.) to award an amount of compensation deemed necessary to compensate the wrongfully incarcerated individual.\(^\text{209}\) Since these statutes lack specific language dealing with physical injury or illness resulting from incarceration, a wrongfully incarcerated individual would have to prove (on a case-by-case basis) that the discretionary award was premised on some physical harm sustained during imprisonment.\(^\text{210}\) On the far end of the spectrum, many of the states with compensation statutes set a daily award,\(^\text{211}\) annual award,\(^\text{212}\) maximum payout,\(^\text{213}\) a payout adjusted to reflect changes in the Consumer price index or state wage base,\(^\text{214}\) or a combination of these measures.\(^\text{215}\) These statutes are most similar to the cases ruling that an award, none of which was “predicated on personal physical injury or physical sickness,” was not excludible under Code Section 104(a)(2).\(^\text{216}\) Accordingly, these statutes have the weakest argument under the two-pronged \textit{Schleier} test that the awards qualify for exclusion under Code Section 104(a)(2).

Moreover, compensation awarded in the form of tuition assistance would likely fail to qualify for exclusion under \textit{Schleier}. For instance, the Montana statute limits compensation paid to wrongfully incarcerated individuals to educational assistance (tuition, fees, books, room and board).\(^\text{217}\) Under \textit{Schleier}, it appears that Montana fails to provide compensation “for any of the . . . traditional harms associated with personal injury.”\(^\text{218}\) If not excluded under Code Section 104(a)(2), this would inevitably leave the wrongfully incarcerated individual with taxable gross income (in the amount of educational assistance awarded) without any available cash flow to pay the resulting federal income tax.

\(^{209}\) See \textit{ALA. CODE} § 29-2-159(a) (2006); \textit{D.C. CODE} §§ 2-421, 2-423 (2001); 705 ILL. COMP. STAT. ANN. 505 / 8(c) (West 2007); \textit{LA. REV. STAT. ANN.} § 572.8H(2) (a)-(c) (Supp. 2011); \textit{MD. CODE ANN., STATE FIN. & PROC. § 10-501(a)(1) (West 2009); \textit{MASS. GEN. LAWS ANN.} ch. 258D, § 5(A) (West Supp. 2011); \textit{N.Y. JUD. CT. ACTS LAW} § 8-b(6) (McKinney 1989); \textit{VT. STAT. ANN. tit. 13, § 5574(b) (West 2009); \textit{W. VA. CODE ANN.} § 14-2-13a(g) (West 2009); \textit{WIS. STAT. ANN.} § 775.05(4) West 2009).


\(^{211}\) \textit{CAL. PENAL CODE} § 4904 (West 2000); \textit{MO. ANN. STAT.} § 650.058(1) (West Supp. 2011).

\(^{212}\) \textit{ALA. CODE} § 29-2-159(a); \textit{TEX. CIV. PRAC. & REM. CODE ANN.} § 103.052(a)(1)(2) (West 2005).

\(^{213}\) \textit{ME. REV. STAT. ANN. tit. 14, § 8242(1), (3) (2003); \textit{MASS. GEN. LAWS ANN.} ch. 258D, § 5(A) (West Supp. 2010); \textit{NEB. REV. STAT. § 29-4604(1), (3) (Supp. 2010); \textit{N.H. REV. STAT. ANN. § 541-B:14, II (LexisNexis 2006); \textit{OKLA. STAT. ANN. lit. 51, § 154(B)(4), (C) (West 2008); \textit{TENN. CODE ANN. § 9-8-108(a)(7)(A); \textit{WIS. STAT. ANN. § 775.05(4) (West 2009).}

\(^{214}\) \textit{OHIO REV. CODE ANN.} §§ 2743.48(E)(2)(a)-(b) (West 2008); \textit{UTAH CODE ANN.} § 78B-9-405(1)(a) (West 2010); \textit{VA. CODE ANN.} § 8.01-195.11(A) (West 2007).

\(^{215}\) 705 ILL. COMP. STAT. ANN. 505 / 8(e) (West Supp. 2010); \textit{IOWA CODE ANN.} § 663A.1(b)(a)–(d) (West 2003); \textit{LA. REV. STAT. ANN. § 15:572.8H(2) (Supp. 2011); \textit{MISS. CODE ANN.} § 11-44-7(2)(c) (West Supp. 2010); \textit{N.J. STAT. ANN. § 52:4C-5(a) (West 2009); \textit{N.C. GEN. STAT. ANN.} § 148-84(a) (West 2009).


\(^{217}\) \textit{MONT. CODE ANN.} § 53-1-214(1)(a)–(c) (2009).

While these nuances and grey areas surrounding the application of the Stadnyk decision and the Schleier two-pronged test in some cases give rise to a valid argument that compensation payments made to wrongfully incarcerated individuals meet the requirements of Code Section 104(a)(2), there is the overriding and limiting "default rule of statutory interpretation that exclusions from income must be narrowly construed." Thus, it presumably follows that these fine distinctions will not escape narrow judicial interpretation, and will thus fail to qualify for exclusion under Code Section 104(a)(2) (ultimately resulting in federal income tax).

B. AN ALTERNATIVE CLASSIFICATION

Even assuming payments made to wrongfully incarcerated individuals narrowly qualify for the exclusionary treatment offered by Code Section 104(a)(2) according to the above analysis, the area remains burdened by uncertainty. Without clarification, the law in this area is left to develop in a piecemeal fashion, possibly leaving some exonerated individuals with a hefty tax bill. Legislation exempting compensation paid to wrongfully incarcerated individuals from gross income has been proposed twice before the Senate Committee on Finance and twice before the House Committee on Ways and Means: none of the proposals were adopted. The IRS has continued to premise exclusion on whether the damages awarded to the exoneree arose from personal physical injury. So while congressional intent remains vague, the IRS appears to be more than willing to tax wrongful incarceration recoveries to the extent they are not on account of personal physical injury or illness.

On the other hand, some (albeit, slight) state legislative action supports the exclusion from income of payments made to wrongfully incarcerated individuals. Certain state statutes providing compensation payments to wrongfully incarcerated individuals specifically exempt such payments from the state's income tax. Even in several states that do not exempt the payments from state income taxes, the statutes themselves contain poignant language with respect to the particular trials faced by wrongfully incarcerated individuals: wrongfully incarcerated individuals have been "uniquely victimized" and thus should be entitled to a remedy given the "particular and substantial horror" of their experience.

219. Id. at 328 (citing United States v. Burke, 504 U.S. 229, 248 (1992) (Souter, J., concurring)).
While state and federal legislative intent remains unclear with respect to the taxability of compensation payments made to wrongfully incarcerated individuals, one thing remains clear: exonerees have paid enough and should not be subject to federal income tax on these payments. One viable solution is federal congressional action—passage of legislation similar to the Wrongful Convictions Tax Relief Act of 2010 (or any of the other similar pieces of proposed legislation). This wholesale exclusion would simply remove compensation payments made to wrongfully incarcerated individuals from gross income.226

A second solution is to reclassify payments made to wrongfully incarcerated individuals: the payments are more similar to disaster relief payments than a tort claim award or settlement. Imagine life, like Cornelius Dupree, abruptly cut short at the age of nineteen. Imagine life subject to what might constitute some of the most abhorrent and violent conditions sanctioned in the United States today—the prison system. Imagine thirty years spent living in such conditions. All of these injustices are on account of any number of missteps within the criminal justice system: eyewitness misidentification, false confessions, incorrect snitch testimony, prosecutorial misconduct, improper forensic evidence,227 but not on account of any personal wrongdoing. How is this not a disaster?

Internal Revenue Code Section 139(a) excludes any amount paid to an individual “to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster.”228 While not the September 11 terrorist attacks, Hurricane Katrina, a severe earthquake, or similar large-scale tragedy, the approximately 3,524 cumulative years served in prison229 by wrongfully incarcerated individuals reflects a more personal disaster. The broad definition of a “qualified disaster” includes that “which is determined by an applicable Federal, State, or local authority . . . to warrant assistance from the Federal, State, or local government or agency or instrumentality thereof.”230 Like application of Code Section 104(a)(2), exclusion for wrongful incarceration compensation payments under Code Section 139 would be construed as “a matter of legislative grace” which is “narrowly construed against the taxpayer.”231 Thus, this remedy too would require specific legislative action to define wrongful conviction and incarceration as a “qualified disaster.” Whether granted their own, wholesale exclusion from gross income or qualified as compensation for a disaster of sorts, payments made to wrongfully incarcerated individuals demand legislative action to avoid federal income taxation.

226. See S. 2421; S. 3892; H.R. 7021; H.R. 4743.
229. Facts on Post-Conviction DNA Exonerations, supra note 8.
230. I.R.C. § 139(c)(1) (2006). A “qualified disaster” also includes destruction caused by terrorism or military action, a federally declared disaster, and disaster concerning a common carrier. Id. § 139(c)(1)–(3).
V. CONCLUSION

This Comment has explored the exoneration and release of innocent individuals from federal and state prison systems through the use of DNA evidence and endeavors like the Innocence Project. Moreover, this Comment has surveyed the federal and state compensation payments available to wrongfully imprisoned individuals. It has examined the current, unsettled federal income tax treatment of these payments (where available), ultimately concluding that, in the current environment, such payments are fully taxable.

But given the price innocent individuals have paid, and the fundamental rights they have had stripped away, when have they paid enough? Rather than purely relying on the strict construction of exclusions from gross income and the *Stadnyk* definition of "physical," which combine to yield a less than ideal result, specific legislative action is needed. Congressional intervention is overdue and necessary in order to ensure that wrongfully incarcerated individuals stop paying, and start living, when they walk out of the prison doors—for the last time.