Schleier v. Commissioner, 119 T. C. 36 (2002)

In Schleier v. Commissioner, the U. S. Tax Court ruled that disability benefits received by a former airline pilot were not excludable from gross income under Section 104(a)(3) of the Internal Revenue Code. The court held that the benefits, funded through wage concessions negotiated by the pilots' union, did not constitute contributions made with after-tax dollars, a requirement for exclusion under the statute. This decision clarifies the scope of Section 104(a)(3), impacting how disability benefits negotiated through collective bargaining are treated for tax purposes.

Parties

Plaintiff/Appellant: Robert Schleier (Petitioner). Defendant/Appellee: Commissioner of Internal Revenue (Respondent).

Facts

Robert Schleier, a former U. S. Airways pilot, left work in July 1995 due to carpal tunnel syndrome. He received $83,046. 54 in disability benefits in 1999 from U. S. Airways through Reliastar Life of New York. These benefits were determined based on Schleier's age, years of service, and salary, not his medical condition. The pilot disability plan was established through collective bargaining between U. S. Airways and the Airline Pilots Association (ALPA), with pilots making wage concessions of approximately $20 million in exchange for the disability benefits. Schleier did not report these benefits as income on his 1999 tax return, leading to a deficiency determination by the IRS.

Procedural History

The IRS determined a deficiency of $19,565 in Schleier's 1999 federal income tax and an accuracy-related penalty under Section 6662(a) of $3,913. The IRS later conceded the penalty. Schleier petitioned the U. S. Tax Court, arguing that the disability benefits should be excluded from gross income under Section 104(a)(3). The Tax Court, applying a de novo standard of review, considered whether the disability benefits qualified for exclusion under the specified section of the Internal Revenue Code.

Issue(s)

Whether disability benefits received by Robert Schleier in 1999, funded through wage concessions negotiated by the Airline Pilots Association, are excludable from gross income under Section 104(a)(3) of the Internal Revenue Code?

Rule(s) of Law

Section 61(a) of the Internal Revenue Code states that gross income includes income

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from whatever source derived. However, Section 104(a)(3) excludes from gross income amounts received through accident and health insurance for personal injuries or sickness, other than amounts received by an employee to the extent such amounts are attributable to contributions by the employer which were not includable in the gross income of the employee or are paid by the employer.

Holding

The U. S. Tax Court held that the disability benefits received by Robert Schleier in 1999 were not excludable from gross income under Section 104(a)(3) of the Internal Revenue Code. The court determined that the benefits were not funded by contributions made with after-tax dollars, as required by the statute.

Reasoning

The court's reasoning focused on the interpretation of Section 104(a)(3) and the nature of the contributions to the pilot disability plan. The court rejected Schleier's argument that the wage concessions made by the pilots constituted contributions to the disability plan, emphasizing that any contributions were made by U. S. Airways, not the employees. The court noted that for disability benefits to be excludable under Section 104(a)(3), the contributions must have been includable in the employee's gross income, which was not the case with the wage concessions. The court highlighted that accepting Schleier's interpretation would broadly extend the exclusion to any negotiated disability package, which was not intended by Congress. The court also clarified that employer contributions to health plans are generally not includable in an employee's gross income under Section 106(a), further supporting its decision. The court considered but dismissed Schleier's argument regarding Pennsylvania law, stating it was irrelevant to the federal tax issue at hand.

Disposition

The U. S. Tax Court sustained the IRS's determination of a deficiency in Schleier's 1999 federal income tax, except for the accuracy-related penalty under Section 6662(a), which was conceded by the IRS.

Significance/Impact

Schleier v. Commissioner is significant for clarifying the scope of Section 104(a)(3) of the Internal Revenue Code. It establishes that disability benefits funded through wage concessions negotiated in collective bargaining agreements do not qualify for exclusion from gross income under this section. This ruling impacts how disability benefits are treated for tax purposes, particularly those arising from union negotiations. The decision underscores the importance of contributions being made with after-tax dollars for exclusion under Section 104(a)(3), and it has been cited in subsequent cases to support similar interpretations of the statute. The case also highlights the distinction between federal tax law and state law in the context of

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disability benefits taxation.

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