

# Federal Agency Seminar



## Taxability and Reporting of Wage Settlements and Judgments

Presented by  
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# Objectives

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- List the 6 items you need to find out when you review a settlement/judgment
- Determine the reporting requirements when the remedy is paid to claimant's attorney

# Case Studies

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- **Case Study #1**

- Harry settled his Title VII claim against his ER on May 10, 2008. The agreement stipulated reinstatement and front wages and attorney fees of \$35K. The \$35K was jointly paid to Tom & Jerry, Esq. and Harry on July 6, 2009.

- **Case Study #2**

- June settled her claim under the Federal Torts Claim Act against Agency for \$15K January 15, 2010. The settlement was for back wages as a result of physical injuries and attorney fees. The Agency paid the claim on June 10, 2010 to June's attorney, Peter, Esq.

# Case Studies

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- **Case Study #3**
- Cindy settled her Title VII claim against her ER on May 24, 2008. The agreement stipulated reinstatement, back wages of \$35K, punitive damages of \$5K, and attorney fees of \$10K. The \$10K was paid directly to Tom & Jerry, Esq., Cindy's attorneys, on June 6, 2009. Cindy was paid her settlement on June 5, 2009.

# Six Items You to Know

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- The claimant
- Nature of the claim
- The remedy
- Is the remedy excluded from gross income?
- The character of the remedy
- Proper timing and reporting of the remedy

# Claimant

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- It is the individual, business, union for its members, etc. that files a claim against the Government
- Sometimes referred as the plaintiff

# Case Studies

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- Case Study #1 –
  - The claimant is Harry whom Harry is being represented by Tom and Jerry, Esq.
- Case Study #2
  - The claimant is June whom is being represented by Peter Esq.
- Case Study #3
  - The claimant is Cindy whom is being represented by Tom and Jerry, Esq.

# Nature of the Claim

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- The statute which the claim was filed under
- The statute determines the remedies available to claimant

# Examples of Statutes that claims are filed under

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- Title VII of the Civil Rights Act of 1964
- Age Discrimination in Employment Act
- Fair Labor Standards Act
- Americans with Disabilities Act
- Family Medical Leave Act
- Federal Torts Claim Act
- Equal Access to Justice Act
- Contract Disputes Act
- Possibility it could be a state statute

# Case Studies

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- Case Study #1 - Title VII of the Civil Rights Act of 1964
- Case Study #2 - Federal Torts Claim Act
- Case Study #3 - Title VII of the Civil Rights Act of 1964

# The Remedy

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- Remedy is recovered by a court award or settlement agreement
  - Legal damages - e.g. compensatory damages, liquidated damages, punitive damages
  - Equitable relief – e.g. back pay, front pay, employment, reinstatement, promotion
- Attorney fees & costs
- Interest maybe imposed to compensate for use or forbearance of money damages

# Types of Wage Monetary Remedies

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- Severance Pay – Eligibility & computation can be found in 5 U.S.C. 5595 & 5 CFR part 550, subpart G
- Back Pay – Computation can be found in 5 U.S.C. § 5596 & 5 CFR part 550
- Front Pay – No computation in the U.S.C. but it is the for lost compensation during the period between judgment and reinstatement or essentially is the equivalent of lost earnings.

# Unknown Remedy

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- Review the nature of the claim to determine what remedies are allowed
- Determination is dependent on facts and circumstances

# Allocation of the Remedy

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- Remedy maybe broken down into several types
- Must determine if all the remedies are allowed under the claim
- Service may disregard the allocation if-
  - Not a bona fide adversarial settlement
  - Allocation not proper nor reasonable

# Age Discrimination in Employment Act

## 29 U.S.C. § 621 *et seq.*

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- Workers' Rights Law
- Back Pay
- NO "Emotional Distress" Damages
- Liquidated Damages (*willful* violation)

# Americans with Disabilities Act of 1990

42 U.S.C. § 12101 *et seq.*

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- Workers' Rights Law
- Back pay
- Compensatory damages for intangible harm ("Distress" Type Damages) or non-economic damages
- Punitive damages

# Civil Rights Act of 1991, 42 U.S.C. §1981a

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- Civil Rights Law
- Back and front pay, but no severance pay
- Compensatory damages, *i.e.*, for emotional distress
- Punitive damages, for *intentional* violations, *i.e.*, disparate treatment

# Equal Pay Act of 1963

29 U.S.C. § 206(d)

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- Workers' Rights Law
- Unpaid Wages
- Unpaid Overtime
- Liquidated Damages--Not Punitive
- NO "Emotional Distress" Damages
- Attorney fees and costs maybe recovered

# Fair Labor Standards Act of 1938

29 U.S.C. § 201 *et seq.*

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- Workers' Rights Law
- Unpaid Wages
- Unpaid Overtime
- Liquidated Damages—Not Punitive
- NO "Emotional Distress" Damages

# Family Medical Leave Act of 1993

29 U.S.C. § 2601 *et seq.*

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- Workers' Rights Law
- Compensatory Damages
  - "equal to" denied/lost wages or benefits
  - "equal to" direct costs of providing care
- Liquidated Damages (**Not Punitive**)
- Punitive Damages equal to the compensatory damages
- NO "Emotional Distress" damages
- Attorney fees and costs maybe recovered

# Case Studies

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- Case Study #1
  - Equitable relief – reinstatement and back wages of \$35K
  - Legal damages – None
  - Costs – undesignated attorney fees in the \$35K back wages
- Case Study #2
  - Equitable relief – back wages of \$15K
  - Legal damages - None
  - Costs – undesignated attorney fees in the \$15K
- Case Study #3
  - Equitable relief – back wages of \$35K
  - Legal Damages – punitive damages of \$5K
  - Costs – designated attorney fees of \$10K

# Exclusion from gross income

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- All remedies are taxable, including attorney fees & interest, with exception of
  - Damages paid on account of personal physical injuries or physical sickness (§104(a)(2))
  - Cost to replace lost property
  - Costs related to physical injury and sickness and emotional distress if not previously deducted under Code §213

# IRC §104(a)(2)

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- A claim must be based upon tort or tort-type rights
- Personal physical injury is an observable bodily harm, such as bruising, cuts, swelling or bleeding.
- A genuine claim under a workers' right statute or under the common law must have been asserted
- **Exception** -- doesn't include punitive damages

# Emotional Distress

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- Emotional distress is not considered a physical injury or a physical sickness.
- Emotional distress damages are not wages
- Medical care on account of emotional distress is excludable under §104(a)(2), if not previously deducted under §213

# Attorney fees & costs

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- Are included in gross income of the claimant no matter if paid to the attorney
- Legal fees paid from a remedy all of which is excludable §104(a)(2) the claimant does not include in gross income the portion of the award paid to the attorney

# Case Studies

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- Case Study #1 – The remedies are taxable
- Case Study #2 – The remedies are non-taxable according to Code §104(b)(2)
- Case Study #3 – The remedies are taxable

# Character of the remedy

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<b>Ordinary Income</b>	<b>Wages</b>
Compensatory Damages	Back Pay
Punitive Damages	Front Pay
Liquidated Damages	Severance Pay
Emotional Damages	Overtime Pay
Interest	
Attorney Fees & Costs	

# Wages - additional information

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- If the remedy is wages, then it is subject to FICA and withholding of income tax
- If excluded from income, then not wages, e.g. back wages under §104(b)(2)
- If legal fees and interest are not stipulated in an award or settlement of “wages”, the full amount of the award can be “wages” to the claimant (Rev. Ruling 80-364)

# Case Studies

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- Case Study #1 – Front wages and attorney fees are taxable as wages to the claimant thus subject to FICA and FIT W/H
- Case Study #2 – The remedy of back wages and attorney fees are not taxable to the claimant under Code §104(d)(2)
- Case Study #3 – The remedy of back wages is taxable as wages (FICA & FIT W/H) and the punitive damages and interest is taxable as ordinary income

# General reporting to claimant

<b>Payment</b>	<b>Reported on</b>
Back Pay	W-2
Front Pay	W-2
Severance Pay	W-2
Compensatory	1099-Misc Box 3
Punitive	1099-Misc Box 3
Liquidated Damages	1099-Misc Box 3
Emotional Damages	1099-Misc Box 3

# Reporting attorney fees and interest

<b>Payment</b>	<b>Reported on</b>
Award Designating Attorney Fees	1099-Misc Box 3
Award not Designating Attorney Fees	1099-Misc Box 3 or W-2 when appropriate
Interest	1099-INT if equal or greater to \$600
Award not Designating Interest	1099-Misc Box 3 or W-2 when appropriate

# What year do we report?

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- Taxes are calculated based on the year of payment
- Taxes are reported based on the year of payment

# Case Studies

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- Case Study #1 - Harry receives a W-2 reporting \$35K for tax year 2009
- Case Study #2 - June receives no Form 1099-MISC since the claim is not taxable to her
- Case Study #3 – Cindy receives a W-2 for the back wages of \$35K for tax year 2009 and Form 1099-MISC box 3 for the \$5K and \$10K for tax year 2009

# Gross proceeds paid to an attorney

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- Payments directly or jointly to the attorney are reportable on Form 1099-MISC Box 14 to the attorney
- Reportable even if the attorney is incorporated
- Reportable to the attorney even if not taxable to the claimant
- Subject to §3406 (back-up withholding provisions (No TIN))

# Case Studies

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- Case Study #1 – Tom & Jerry, Esq. jointly received the \$35K with Harry, thus they should be issued a Form 1099-MISC Box 14 reporting \$35K
- Case Study #2 - Peter, Esq. was directly paid \$15K, thus he should be issued a Form 1099-MISC Box 14 reporting \$15K
- Case Study #3 – Tom & Jerry, Esq. were directly paid \$10K, thus they should be issued a Form 1099-MISC box 14 reporting \$10K

# Case Study #1 Summary

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<b>TY to Report</b>	<b>Character of Remedy</b>	<b>Report</b>	<b>Recipient</b>	<b>Amount</b>
2009	Wages	W-2	Harry	\$35K
2009	Information	1099 -MISC Box 14	Tom & Jerry, Esq.	\$35K

# Case Study #2 Summary

<b>TY to Report</b>	<b>Character of Remedy</b>	<b>Report</b>	<b>Recipient</b>	<b>Amount</b>
2010	Ordinary Income	None – not taxable	Harry	\$15K
2010	Information	1099-MISC Box 14	Tom & Jerry, Esq.	\$15K

# Case Study #3 Summary

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<b>TY to Report</b>	<b>Character of Remedy</b>	<b>Report</b>	<b>Recipient</b>	<b>Amount</b>
2009	Wages	W-2	Cindy	\$35K
2009	Ordinary Income	1099-MISC Box 3	Cindy	10K
2009	Ordinary Income	1099-MISC Box 3	Cindy	\$5K
2009	Information	1099- MISC Box 14	Tom & Jerry, Esq.	\$10K

# Misc Item – FMS Judgment Fund

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- The Judgment Fund is a third party payor
- Allows certain judgments to be paid from a continuous appropriation
- FMS Judgment Fund doesn't report the payments it makes to the Service
- Judgment Funds position it is the responsibility of the subject or requesting agency
- Will reimburse the Agency share of FICA tax if request

# Summary

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- It was demonstrated the six items that need to know properly report a non-wage remedy of settlement or judgment
- If payments the remedy or a portion of the remedy is directly paid to an attorney it is a reportable payment to the attorney

*Any Questions?*



# Resources

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- [www.irs.gov](http://www.irs.gov)
- Instructions for Form 1099-MISC

# Presenter Contact Information

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