T.C. Memo. 1975-183

Payments received by an employee are not excludable under Section 105(c) as payments for permanent injury if they are deemed compensation for services rendered and lack a direct causal link to the injury itself, particularly when the employee is not demonstrably absent from work.

Summary

Robert Laverty, a vice president at Thriftimart, sought to exclude a portion of his salary from gross income under Sections 105(c) and 105(d) of the Internal Revenue Code, claiming it represented "sick pay" related to a permanent injury sustained in a prior airplane crash. The Tax Court denied the exclusion. The court reasoned that Laverty's salary payments were fundamentally compensation for services rendered, not payments specifically calculated as indemnity for his injury or due to absence from work. The court highlighted that Laverty's salary remained unchanged despite his condition, his productivity was not shown to be impaired, and the payments were not computed with specific reference to the nature of his injury.

Facts

Robert Laverty was a vice president and director at Thriftimart, a large grocery chain. In 1957, Laverty sustained serious injuries in an airplane crash while on company business, resulting in permanent vision loss in one eye and partial disability. To manage his ongoing physical condition, Laverty adhered to a daily exercise routine, which required him to be away from the office for several hours each day. Despite this, Thriftimart continued to pay Laverty his full salary, which increased over time as he advanced within the company. Laverty claimed that 25% of his salary constituted excludable "sick pay" related to his injury, representing the estimated time spent on his daily exercise regimen. Thriftimart had a wage continuation plan for salaried employees and an informal arrangement to continue full salary for long-term employees returning after illness or injury. Laverty did not file for state disability insurance or workmen's compensation for the years in question concerning the injury.

Procedural History

This case originated in the U.S. Tax Court. Laverty petitioned the court to dispute the Commissioner of Internal Revenue's determination of deficiencies and additions to his income tax for 1965 and 1966. Laverty sought to exclude a portion of his salary under Sections 105(c), 105(d), and initially Section 106 of the Internal Revenue Code.

Issue(s)

1. Whether payments received by Laverty from Thriftimart are excludable from gross income under Section 105(c) as payments for the permanent loss of a bodily

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function, computed with reference to the nature of the injury and without regard to absence from work.

2. Whether payments received by Laverty from Thriftimart are excludable from gross income under Section 105(d) as wage continuation payments for a period during which the employee is absent from work on account of personal injuries or sickness.

3. Whether Section 106 applies to exclude employer contributions to accident and health plans from Laverty's gross income.

Holding

1. No, because the payments were not demonstrably computed with reference to the nature of Laverty's injury but were fundamentally regular compensation for services rendered. The causal link between the injury and the salary amount was not sufficiently established.

2. No, because Laverty was not considered "absent from work" within the meaning of Section 105(d). His regular salary was deemed compensation for services rendered, despite his daily exercise routine.

3. No, because Section 106 pertains to employer contributions to accident and health plans, not direct salary payments made to employees.

Court's Reasoning

The court reasoned that for Section 105(c) to apply, payments must "constitute payment for the permanent loss…of a member or function of the body…." The court emphasized that the loss must be the direct cause of the payment. It found no evidence that Laverty's salary was determined or increased specifically due to his injury. The court noted that Laverty's productivity was not shown to be impaired, evidenced by his career advancement. Furthermore, Thriftimart's intention was to compensate Laverty for his services. The court stated, "Subsection (1) of section 105(c) requires that the amount 'constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement of the taxpayer.' (Emphasis supplied.) In other words, the loss must be the cause of the payment." Regarding Section 105(d), the court held that Laverty was not "absent from work" as required for exclusion. His daily exercise routine, while necessary, did not constitute an absence from work in the statutory sense because he continued to perform substantial services for Thriftimart and was compensated for those services. Finally, the court dismissed the Section 106 claim, clarifying that it applies to employer contributions to health plans, not direct salary payments.

Practical Implications

Laverty v. Commissioner provides important clarification on the scope of income

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exclusions under Sections 105(c) and 105(d) for employer-provided accident and health benefits. It underscores that simply labeling a portion of salary as “sick pay” or related to an injury is insufficient for tax exclusion. To qualify for exclusion under Section 105(c), payments must be demonstrably linked to a permanent injury and computed with reference to the nature of that injury, not merely be a continuation of regular salary. The case also clarifies that “absence from work” under Section 105(d) requires a genuine absence, not just adjustments to a work schedule to accommodate health needs while still performing regular job duties. This case emphasizes the necessity for employers to clearly document the intent and basis for payments related to employee health conditions to ensure proper tax treatment. It highlights that courts will scrutinize the causal relationship between the injury and the payment, as well as the nature of the payment as either indemnity for injury or compensation for services rendered. Subsequent cases would likely distinguish situations where specific, separate payments or plans are established for permanent injury indemnity, distinct from ongoing salary compensation.

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