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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
IRENE C. TRITZ[1]	Case No. 592022

Year	Tax
2006	$19,353

Representing the Parties:

For Appellant: Irene C. Tritz

For Franchise Tax Board: Raul Escatel, Tax Counsel

QUESTION: Whether appellant has shown that respondent erred by not allowing damages awarded pursuant to a settlement agreement to be excluded from her taxable income.

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[1] The 2006 California return at issue bears the signatures of both Irene Tritz and and her spouse, Richard J. Tritz. Respondent issued both the Notice of Proposed Assessment (NPA) and the Notice of Action (NOA) to Richard J. Tritz and Irene Tritz. California Code of Regulations, title 18, section 5420, subdivision (a)(9), requires every Appeal Letter to contain the signature of each appellant who is filing the appeal, whether jointly or separately, or the signature of an authorized representative made on behalf of each appellant who is filing the appeal. In this case, only Irene C. Tritz signed the appeal, and thus we must treat this matter as an appeal by Irene C. Tritz. "Appellant," therefore, will refer only to Irene C. Tritz.

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HEARING SUMMARY

Background

Appellant filed several complaints against her former employer, the United States Postal Service (USPS). In 1991, appellant filed a lawsuit in federal district court and the court ruled in a bench trial that the USPS discriminated against appellant on the basis of gender. The parties entered into a settlement agreement which provided that the USPS would promote appellant to a higher position and raise her pay level. In 2004, appellant filed a second complaint in federal district court against the USPS. The jury found the USPS liable for gender discrimination and awarded appellant damages in the amount of $275,000. After the judgment was entered on October 27, 2005, the USPS filed a motion to vacate the judgment. On December 20, 2005, the court held a settlement conference with the parties that resulted in a settlement agreement, which was placed on the record. The parties agreed that, in exchange for appellant dismissing all of her pending claims against the USPS, the USPS would pay appellant the sum of $225,000 for emotional distress and provide her with a letter of recommendation. According to the court transcript, the court and appellant made the following statements:

> The court: "Now, I've had conversations privately with Mr. Tritz – with Mrs. Tritz, I'm sorry, with respect to the tax consequences, and Mrs. Tritz understands that there are no – there is no guarantees, there are no representations with respect to the tax consequences of that $225,000. That's going to be something that is between Mrs. Tritz, the IRS, and her tax preparer. Is that acceptable, Mrs. Tritz?"
>
> Ms. Tritz: "Yes, it is, Your Honor."

(Resp. Opening Br., pp. 1-2, exhibits A-C.)

On January 23, 2006, appellant filed a Motion to Vacate the Settlement Agreement and an Order Dismissing the Action with the federal district court. On February 7, 2006, the federal district court denied appellant's motion. On February 17, 2006, a Stipulation and Agreement for Compromise Settlement and an Order Dismissing Action were filed with the federal district court (hereinafter referred to as the 2006 settlement agreement). Paragraph 9 of the 2006 settlement agreement states, "The parties agree that the $225,000 settlement amount is damages in compensation for Plaintiff's claimed emotional distress as an injury to Plaintiff." Paragraph 11 of the 2006 settlement agreement states, in part, "The parties further agree that any other prior or contemporaneous representations or understandings not explicitly contained in this written Settlement Agreement, whether written or oral, are of no further legal

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or equitable force or effect." (Resp. Opening Br., p. 2, exhibit D.)

Appellant and her spouse filed a timely California return for the 2006 tax year. They used the joint filing status and reported wages of $63,950 and California adjustments (an addition) of $319. The couple reported California adjusted gross income (AGI) of $64,269 and claimed itemized deductions of $40,604, reporting California taxable income of $23,665 and a tax of $342. After applying a personal exemption credit of $182, the couple reported a tax liability of $160. The couple apparently remitted payment of the tax liability of $160 when they filed their 2006 California joint return. (Resp. Opening Br., p. 4, exhibit I.)

After receiving information from the Internal Revenue Service (IRS) concerning the adjustments the IRS made to the couple's 2006 federal joint return, respondent audited the couple's 2006 California joint return. According to respondent, the federal information shows that the couple had federal AGI of $288,950 and federal itemized deductions of $32,570,[2] whereas the couple's 2006 California return reported federal AGI of $63,950 and federal itemized deductions of $41,460. Respondent determined that the couple was liable for additional tax due to the differences between the amounts of federal AGI and itemized deductions reported on the couple's federal 2006 return and California 2006 return. (Resp. Opening Br, p. 4, exhibit I.)

Respondent issued an NPA dated September 9, 2009, for tax year 2006. The NPA increases the couple's taxable income from $23,665 to taxable income of $257,555, an increase of $233,890 (i.e., $288,950 of federal AGI less $63,950 of reported California AGI less $32,570 of federal itemized deductions plus $41,460 of reported federal itemized deductions on the couple's California return). The NPA proposes additional tax of $19,353 plus interest. The NPA provides that respondent stopped charging interest beginning 18 months from the later of the original due date of the return or the date on which the couple filed the return. (Resp. Opening Br, p. 4.)

Appellant protested the NPA in a letter dated November 4, 2009. Appellant requested copies of all information that respondent received from or sent to any agency or person concerning this

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[2] The couple's 2006 federal return reports a lawsuit settlement income of $225,000 on line 21 (as "Other Income") and subtracts $225,000 on line 36 (as an adjustment to gross income), resulting in federal AGI of $63,950. The couple claimed itemized deductions of $41,460 on their 2006 federal return.

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assessment. Appellant described the background and results of the two actions she previously filed against the USPS. Appellant asserted that the federal court informed her that the settlement proceeds would not be subject to income tax. In addition, she requested that respondent postpone any formal collection action so her attorney could examine all necessary records. (Resp. Opening Br., p. 5, exhibit K.)

On June 7, 2010, appellant filed an amended complaint in pro per in federal district court against the Postmaster General, the USPS, the Commissioner of the IRS, a senior attorney of the USPS (collectively referred to as the federal defendants), and Selvi Stanislaus, in her official capacity as Executive Officer of respondent, plus Does 1 through 100. The amended complaint included the following causes of action: 1) fraud/misrepresentation; 2) contract voidable - undue influence; 3) breach of settlement agreement (1991 and 2005); 4) discrimination; 5) retaliation; 6) hostile environment; 7) interference with the Court; 8) final contract violates the Right of Others; 9) public value; 10) conspiracy; and 11) intentional infliction of emotional distress. In paragraph 46 of appellant's amended complaint, she indicates that respondent issued the NPA because the USPS provided the IRS with a Form 1099 listing the settlement proceeds as taxable income. (Resp. Opening Br, pp. 3-4, exhibit F.)

The federal defendants and Ms. Stanislaus filed motions to dismiss all claims against them in appellant's first amended complaint. On October 8, 2010, the federal district court issued a Minute Order Granting Federal Defendants' Motion to Dismiss in this action. On October 13, 2010, the federal district court issued a similar minute order granting the remaining defendant and Ms. Stanislaus's, motion to dismiss in this action. According to respondent, appellant subsequently filed an appeal with the Ninth Circuit Court of Appeal. In its opening brief, respondent states that the appeal is pending and that it will provide updates to the Board as they become available. (Resp. Opening Br., pp. 4-5, exhibits G-H.)

Respondent apparently sent appellant a letter dated September 3, 2010, in which it explained its position, provided a copy of the pertinent IRS Record of Account, and requested a response from appellant by no later than October 3, 2010. After not receiving a response to its September 3, 2010 letter, respondent issued an NOA dated August 30, 2011, affirming the NPA. The NOA provides that

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respondent suspended interest for the time period reflected in R&TC section 19116 and it resumed 15 days after the date of the NPA. (Resp. Opening Br., p. 5, exhibits K-L.)

This timely appeal followed. At appellant's request, this appeal was deferred until November 19, 2011, to allow appellant time to provide the Board with documentation pertaining to the matter she claims was pending before the Ninth Circuit Court of Appeals. In a letter dated November 28, 2011, the Board's staff informed appellant that this appeal was returned to active status because it did not receive the requested documentation by the November 19, 2011 deadline.

Contentions

Appellant's Contentions

Appellant states that the proposed assessment is the result of a breach of contract with the USPS. Appellant asserts that she accepted the settlement amount, even though it was less than the amount the jury awarded her, because it was "non-taxable." She further asserts that the USPS breached the settlement agreement by erroneously issuing a Form 1099 listing the settlement award as taxable income. Appellant contends that this litigation is pending before the Ninth Circuit Court of Appeals; she provides the name of the deputy attorney general who is representing the State of California. Appellant states, "If I am successful in getting this issue resolved, I will have the paperwork sent to you to dissolve this tax." In the meantime, she requests an abatement of this appeal by the Board until the Ninth Circuit Court of Appeals reaches a decision. (Appeal Letter.)

Respondent's Contentions

Respondent argues that appellant fails the two-prong test for the exclusion of settlement proceeds set forth in *Commissioner v. Schleier* (1995) 515 U.S. 323, as modified by the 1997 amendment to Internal Revenue Code (IRC) section 104(a)(2) (hereinafter referred to as the *Schleier* test). Respondent contends that appellant fails the second prong of the *Schleier* test, which requires that the damages were received on account of personal physical injuries or physical sickness. Respondent argues that there must be a direct causal link between the damages and the sustained personal physical injuries. Respondent contends that the courts first look at the settlement agreement's language in determining whether the damages were paid for personal physical injuries or physical sickness. Respondent asserts that the 2006 settlement agreement expressly allocates the entire settlement award as

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compensation for appellant's claimed emotional distress. Citing *Wells v. Commissioner*, T.C. Memo 2010-5, respondent contends that, for purposes of paragraph (2) of IRC section 104(a), emotional distress shall not be treated as a physical injury or physical sickness. It asserts that there is nothing in the 2006 settlement agreement which indicates that the USPS intended to designate any of the settlement proceeds for any physical injury. It further asserts that appellant did not make any allegations that the USPS physically injured her or caused her any physical sickness. Respondent notes that appellant indicated in the various pleadings that she suffered great distress and anxiety as a result of the USPS's actions. Citing *Connolly v. Commissioner* (2007) T.C. Memo 2007-98, respondent argues that damages are not qualified for exclusion from gross income due to emotional distress, even if there are physical symptoms, such as fatigue, insomnia, and indigestion. (Resp. Opening Br., pp. 7-9.)

Respondent also contends that appellant fails the first prong of the *Schleier* test, which requires the underlying cause of action giving rise to the settlement award be based upon tort or tort type rights. Respondent asserts that it is evident from the 2006 settlement agreement and appellant's complaint, that appellant's allegations are based on economic rights and awards based on a breach of contract, are generally subject to tax. (Resp. Opening Br., pp. 7-8.)

Respondent notes that, although appellant appears to be arguing that she was duped into believing the settlement proceeds would not be taxable, "the law is clear" that appellant's settlement proceeds are taxable. It points out that the court transcript shows that in open court on December 20, 2005, the federal district judge informed appellant that there were no guarantees as to the taxability of the settlement proceeds, and appellant expressly accepted this representation. Respondent asserts that, by signing the document, appellant agreed to the terms of the 2006 settlement agreement. Respondent also asserts that paragraph 11 of the 2006 settlement agreement contains an integration clause that supersedes any other oral or written representations or understandings. (Resp. Opening Br., pp. 9-10, exhibits C-D.)

Lastly, respondent asserts that the proposed assessment is based on a federal determination. Respondent contends that under Revenue & Taxation Code (R&TC) section 18622, appellant must concede the accuracy of the federal determination or show how it is erroneous. Respondent contends that the proposed assessment is presumptively correct because it is based on a

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federal audit report, and appellant has the burden of proving that the determination is not accurate. Respondent asserts that appellant concedes that both the IRS and respondent determined that the settlement proceeds are taxable and appellant has failed to provide any information which establishes that the federal determination is erroneous. (Resp. Opening Br., p. 10.)

Applicable Law

Accuracy of Assessment

A taxpayer must either concede the accuracy of a federal determination or show wherein that determination is erroneous. (Rev. & Tax. Code, § 18622.) A deficiency issued by respondent based on a federal audit is presumed to be correct and the taxpayer has the burden to prove that the determination is erroneous. (*Appeal of Sheldon I. and Helen R. Brockett*, 86-SBE-109, June 18, 1986.)[3] It is well-established that deductions and exclusions are a matter of legislative grace and are allowable only where the conditions established by the Legislature have been satisfied. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of George R. II and Edna House*, 93-SBE-016, Oct. 28, 1993.) Respondent's determination that a deduction or exclusion should be disallowed is presumed correct and an appellant must prove his entitlement to the claimed deductions or exclusions (*Welch v. Helvering* (1933) 290 U.S. 111; *Appeal of George R. II and Edna House*, *supra*). Unsupported assertions cannot satisfy that burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted, credible, competent, and relevant evidence showing that respondent's determinations are incorrect, such proposed assessments must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) An appellant's failure to produce evidence that is within her control gives rise to a presumption that such evidence is unfavorable to her case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

IRC section 104(a)(2)

R&TC section 17071 incorporates IRC section 61. IRC section 61(a) provides that gross income includes all income from whatever source derived, except as otherwise expressly provided by statute. Although IRC section 61(a) broadly defines as income any accession to wealth, statutory

[3] State Board of Equalization cases (designated "SBE") can generally be viewed on the Board's website (www.boe.ca.gov).

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exclusions from income are narrowly construed. (*Commissioner v. Schleier, supra*, 515 U.S. at 328; *United States v. Burke* (1992) 504 U.S. 229, 233.)

R&TC section 17131 incorporates IRC section 104. IRC section 104(a)(2) excludes from gross income, among other items, damages received pursuant to a settlement "on account of personal physical injuries or physical sickness." IRC section 104(a) further provides, "For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness." It also provides that "the preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care . . . attributable to emotional distress." Medical care is defined for purposes of this section in IRC section 213(d)(1), subparagraph (A) or (B).

Prior to its amendment by the Small Business Job Protection Act of 1996 (SBJPA), Pub. L. 104-188, sec. 1605, 110 Stat. 1838, IRC section 104(a)(2) excluded from gross income amounts received on account of personal injuries or sickness. The reference to personal injuries in the former version of IRC section 104(a)(2) included "nonphysical injuries to the individual, such as those affecting emotions, reputation, or character". (*United States v. Burke, supra*, 504 U.S. at p. 235 fn. 6, p. 239.) (See also *Robinson v. Commissioner* (T.C. 1994) 102 T.C. 116, 126); *Fono v. Commissioner*, 79 T.C. 680, 692 (1982), affd. without published opinion 749 F.2d 37 (9th Cir. 1984).) On August 20, 1996, the SBJPA amended IRC section 104(a)(2) to exclude from gross income "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness". (SBJPA, § 1605(a), 110 Stat. 1838.) The SBJPA amendment thus narrowed the exclusion set forth in IRC section 104(a)(2) by replacing "personal injuries" to "personal physical injuries" and replacing "sickness" to "physical sickness." The legislative history of this amendment clarifies that "the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress." (H. Conf. Rept. 104-737, at p. 301 fn. 56 (1996), 1996-3 C.B. 741, 1041 fn. 56.) (See also *Hawkins v. Commissioner* (2005) T.C. Memo 2005-149.) Section 1605(d) of the SBJPA, 110 Stat. 1839, provides (with an inapplicable exception) that "the amendments made by this section shall apply to amounts received after the date of the enactment of this Act, in taxable years ending after such date."

It is clear from the express language of IRC section 104(a) that emotional distress,

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including mental anguish, humiliation, embarrassment, and anxiety, shall not be treated as a physical injury or physical sickness. "Physical manifestations of emotional distress such as fatigue, insomnia, and indigestion do not transform emotional distress into physical injury or physical sickness." (*Connolly v. Commissioner, supra*. See also *Lindsey v Commissioner*, T.C. Memo 2004-113, aff'd. (8th Cir. 2005) 422 F.3d 684.)

In *Wells v. Commissioner, supra*, the Tax Court specifically held that emotional distress due to depression does not constitute a personal physical injury or physical sickness under IRC section 104(a)(2). In that case, the taxpayer filed a lawsuit against her employer asserting claims for employment discrimination and retaliation. The parties settled the lawsuit and the taxpayer received a settlement payment pursuant to a settlement agreement, which provides that the payment was made "as damages for her emotional distress due to depression and other claims, not as wages or back pay." The taxpayer did not argue "that the characterization of the payment does not accurately reflect the nature of the claim or the settlement payment[.]" Applying IRC section 104(a)(2), the Tax Court held that the taxpayer failed to establish that she fell within the clear scope of the statutory exclusion.

In *Commissioner v. Schleier, supra*, 515 U.S. at p. 336-337, the United States Supreme Court set forth the two-prong *Schleier* test for determining whether amounts are excludable from gross income under IRC section 104(a)(2): (1) the underlying claims must be based on tort or tort type rights; and (2) the damages received must be on account of personal injuries or sickness. The *Schleier* test was reformulated to incorporate the amendment to IRC section 104(a)(2) pursuant to the SBJPA. (See *Shaltz v. Commissioner*, T.C. Memo. 2003-173; *Henderson v. Commissioner*, T.C. Memo. 2003-168.) The second prong of the *Schleier* test thus requires proof that the damages were received on account of personal physical injuries or physical sickness. Other than imposing this additional requirement into the second prong of the *Schleier* test, the SBJPA amendment did not alter the *Schleier* test. (*Goode v. Commissioner* (2006) T.C. Memo 2006-48.)

<u>Second Prong of *Schleier* Test</u>

In determining whether a settlement was paid on account of personal physical injuries or physical sickness, the courts will first examine the language in the settlement agreement. (*Massot v. Commissioner* (2000) T. C. Memo 2000-24.) "Express allocations in a settlement, identifying payment

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amounts deemed eligible for the section 104(a)(2) exclusion, are generally accorded conclusive effect for tax purposes." (*Goode v. Commissioner, supra*, citing *Fono v. Commisssioner, supra*.) The courts will not defer to the express allocations in a settlement, however, "where circumstantial factors reveal that the designation of the settlement proceeds was not the result of adversarial, arm's length, and good faith negotiations, and is incongruous with the 'economic realities' of the taxpayer's underlying claims." (*Goode v. Commissioner, supra*, citing *Bagley v. Commissioner* (1995) 105 T.C. 396, 406-410. See also *Massot v. Commissioner, supra*.)

First Prong of *Schleier* Test

When an award arises in the context of both tort and non-tort claims, the taxpayer must provide the evidence to show that the award is properly allocated to the tort claims; otherwise, the entire award is considered to be taxable income. (*Taggi v. United States* (2d Cir. 1994) 35 F.3d 93, 96-97; *Hess v. Commissioner*, T.C. Memo 1998-240.) When damages are received pursuant to a settlement agreement, the nature of the claim that was the actual basis for settlement determines whether the settlement amounts are excludable from gross income under IRC section 104(a)(2). (*Id.*; See also *United States v. Burke, supra*; *Prasil v. Commissioner*, T.C. Memo 2003-100.) "A key question to ask is: 'In lieu of what were the damages awarded?'" (*Robinson v. Commissioner, supra*, 102 T.C. 116, 126.) The determination of the nature of the claim is a factual inquiry and is generally made by reference to the settlement agreement in light of the surrounding circumstances, including the details surrounding the litigation, the allegations contained in the complaint, and the course of the parties' settlement negotiations. (*Goode v. Commissioner, supra; Robinson v. Commissioner, supra*.). In *Robinson v. Commissioner, supra,* the Tax Court stated:

> When the settlement agreement allocates clearly the settlement proceeds between tortlike personal injury damages and other damages, the allocation is generally binding for tax purposes (and the tortlike personal injury damages are excludable under section 104(a)(2)) to the extent that the agreement is entered into by the parties in an adversarial context at arm's length and in good faith. An important factor in determining the validity of the agreement is the "intent of the payor" in making the payment. If the payor's intent cannot be clearly discerned from the settlement agreement, his or her intent must be determined from all the facts and circumstances of the case in issue there. Factors to consider include the details surrounding the litigation in the underlying proceeding, the allegations contained in the payee's complaint and amended complaint in the underlying proceeding, and the arguments made in the underlying proceeding by each party there. None of these factors is always outcome-determinative; in a given case, any of these factors may ultimately be persuasive or ignored.

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(102 T.C. 116, 127-128 (citations omitted).) (See also *Green v. Commissioner* (5th Cir. 2007) 507 F.3d 857, 868, affg. T.C. Memo 2005-250; *Threlkeld v. Commissioner* (1986) 87 T.C. 1294, 1306-1307, affd. (6th Cir. 1988) 848 F.2d 81.)

Prior to January 23, 2012, Treasury Regulation section 1.104-1(c) provided:

> Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) 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.

Effective January 23, 2012, the IRS issued a final regulation amending Treasury Regulation section 1.104-1(c) to reflect the SBJPA amendments to IRC section 104(a)(2), and to delete the "tort or tort-type rights" requirement. (Internal Revenue Bulletin 2012-12, TD 9573.)[4] The final regulation adopts without substantive change the IRS's proposed amendments to Treasury Regulation section 1-104-1(c). (§ 1.104-1(c), Proposed Income Tax Regs., 74 Fed. Reg. 47153 (Sept. 15, 2009).) Amended Treasury Regulation section 1.104-1(c)(3) provides:

> This paragraph (c) applies to damages paid pursuant to a written binding agreement, court decree, or meditation award entered into or issued after September 13, 1995, and received after January 23, 2012. Taxpayers also may apply these final regulations to damages paid pursuant to a written binding agreement, court decree, or mediation award entered into or issued after September 13, 1995, and received after August 20, 1996. . . .

STAFF COMMENTS

IRC section 104(a)(2)

The portion of amended Treasury Regulation section 1.104-1(c) which removes the requirement that, to be excludable, the damages had to be based on "tort or tort type rights" does not appear to be relevant in this appeal because the issue here is whether appellant received emotional distress damages pursuant to the settlement agreement. (See *Wells v. Commissioner*, *supra*, T.C. Memo 2010-5, fn. 4.) ("This is not an issue we need to consider since we decide this case on the second prong of the test.") Even assuming that the "tort or tort type rights" requirement set forth in the first prong of the *Schleier* test does not apply to this appeal, appellant still must show that she did not receive

[4] See www.gpo.gov/fdsys/pkg/FR-2012-01-23/html/2012-1255.htm; http://www.irs.gov/irb/2012-12_IRB/ar05.html.

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damages for emotional distress in order for the gross income exclusion to apply. (Int.Rev. Code, § 104(a)(2).) Furthermore, the final regulation does not appear to apply to this appeal because appellant did not receive the damages at issue after January 23, 2012, and there is no evidence in the appeal record that the parties agreed to apply these final regulations to damages appellant received in 2006. It thus appears that, for the damages at issue to be excludable under IRC section 104(a)(2), both prongs of the *Schleier* test must be satisfied.

Second Prong of *Schleier* Test

Assuming the Board determines that the USPS paid appellant $225,000 as damages for emotional distress, it appears that, as a matter of law, such damages, not being attributable to physical injury or physical sickness, are not excludable from appellant's gross income, except to the extent that appellant expended any amounts for medical care to treat her emotional distress. (Int. Rev. Code, § 104(a)(2); *Wells v. Commissioner, supra*, T.C. Memo 2010-5.) Appellant should be prepared at oral hearing to present evidence to prove that the settlement payment of $225,000 was received on account of a physical injury or physical sickness other than the physical symptoms included in the term "emotional distress". Staff notes that the record does not disclose that any settlement proceeds were designated as reimbursement for medical care attributable to the treatment of emotional distress. Appellant should be prepared to show, if applicable, that any portion of the $225,000 amount was designated as reimbursement for medical care attributable to the treatment of emotional distress.

First Prong of *Schleier* Test

Assuming the Board determines that appellant satisfies the second prong of the *Schleier* test by showing the $225,000 amount was received on account of personal physical injuries or physical sickness, the parties should be prepared to discuss whether appellant satisfies the first prong of the *Schleier* test, i.e., whether the settlement award was properly allocated to an underlying cause of action based upon tort or tort-type rights. Staff notes that pages 2, 3, 7, and 16 are missing from the copy of the first amended complaint attached as Exhibit F to respondent's opening brief. The parties may wish to provide the Board a complete copy of the first amended complaint prior to the scheduled hearing.

Federal Determination

It is unclear what adjustments, if any, the IRS made to the couple's 2006 federal return

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and account, because respondent has not provided a copy of appellant's 2006 federal transcript. Respondent may wish to provide the Board with a copy of the couple's 2006 federal transcript and be prepared to explain at the hearing any adjustments that the IRS made to the couple's 2006 federal return. Appellant should be prepared to discuss whether she concedes the accuracy of the federal determination. Otherwise, she should provide information and legal authority showing the federal determination is erroneous.

Additional Evidence

Pursuant to California Code of Regulations, title 18, section 5523.6, if appellant is able to locate any additional evidence supporting her appeal, it should be submitted if possible to the Board and respondent at least 14 days prior to the hearing date including, but not limited to, any document showing the status or outcome of her appeal that was pending with the Ninth Circuit Court of Appeals.[5]

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[5] Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879 MIC: 80, Sacramento, CA 94279-0080

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