



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D. C. 20224

OFFICE OF THE CHIEF COUNSEL

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The Honorable Mark R. Warner  
United States Senate  
Washington, DC 20510

Dear Senator Warner:

I am responding to your letter dated March 12, 2014, on behalf of your constituent asked why a taxpayer who recovers a settlement for employment discrimination must treat the settlement proceeds as an accession to wealth that is included in gross income. She believes that losses suffered by the victim such as additional finance charges, late payment fees, loss of a car or home, and emotional distress due to financial losses should be deductible from any recovery.

Gross income includes all income from whatever source derived unless excluded by law. (section 61 of the Internal Revenue Code). The Supreme Court of the United States has stated that Congress intended to exercise the full measure of its taxing power in enacting section 61, and that the definition of gross income sweeps broadly to "all accessions to wealth, clearly realized, and over which the taxpayers have complete dominion" (*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955)).

The Supreme Court has also ruled that economic damages recovered for employment discrimination are accessions to wealth included in gross income (*United States v. Burke*, 504 U.S. 229 (1992) (Title VII of the Civil Rights Act) and *Commissioner v. Schleier*, 515 U.S. 323 (1995) age discrimination)). Gross income also includes back pay, front pay, and emotional distress damages recovered in an action for disability discrimination (*Johnson v. United States*, 228 F. Supp.2d 1218 (D. Colo. 2002)).

A taxpayer can exclude from gross income damages received on account of personal physical injuries or physical sickness (section 104(a)(2) of the Code). However, damages received for emotional distress do not qualify for this exclusion, unless they are recovered because of a personal physical injury or physical sickness or are not in excess of the amount paid for medical care due to the emotional distress (section 104(a) of the Code).

Deductions from gross income are allowable only as specifically provided by statute (*INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992)). Nothing in the law allows deductions for the types of losses \_\_\_\_\_ mentions in her letter.

Also, the law does not permit taxpayers to limit the additional marginal tax liability that results from including in income a lump sum settlement award resulting from an employer's discrimination over a period of years.

Thus, statutory changes to the Internal Revenue Code would be necessary to allow taxpayers to exclude employment discrimination awards from gross income, to deduct the types of losses \_\_\_\_\_ describes in her letter, or to limit their tax liability on lump-sum awards that represent several years of compensation.

I am sorry that my response is not more favorable, but I hope this information is helpful. If you have any questions, please contact me at \_\_\_\_\_ or \_\_\_\_\_, at \_\_\_\_\_.

Sincerely,

Andrew J. Keyso  
Associate Chief Counsel  
(Income Tax and Accounting)