

Rev. Rul. 85-97

1985-2 C.B. 50, 1985-29 I.R.B. 5.

Internal Revenue Service

Revenue Ruling

DAMAGES; PERSONAL INJURY SETTLEMENT; LOST WAGES

Published: July 22, 1985

SECTION 104.-COMPENSATION FOR INJURIES OR SICKNESS, 26 CFR 1.104-1: Compensation injuries or sickness

Damages; personal injury settlement; lost wages. The entire amount received by an individual in settlement of a suit for personal injuries sustained in an accident, including the portion of the amount allocable to the claim for lost wages, is excludable from the individual's gross income. Rev. Rul. 61-1 amplified.

ISSUE

Are amounts received by a taxpayer, under the circumstances described below, excludable from gross income as damages received on account of personal injuries?

FACTS

The taxpayer was seriously injured when struck by a bus. To recover for the injuries suffered as a result of the negligent operation of the bus, the taxpayer sued the bus company. The complaint alleged that, as a direct and proximate result of being struck by the bus, the taxpayer had sustained serious and permanent injuries, had been unable to pursue normal employment activities and had lost had suffered and would continue to suffer great pain of body and mind, had permanent disability, deformity, and loss of earning capacity, and had incurred and would incur in the future hospital, doctors' and related bills in an effort to be cured of these injuries. The complaint asked for compensatory damages of 5x No punitive damages were requested. Prior to trial, the taxpayer and the bus agreed to a settlement under the terms of which the taxpayer received a lump-sum payment of 3x dollars in exchange for a full release of all the taxpayer's claims against the bus company. The taxpayer had not deducted any medical expenses in a prior year.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides, in part, that except as otherwise provided in subtitle A, gross income means all income from whatever derived.

Section 104(a)(2) of the Code excludes from gross income the amount of any received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

Section 1.104-1(c) of the Income Tax Regulations provides, in part, that the term 'damages received (whether by suit or agreement)' means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in

lieu of such prosecution.

Rev. Rul. 61-1, 1961-1 C.B. 14, holds that the entire amount received by a railroad employee in settlement of any and all claims that the employee had against the railroad for personal injuries is excludable from gross income under section (a)(2) of the Code, even though the employee elected to apportion part of the settlement amount to 'time lost' in order to receive railroad retirement credit for the time the employee was unable to work. The revenue ruling states that the fact that the 'time lost payments' constituted compensation for purposes of the taxes imposed by the Railroad Retirement Tax Act does not preclude the application of the exclusion from gross income under section 104(a)(2). Thus, the ruling indicates the exclusion provided by section 104(a)(2) extends to personal injury damages allocable to lost wages. Also cf., *Norfolk & Western Ry. Co. v. Liepelt*, 444 U.S. 490 (1980) (defendant is entitled to an instruction to jury that damages for lost future wages are not subject to federal income taxation).

In the instant case, the entire 3x dollars settlement amount, including the allocable to the claim for lost wages, represents compensation for personal sustained by the taxpayer when the taxpayer was struck by the bus. Therefore, the exclusion provided by section 104(a)(2) of the Code extends to the entire amount.

HOLDING

The entire 3x dollars settlement amount is excludable from the taxpayer's gross income under section 104(a)(2) of the Code and the regulations thereunder.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 61-1, 1961-1 C.B. 14, is amplified.

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