T.C. Summary Opinion 1999-41

UNITED STATES TAX COURT

KRISTOFER L. BERGE, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10751-97S. Filed March 9, 1999.

Jonathan M. Berge, for petitioner.

Jason M. Silver, for respondent.

NAMEROFF, Special Trial Judge: This case was heard pursuant to the provisions of section 7463.[1] The decision to be entered is not reviewable by any other court, and this opinion should not be cited as authority. Respondent determined a deficiency in petitioner's 1993 Federal income tax in the amount of $3,500.

The sole issue for decision is whether proceeds petitioner received from his age discrimination lawsuit are included in gross income.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the year at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

The parties submitted this case fully stipulated pursuant to Rule 122. The stipulation of facts and the attached exhibits are incorporated herein by this reference. At the time he filed his petition, petitioner resided in Las Vegas, Nevada.

Background

During the year at issue, petitioner was employed as a pilot for Northwest Airlines (Northwest). In 1993, in settlement of a lawsuit under the Age Discrimination in Employment Act of 1967 (ADEA), Pub. L. 90-202, 81 Stat. 602, against Northwest, petitioner received the following amounts: (1) $10,093 in back wages; (2) $3,365 in liquidated damages; and (3) $4,542 in interest income.

Petitioner received a letter dated February 10, 1994, from the U.S. Equal Employment Opportunity Commission (EEOC)[2] which stated:

> Enclosed you will find a recent decision of the United States Court of Federal Claims in Bennett v. United States, [30] Fed. Cl.[396], 1994 WL 5722 (Fed. Cl.) (January 5, 1994). The Court in Bennett held that "ADEA settlement payments for back pay and liquidated damages are not taxable." We have also enclosed a copy of a recent IRS ruling regarding the taxability of money received in settlement of sex and race discrimination claims.
>
> Please consult your account or tax consultant regarding the effect of the enclosed, if any, on your recent recovery in the subject action.

Petitioner's Form W-2, Wage and Tax Statement, from Northwest for 1993 reflected back pay in the amount of $10,093.

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[2] The EEOC brought the ADEA claim against Northwest on behalf of petitioner.

Petitioner reported this amount on line 7 (wages, salaries, tips, etc.) of his 1993 Form 1040, U.S. Individual Income Tax Return. Petitioner then deducted $10,093 on line 22 (other income) of his return as nontaxable back pay. The liquidated damages of $3,365 was reflected in box 14 of the Form W-2 under "other" and was not reported on petitioner's return. Petitioner reported the interest income of $4,542 on Schedule B, Interest and Dividend Income.

In the notice of deficiency issued March 12, 1997, respondent included the back pay and liquidated damages in petitioner's income with the following explanation:[3]

> The Supreme Court ruled in Schleier v. Commissioner, [75 AFTR 2d, 95-2675] * * * that recovery under * * * (ADEA) is not excludable from gross income under Section 104(a)(2) of the Internal Revenue Code. Therefore, such recoveries are taxable under Section 61 of the Internal Revenue Code.

Discussion

Except as otherwise provided, gross income includes income from all sources. Sec. 61(a); Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955). While section 61(a) is to be broadly construed, statutory exclusions from income must be narrowly construed. Commissioner v. Schleier, 515 U.S. 323, 328 (1995). Under section 104(a)(2), gross income does not include "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".

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[3] There are also computational adjustments with regard to itemized deductions and alternative minimum tax.

The Supreme Court has held that recoveries received for claims based on ADEA are not excludable from gross income under section 104(a)(2). Commissioner v. Schleier, supra. The Supreme Court stated:

> Like the pre-1991 version of Title VII, the ADEA provides no compensation "for any of the other traditional harms associated with personal injury." Monetary remedies under the ADEA are limited to back wages, which are clearly of an "economic character," and liquidated damages, which we have already noted serve no compensatory function. Thus, though this is a closer case than Burke [504 U.S. 229 (1992)], we conclude that a recovery under the ADEA is not one that is "based upon tort or tort type rights."

Commissioner v. Schleier, supra at 336. Accordingly, petitioner is not entitled to exclude from income the back wages and liquidated damages he received from Northwest.

Petitioner does not dispute the holding in Schleier, but he does dispute the actions of the Commissioner in applying Schleier to his situation.

Petitioner's argument is as follows: In 1993, the Commissioner issued Rev. Rul. 93-88, 1993-2 C.B. 61, which states that settlement proceeds from certain discrimination cases are the result of tort or tortlike claims, and, therefore, are nontaxable.[4] The Supreme Court in Schleier ruled that the

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[4] This ruling covered the following types of discrimination: Disparate gender and race discrimination under tit. VII of the Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241, as amended by the Civil Rights Act of 1991, Pub. L. 102-166, 105 Stat. 1071; and disparate discrimination under the Americans with Disabilities Act of 1990, Pub. L. 101-336, 104 Stat. 327. These statutes provided for a broad range of compensatory damages for claims such as future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of (continued...)

critical factor was whether the damages were received on account of physical injury, which encompasses the tort or tortlike criteria. The Commissioner then issued Rev. Rul. 96-65, 1996-2 C.B. 6, revoking Rev. Rul. 93-88 and concluding that back pay received in settlement of those discrimination claims is taxable. However, the Commissioner ruled further that Rev. Rul. 96-65 was to be applied prospectively only.[5] Therefore, petitioner contends, because ADEA claims are the same as other discrimination claims, Rev. Rul. 96-65 should also include ADEA claims and be applied prospectively only. Additionally, petitioner argues that he relied on "established" and settled case law which supported excludability of ADEA damages at the time he filed his return.

There are several flaws to petitioner's logic. First, with the issuance of Rev. Rul. 93-88, the Commissioner was no longer contesting the taxability of discrimination claim settlements as described therein. This position likely was due to the Supreme Court holding in United States v. Burke, 504 U.S. 229 (1992).[6]

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[4](...continued) enjoyment of life, and nonpecuniary losses. Claims pursuant to ADEA do not permit such compensatory damages.

[5] Pursuant to the authority in sec. 7805(b), the "Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws shall be applied without retroactive effect."

[6] In Burke, the taxpayers received back pay for disparate gender discrimination under tit. VII of the Civil Rights Act of 1964 prior to the 1991 amendment. The Supreme Court held that the back pay received was taxable since pre-1991 tit. VII did not (continued...)

ADEA was not included in Rev. Rul. 93-88, and the Commissioner was actively pursuing the position that ADEA settlement proceeds were taxable, obviously resulting in the Schleier decision justifying the Commissioner's litigating position. Consequently, when Schleier was decided, a change of position was required with respect to the Commissioner's litigating position as to the matters covered in Rev. Rul. 93-88, but not with respect to ADEA claims. Therefore, apparently with fairness in mind, the Commissioner decided to apply the change prospectively only and issued Rev. Rul. 96-65. Thus, there is no violation of any so-called duty of consistency--the Commissioner has consistently treated all ADEA claimants alike.

Secondly, petitioner could not have relied on established or settled law on the excludability of ADEA proceeds. The Supreme Court had not spoken definitively on the issue, and as already explained, the Commissioner was consistently contesting the excludability of the damages. At the time petitioner filed his return in 1994, the excludability of ADEA settlements was being litigated in several jurisdictions. The result of this litigation was a split among the Courts of Appeals in 1994. The Courts of Appeals for the Fifth and Ninth Circuits held that ADEA damages were nontaxable, Schmitz v. Commissioner, 34 F.3d 790 (9th Cir. 1994), affg. T.C. Memo. 1991-373; Schleier v.

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[6](...continued)
allow awards for compensatory or punitive damages, but if those damages were available, then the back pay would be nontaxable.

Commissioner, 26 F.3d 1119 (5th Cir. 1994), affg. without published opinion an Order of this Court dated July 7, 1993, while the Court of Appeals for the Seventh Circuit held that ADEA damages were taxable, Downey v. Commissioner, 33 F.3d 836 (7th Cir. 1994), revg. 100 T.C. 634 (1993). It was very clear that this was not an area of settled law. Furthermore, petitioner stated that he relied on Bennett v. United States, 30 Fed. Cl. 396 (1994), which was brought to his attention in the letter from the EEOC; however, on appeal, Bennett was reversed in accordance with the decision in Schleier. Bennett v. United States, 60 F.3d 843 (Fed. Cir. 1995).

While we may sympathize with petitioner, we cannot ignore the clear dictates of Schleier that damages received pursuant to the ADEA are subject to Federal income tax. Therefore, we sustain respondent's determination.

Reviewed and adopted as the report of the Small Tax Case Division.

Decision will be entered

for respondent.