

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

| | | |
|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 25924 |
| [Redacted], |) | |
| |) | |
| Petitioners. |) | DECISION |
| _____ |) | |

On June 17, 2013, the Income Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted] and [Redacted] (taxpayers), proposing denial of a refund of Idaho individual income tax in the amount of \$7,080 for taxable years 2010 and 2011.

The taxpayers filed a timely protest and petition for redetermination. The taxpayers requested an informal hearing, which was held on December 30, 2013. Present at the hearing were Mrs. [Redacted], Tax Policy specialist [Redacted] and Tax Auditor [Redacted]. Mrs. [Redacted] explained her situation and the circumstances surrounding the audit adjustments, but did not submit additional information. The Commission has reviewed the file, is advised of its contents, and hereby issues its decision.

The taxpayers timely filed their 2010 and 2011 Idaho individual income tax returns, and submitted an amended Idaho return for taxable year 2011 on or about August 28, 2012. Upon receipt of the amended return, both the original 2010 and the amended 2011 Idaho returns were referred to the Bureau for review.

The Bureau determined the reduction in taxable income shown in the amended return should not be allowed and sent the taxpayers an NODD. The taxpayers appealed the NODD and their file was transferred to the Legal/Tax Policy Division for administrative review.

Mrs. [Redacted] received payments in both taxable year 2010 and 2011, from a civil rights lawsuit against the [Redacted]. On December 14, 2010, Mrs. [Redacted] received \$47,778 for legal fees and costs, and on January 20, 2011, she received a full and final settlement payment in the amount of \$150,000. The taxpayers timely filed their 2010 federal and state tax returns, but did not report any of the payments for legal fees and costs in their gross income. The taxpayers' 2011 return reported a portion, \$90,000, of the settlement amount as taxable income and the appropriate taxes were paid. In August 2012, the taxpayers filed a 2011 Amended Idaho Individual Income Tax Return removing the \$90,000 from taxable income. In the explanation of the change to income, the preparer referenced Internal Revenue Service publication 525. Attached to the return was a letter from Mrs. [Redacted] stating her reasons for considering a large portion of the settlement as compensation for emotional distress due to physical injury or sickness.

Internal Revenue Code § 104 states:

Internal Revenue Code § 104 **Compensation for injuries or sickness.**

(a) In general.

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, **gross income does not include**—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) 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;**

(3) amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer);

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a

disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980; and

(5) amounts received by an individual as disability income attributable to injuries incurred as a direct result of a terroristic or military action (as defined in section 692(c)(2)).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401 (a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee. **For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.** The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1) attributable to emotional distress. (Emphasis added.)

In their letter of protest, Mrs. [Redacted] presented her arguments as to why she felt a portion of the settlement she received in 2011 from the [Redacted] should be compensatory damages for physical injury or illness, even though the settlement did not specify the reason for the settlement, but rather stated the payment constituted a complete settlement of all claims, a general release. Mrs. [Redacted] submitted two amended returns with the [Redacted] in which she claimed 70 percent of the amount received in the settlement was due to physical injury or sickness. To date, there is no indication that the [Redacted] has accepted the amended return. However, the taxpayers have requested the state of Idaho take a second look at their claim and give them relief of whatever percentage they see fit.

Mr. [Redacted] is a Certified Family Home provider and Mrs. [Redacted] has been a [Redacted] since 1994, and, since 1995 has been in a [Redacted] with the [Redacted] to provide [Redacted]. Obviously, this type of work is governed and monitored by several different agencies, and employees are subject to background and criminal history checks. The [Redacted] is one of the regulatory agencies, along with the [Redacted]. Any allegations of abuse, neglect,

self-neglect, or exploitation involving vulnerable adults is investigated and if the reported allegations are determined credible, can result in the loss of a [Redacted] and [Redacted].

On or about June 28, 2007, Mrs. [Redacted] was notified that [Redacted] for [Redacted] and [Redacted] to operate a [Redacted] were either suspended or revoked, and in addition, informed that she was placed on an [Redacted] list by [Redacted]. Mrs. [Redacted] believed these actions were unwarranted and that the actions were taken without allowing her due process. Shortly after Mrs. [Redacted] was notified of the suspension of her [Redacted] she was also instructed to stay away from the residence of Mr. [Redacted] and [Redacted] as long as it remained a [Redacted] because of her issues with [Redacted]. [Redacted] actions, along with the separation from her family, took its toll on Mrs. [Redacted]. She became unemployed and her emotional state deteriorated. Mrs. [Redacted] subsequently filed a civil rights actions lawsuit against the officials employed by the [Redacted]

In January 2011, Mrs. [Redacted] and the [Redacted] reached an out-of-court settlement. The Settlement Agreement paying Mrs. [Redacted] \$150,000 stated: “The payment constitutes general damages.”

The Tax Commission recognizes the taxpayer’s emotional distress may have contributed to her [Redacted]. However, the income she received from [Redacted] to settle her lawsuit was not for physical injuries or physical sickness; it was for general damages. For income tax purposes, “. . .emotional distress shall not be treated as a physical injury or physical sickness.” Pursuant to the IRS Code and Idaho tax law, the entire settlement is gross income during the year it was received.

The taxpayers have provided nothing that would suggest the Bureau’s determination denying the reduction in taxable income claimed in the taxpayers’ Amended Idaho Individual

Income Tax Return for 2011 was in error. The taxpayers have provided nothing to support a finding that a portion of the settlement she received in 2011 is nontaxable income. The taxpayers have not met their burden of proof.

THEREFORE, the Notice of Deficiency Determination dated June 17, 2013, is APPROVED and MADE FINAL.

IT IS ORDERED and this DOES ORDER, that the taxpayers pay the following amount of tax, penalty and interest:

| <u>YEAR</u> | <u>REFUND CLAIMED</u> | <u>REFUND ALLOWED</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|---------------------------|---------------------------|------------|----------------|-------------------|----------------|
| 2010 | | | \$ 53 | \$10 | \$ 6 | \$ 69 |
| 2011 | (\$6,349) | 0 | 6,616 | 31 | 83 | 7,030 |
| | | | | | PRIOR PAYMENTS | <u>(6,249)</u> |
| | | | | | TOTAL DUE | <u>\$ 850</u> |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayers' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2014.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2014, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.
