

Verdicts & Settlements

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Patient settles medical claim over amputations

The case involved an African-American male, age 39, who had acute myelogenous leukemia and was undergoing rounds of chemotherapy, causing him to be seriously immunocompromised.

As a result of an eye irritation, known as iritis, a common complication of chemotherapy, he was admitted to the hospital for observation.

During his stay he became volume-depleted and developed a fever.

The plaintiff alleged that the hospital failed to timely administer antibiotics and deal appropriately with his lack of volume, causing him to become septic and hypotensive, which resulted in the loss of both arms below the elbow and both legs below the knee.

The case continues against four physicians.

Editor's note: *The information in Lawyers Weekly's verdicts and settlements reports was submitted by the counsel for the prevailing party and represents the attorney's characterization of the case.*

Verdict Report

Type of action: Medical malpractice

Injuries alleged: Quadruple amputations

Case name: Confidential

Case number: Confidential

Court: Confidential

Verdict or settlement: Settlement (mediated)

Date: Dec. 18, 2009

Amount: \$11.3 million

Plaintiff's attorneys: Wade E. Byrd of Law Offices of Wade E. Byrd (Fayetteville); John Drew Warlick and Jack Swart of Law Offices of John Drew Warlick (Jacksonville); Tom Comerford and Cliff Britt of Comerford & Britt (Winston-Salem)

Plaintiffs might receive emotional distress damages tax-free after 2010

Commentary

By JEREMY BABENER, Special to Lawyers Weekly
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The plaintiff attorney and structured settlement communities had an opportunity at a Treasury hearing last month to influence the tax treatment of personal injury plaintiffs' damages.

The Feb. 23 hearing concerned the Treasury's proposed regulations for § 104(a)(2) of the Tax Code, which generally excludes from plaintiffs' income damages paid on account of personal physical injuries and physical sickness.

Some in the plaintiff attorney and structured settlement communities took that opportunity to recommend regulations exempting damages from taxable income even where the physical requirement cannot be demonstrably satisfied.

Fortunately for future plaintiffs, and those in the structured settlement industry, this was by no means a last opportunity.

Treasury's § 104(a)(2) hearing

In a nutshell, the proposed regulations considered at the hearing would do two things:

- First, they would eliminate the requirement that damages be based on "tort or tort type rights" in order to qualify for the § 104(a)(2) tax exclusion.

- Second, they would incorporate 1996 legislation requiring that personal injuries and sickness damages be "physical" in order to qualify for the § 104(a)(2) exclusion.

Many recognize that, while the favorable tax treatment of structured settlements is not necessarily the only or best reason to use them, it can act as a strong incentive for plaintiffs to do so. Very likely, such use reduces the frequency of premature lump-sum dissipation.

That personal injury plaintiffs settling for non-physical damages generally cannot exclude their recovery likely deters many of them from structuring. Working to expand the tax exclusion of such damages would greatly benefit personal injury plaintiffs, and may well lead to an increase in structuring.

To those ends, members of the trial attorney and structured settlement communities submitted to and spoke at the Treasury hearing last month.

Those speaking on the constraints and ambiguity of the tax exclusion's physi-

cal requirement urged for a broader interpretation of "physical," such that more damages could be received tax-free. For example, one attorney suggested that victims of prolonged sexual abuse, even where observable bodily harm cannot be shown, be presumed to receive their damages on account of a physical injury.

Cool reception

To most urgings at the hearing, the Treasury panel of four repeatedly suggested that recommendations made by those in the industry might not be possible without a second notice and comment period. Why, the panel asked, should the proposed regulations be delayed?

Technically, the IRS could incorporate the suggestions without another notice and comment period because the proposed regulations are "interpretive." Unlike "legislative" regulations, interpretive regulations are not subject to the rule-making requirements found in § 553(b) of the Administrative Procedure Act. The IRS often goes through the notice and comment procedure anyway, but not always.

Of course, even if implied exceptions to the physical requirement of the tax exclusion were incorporated into regulations by expanding the definition of "physical," current tax law withholds the favorable tax exclusion from a very common type of personal injury: emotional distress.

Moreover, legislative history holds that symptoms of emotional distress, even if purely physical, are also ineligible for the exclusion.

The Treasury simply cannot undo tax law by issuing regulations, and further, is unlikely to produce language contradicting legislative history. Thus, the plaintiff attorney and structured settlement communities can only open up the tax exclusion to all personal injuries by lobbying to amend § 104(a)(2), eliminating the physical requirement and emotional distress language inserted by the Small Business Job Protection Act of 1996.

Against the 'physical' requirement?

Opposition to the 1996 legislation's requirement that damages be "physical" to escape taxation is nothing new.

In fact, when President Clinton signed the original legislation into law, he expressed "reservations about a provision in the Act which makes civil damages based on non-physical injury or illness taxable. Such damages are

paid to compensate for injury, whether physical or not, and are designed to make victims whole, not to enrich them. These damages should not be considered a source of taxable income."

Since that time, a number of taxpayers have argued that the physical requirement violates the constitution. In 2006, the D.C. Circuit Court of Appeals agreed with one taxpayer in *Murphy v. IRS*. However, the decision was soon vacated, and the court found against the taxpayer the next year.

The physical requirement of the damages exclusion has also faced much, though not uniform, criticism in academic literature.

For example, in *Sex, Race, and Age: Double Discrimination in Torts and Taxes*, Professor Mark Wolff of St. Thomas University School of Law wrote, "medical research over the past 138 years has demonstrated that emotional and physical pain are not quantitatively different. So why is there a major discrepancy between the law and medical research?"

Others have attacked the physical requirement indirectly, attempting to expand the meaning of "physical."

In its recent submission to last month's Treasury hearing, the ABA Tax Section argued, "As a result of recent technological advancements in medicine, we now know that many maladies formerly believed to be purely psychological, and thus not within the scope of § 104(a)(2), have physical origins." For example, some psychological disorders result from changes in brain chemistry.

Turning to legislation

From President Clinton's signing statement and failed taxpayers' constitutional challenges, to academic arguments and suggested changes to proposed regulation, criticisms of the physical requirement have largely failed to effect change.

Thus, the implied suggestion made by last month's Treasury panel may be plaintiff attorneys' and the structured settlement industry's best bet: propose legislation.

As those in the structured settlement industry know, the legislative route has been successfully taken before. In 1982, IBAR Inc. lobbied for the exclusion of damages paid via periodic payments, and the establishment of § 130.

Section 130 now allows assignment companies (sometimes referred to as structured settlement companies) to receive a defendant's transfer of monies

tax-free through a "qualified assignment." These companies can then purchase an annuity and direct payments to a personal injury claimant.

In 1997, the National Structured Settlements Trade Association successfully lobbied Congress to allow qualified assignments for workers' compensation payments.

In 2001, the structured settlement primary market and the structured settlement secondary market agreed on compromise legislation relating to factoring. Enacted in the "Victims of Terrorism Tax Relief Act of 2001," § 5891 provides an excise tax on the sale of the right to receive future structured settlement payments without court approval.

The structured settlement industry lobby has proven its ability to influence legislation. Likewise, plaintiff lawyers have historically demonstrated considerable lobbying power.

Good timing

Where opponents of the physical requirement have previously failed, in 2010 they may succeed.

On Dec. 31, 2009, as required by law, the National Taxpayer Advocate ("Your Voice at the IRS") submitted the *2009 Annual Report to Congress*. Placed as third on the list of 11 recommended legislative actions, readers find, "Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income."

The Advocate's argument supporting the recommendation reads much like Professor Wolff's: "Although it is becoming increasingly accepted in the medical community that mental illness is caused by physical changes in the body and produce physical symptoms — effectively blurring the line between physical and mental suffering — the law continues to treat taxpayers differently according to their illness."

It would seem that those opposed to the physical requirement of the tax exclusion have the momentum, planned or otherwise. If there was a year to reverse the 1996 legislation's impact, it looks like that year is 2010.

Editor's note: Babener, author of *Justifying the Structured Settlement Subsidy* (*NYU Journal of Law & Business*), and upcoming articles in the *NYU Journal of Legislation & Public Policy and Tax Notes*, is a third-year student at the New York University School of Law. His writings are available at www.taxstructuring.com.