Rickel v. Commissioner, 92 T. C. 510 (1989)

Liquidated damages received under the Age Discrimination in Employment Act (ADEA) for personal injury due to age discrimination are excludable from gross income.

Summary

Frank E. Rickel received settlement payments from his former employer after an age discrimination lawsuit under the ADEA. The U. S. Tax Court held that 50% of the settlement was excludable from gross income as liquidated damages for personal injury, while the other 50% was taxable as wage-related damages. The court also ruled that legal fees were only deductible to the extent they related to the taxable portion of the settlement. The decision highlights the tax treatment of discrimination settlements and the allocation of legal fees between taxable and non-taxable income.

Facts

Frank E. Rickel, aged 59, was employed by Malsbary Manufacturing Co. as general sales manager. He was not promoted to president and was later discharged, with younger employees filling both roles. Rickel sued Malsbary and its parent company, Carlisle Corp. , for age discrimination under the ADEA and the Fair Labor Standards Act (FLSA). The jury found age discrimination in both the failure to promote and the discharge. The parties settled for $180,000, with payments made over several years. The settlement did not allocate amounts between different claims.

Procedural History

Rickel and his wife filed tax returns for 1983 and 1984, excluding the settlement payments from income. The IRS assessed deficiencies and additions to tax, which the Rickels contested in the U. S. Tax Court. The court ruled on the tax treatment of the settlement payments, allocation of legal fees, and potential additions to tax for substantial underpayment.

Issue(s)

1. Whether any portion of the settlement payments received under the ADEA for age discrimination is excludable from gross income.
2. Whether legal fees paid in relation to the lawsuit are deductible if a portion of the settlement is excludable.
3. Whether the Rickels are liable for an addition to tax under section 6661(a) for substantial understatement of income tax.

Holding

1. Yes, because 50% of the settlement payments were allocable to liquidated damages for personal injury under the ADEA, which are excludable from gross

income under section 104(a)(2).
2. No, because legal fees are only deductible to the extent they relate to the taxable portion of the settlement, as per section 265(1).
3. Yes, because the Rickels did not have substantial authority for excluding the settlement payments from income and did not adequately disclose the potential tax liability.

Court’s Reasoning

The court applied section 104(a)(2), which excludes damages received for personal injuries from gross income. It determined that age discrimination claims under the ADEA involve both wage-related damages and liquidated damages for personal injury. The court relied on previous cases like Metzger v. Commissioner and Thompson v. Commissioner, which established that liquidated damages for discrimination claims are compensatory and excludable from income. The court inferred a 50/50 allocation between the two types of damages due to the lack of specific allocation in the settlement agreement. Regarding legal fees, the court applied section 265(1), disallowing deductions for fees related to the excludable portion of the settlement. For the addition to tax, the court found that the Rickels lacked substantial authority for their tax position and failed to disclose the income on their return.

Practical Implications

This decision guides attorneys and taxpayers on the tax treatment of discrimination settlement payments. It establishes that liquidated damages under the ADEA for age discrimination are excludable from income, while wage-related damages are taxable. Practitioners must carefully allocate settlement payments and legal fees between taxable and non-taxable components. The case also emphasizes the importance of disclosing potential tax issues on returns to avoid additions to tax. Subsequent cases, such as Byrne v. Commissioner, have followed this allocation approach in similar discrimination settlement contexts.

