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### **The Dramatic Life of The Murphy Case Ends With Personal Injury Damages Taxable.**

**By Elizabeth A. Moreno, Esq.**

The dramatic life of the Murphy case came to a quiet end when the U.S. Supreme Court declined to hear the case which signaled the taxation of personal injury damages.

The U.S. Appeals Court for the D.C. Circuit shocked the tax world with its initial Murphy decision, in which it ruled that damages awarded a whistleblower were not taxable under the Constitution. Murphy filed a complaint with the Department of Labor alleging that her former employer, the New York Air National Guard (NYANG), in violation of various whistle-blower statutes, had "blacklisted" her and provided unfavorable references to potential employers after she had complained to state authorities of environmental hazards on a NYANG airbase. The Secretary of Labor determined the NYANG had unlawfully discriminated and retaliated against Murphy. Murphy submitted evidence that she had suffered both mental and physical injuries as a result of the NYANG's blacklisting her. Upon finding Murphy had also suffered from other "physical manifestations of stress" including "anxiety attacks, shortness of breath, and dizziness," the ALJ recommended compensatory damages totaling \$70,000, of which \$45,000 was for "emotional distress or mental anguish," and \$25,000 was for "injury to professional reputation" from having been blacklisted. None of the award was for lost wages or diminished earning capacity.

Surprisingly, the three-judge U. S. Appeals Court for the D. C. Circuit quietly withdrew its original decision and issued a more conventional ruling holding that the whistleblower damages were taxable. The Court adopted the IRS's baseless argument. The IRS urged the Court to treat damages to people differently from damages to property. The IRS contended that compensation awarded to a person for the loss of an arm or a leg was not payment to make a person "whole" but was payment obtained as part of a "forced sale" In other words, if a person suffered a mental breakdown after witnessing her/his child being murdered, payment for that mental breakdown was taxable - as the victim (according to the IRS) simply was "forced" to sell his or her mental health, and obtained "income" based on the forced sale theory.

In a remarkable reversal of its prior decision, the Court adopted this baseless argument. The Court held that "Murphy's situation seems akin to an involuntary conversion of assets; she was forced to surrender some part of her mental health and reputation in return for monetary damages."

As a result of the U. S, Supreme Court's rejection of Murphy's appeal, plaintiffs must pay taxes on compensatory damages for emotional distress or loss of reputation, if those damages are caused by employment discrimination or retaliation. The court has reasoned that the original harm is not

personal injury but is akin to the taking of property and therefore is taxable. Plaintiff's attorneys cannot argue in an employment case that the settlement agreement should state that a portion of damages be considered 'personal injury or emotional distress' in order to escape the tax man. That argument will no longer work with Big Brother IRS.

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