

Settlement from car accident was excluded income not reportable on Form 1099

Chappell v. International Steel Group (DC IN 2/26/2010) 105 AFTR 2d ¶ 2010-563

A district court has concluded that an individual's settlement from a motor vehicle accident was excluded from his gross income under Code Sec. 104(a)(2), and as a result there was no reason for the payor to require the individual to provide information to report the settlement to IRS.

Background on damage awards. Whether damages received by a taxpayer as a result of injury is governed by Code Sec. 104(a)(2). The Small Business Job Protection Act of '96 (SBJPA, P.L. 104-188) amended Code Sec. 104(a)(2) to provide that (1) punitive damages do not qualify for the income exclusion and (2) the income exclusion generally is limited to amounts received on account of personal "physical" injuries or "physical" sickness. SBJPA's legislative history indicated that the term "emotional distress" includes physical symptoms (e.g., insomnia, headaches, stomach disorders) which may result from the emotional distress. (H Rept No. 104-586 (PL 104-188) p. 144) SBJPA § 1605(b) further amended Code Sec. 104(a) to provide that, for purposes of Code Sec. 104(a)(2), even though emotional distress is not considered a physical injury or a physical sickness, damages not in excess of the amount paid for "medical care" (described in Code Sec. 213(d)(1)(A) or Code Sec. 213(d)(1)(B)) for emotional distress are excluded from income. In September of 2009, IRS issued proposed regs reflecting these statutory amendments (see Federal Taxes Weekly Alert 09/17/2009).

Background on reporting. Under Code Sec. 6041, with limited exceptions, every person, corporate or otherwise, engaged in a trade or business who, in the course of that business, makes payments aggregating \$600 or more to another person (e.g., an independent contractor) in a calendar year must file an information return (Form 1099-MISC) setting forth the name and address of the payee and the amount paid, and furnish a statement to the payee. Reportable payments include: rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits and income. (Code Sec. 6041, Reg. § 1.6041-1)

The 2010 Instructions for Form 1099-MISC provide that all punitive damages, any damages for nonphysical injuries or sickness, and any other taxable damages are required to be reported in Box 3 (Other Income). However, taxpayers aren't required to report amounts that are received on account of personal physical injuries or physical sickness or that do not exceed the amount paid for medical care related to emotional distress.

Facts. In 2005, Antonio Chappell was injured in a motor vehicle accident due to a collision with an employee of International Steel Group n/k/a Mittal Steel USA, Inc. (Mittal). He suffered injuries to his lower back, causing pain to his right side and running down his right leg. Chappell sued, claiming that he incurred medical bills, suffered lost wages, experienced pain and suffering, and that his injuries were permanent in nature and would cause additional medical bills and pain and suffering in the future. Under a settlement agreement reached in 2009, Mittal and the third-party defendant, Haas Environmental, agreed to each pay Chappell \$45,000. Mittal, by counsel, forwarded to Chappell's counsel a Form W-9, Request for Taxpayer Identification Number and Certification, to verify his correct Social Security number for tax reporting purposes. A dispute arose between the parties as to whether Mittal's needed to fulfill its IRS information reporting obligations by means of the

Form W-9 and the filing of a Form 1099. Chappell refused to sign the Form W-9 and maintained that no Form 1099 reporting was required.

District court's conclusion. Looking to the Supreme Court's decision in *Schleier v. Comm.*, (S CT 1995) 75 AFTR 2d 95-2675, the district court concluded that Chappell's recovery should be excluded from his gross income under Code Sec. 104(a)(2). Accordingly, it found that there was no reason for Mittal to require Chappell to report the settlement.

The district court reasoned that Chappell's case was in line with the hypothetical proposed by the Supreme Court in dicta in *Schleier*. In its analysis of Code Sec. 104(a)(2)'s language, the Supreme Court posited a hypothetical in which it assumed that a taxpayer was injured in an automobile accident and as a result suffered medical expenses, lost wages, and pain, suffering, and emotional distress. It explained that the entire amount would be excludable under Code Sec. 104(a)(2), assuming that the taxpayer had not deducted his medical expenses previously. There are two independent requirements that a taxpayer must meet before gross income is excluded under Code Sec. 104(a)(2): (1) the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is based upon tort or tort type rights; and (2) the taxpayer must show that the damages were received "on account of personal injuries or sickness." The Supreme Court said, "The critical point this hypothetical illustrates is that each element of the settlement is recoverable not simply because the taxpayer received a tort settlement, but rather because each element of the settlement satisfies the requirement set forth in Code Sec. 104(a)(2) ...that the damages were received "on account of personal injuries or sickness.""

The district court found that Chappell's requests for relief fell within the exclusions of Code Sec. 104(a)(2). Because he didn't request relief for emotional damages, the SBJPA amendment since *Schleier* was decided had no impact on the settlement. His injuries were caused by the negligent operation of a motor vehicle by one of Mittal's employee. He suffered personal physical injuries to his lower back. The only relief that Chappell sought was compensation for medical bills, lost wages, pain and suffering, and future medical bills and pain as a result of his injuries. The court also rejected Mittal's argument that the fact that Chappell took a loan against his settlement proceeds somehow changed what the settlement was compensating Chappell for (to repayment of principle and interest) or affected Mittal's tax liability.