

Federal Agency Seminar



Taxability and Reporting of Non-Wage Settlements and Judgments

Presented by
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Objectives

- 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

- **Case Study #1**

- Harry settled his Title VII claim against his ER on May 10, 2008. The agreement stipulated reinstatement and punitive damages of \$35,000 were paid jointly to Harry and his attorney on July 6, 2009. The attorney fees of \$15,000 were paid on November 15, 2010 to Tom & Jerry, Esq., Harry's attorneys.

- **Case Study #2**

- June settled her claim under the Federal Torts Claim Act against Agency for \$15,000 January 15, 2010. The settlement was for compensatory damages for her physical injuries and attorney fees. The Agency paid the claim on June 10, 2010 to June's attorney, Peter, Esq.

Six Items You to Know

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

Claimant

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

Case Studies

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

Nature of the Claim

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

Examples of Statutes that claims are filed under

- 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

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

Remedy

- 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 maybe awarded
- Interest maybe imposed to compensate for use or forbearance of money damages

Types of non-wage monetary remedies

- Compensatory Damages
- Consequential Damages
- Punitive Damages
- Liquidated Damages
- Medical Expenses and Costs
- Cost to replace lost property
- Emotional Distress
- Attorney Costs and Fees

Unknown Remedy

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

Allocation of the Remedy

- 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.*

- 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.*

- 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

- 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)

- 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.*

- 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.*

- 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

Federal Torts Claim Act

28 U.S.C. § 1346(b)

- Permits private parties to sue the United States in a federal court for most torts committed by persons acting on behalf of the United States
- Limited waiver of sovereign immunity
- Broad range of remedies available

Equal Access to Justice Act

5 U.S.C. § 504 & 28 U.S.C. § 2412

- Claimant must be the “prevailing party” in litigation that was a material factor in bringing a desired result and the outcome was required by law and was not an unjustified act of the Government
- Reasonable fees and other expenses
 - Attorney fees not to exceed \$125 per hour
 - Cost of studies, analysis, engineering reports, etc.

Case Studies

- Case Study #1
 - Equitable relief – reinstatement
 - Legal damages
 - Punitive Damages - \$35,000
 - Costs - Attorney Fees of \$15,000
- Case Study #2
 - Equitable relief – none
 - Legal damages
 - Compensatory Damages – undesignated in the \$15,000
 - Costs – undesignated attorney fees in the \$15,000

Exclusion from gross income

- All remedies are taxable, including attorney fees, 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)

- 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

- 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's fees, costs & interest

- If legal fees and interest are paid as part of the remedy they 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

- Case Study #1 – The remedies are taxable to the claimant
- Case Study #2 – The remedy is not taxable to the claimant under Code §104(b)(2).

Character of the remedy

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

Wages - additional information

- 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

- Case Study #1 – The punitive damages and attorney fees are ordinary income
- Case Study #2 – Compensatory damages and attorney fees are ordinary income

General reporting to claimant

Payment	Reported on
Wages	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

Payment	Reported on
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?

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

Case Studies

- Case Study #1
- Harry receives a Form 1099-MISC reporting \$35,000 in Box 3 for tax year 2009
- Harry receives a Form 1099-MISC reporting \$15,000 reporting \$15,000 in Box 3 for tax year 2010
- Case Study #2
- June receives no Form 1099-MISC since the claim is not taxable to her

Gross proceeds paid to an Attorney

- 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

- Case Study #1 –
 - Harry's attorneys, Tom and Jerry, Esq.
 - Were jointly paid \$35K in TY 2009, thus a Form 1099-MISC Box 14 should report \$35K
 - Were directly paid \$15K in TY 2010, thus a Form 1099-MISC Box 14 should report \$15K
- Case Study #2
 - June's attorney, Peter, Esq., was directly paid \$15,000, thus a Form 1099-MISC Box 14 should report \$15K

Case Study #1 Summary

TY to Report	Character of remedy	Report	Recipient	Amount
2009	Ordinary	1099-MISC Box 3	Harry	\$35K
2009	Information	1099-MISC Box 14	Tom & Jerry, Esq.	\$35K
2010	Ordinary	1099-MISC Box 3	Harry	\$15K
2010	Information	1099-MISC Box 14	Tom & Jerry, Esq.	\$15K

Case Study #2 Summary

TY to Report	Character of Remedy	Report	Recipient	Amount
2010	Ordinary	None – Not taxable	June	\$15K
2010	Information	1099-MISC Box 14	Peter, Esq.	15K

Misc Item – FMS Judgment Fund

- 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 is reporting payments is the responsibility of the subject or requesting agency

Summary

- 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

- www.irs.gov
- Instructions for Form 1099-MISC

Presenter Contact Information

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