

Tax Tips

Taxation of Age Discrimination Awards

The law permits individuals to exclude from gross income only those damages which are received on account of a personal physical injury or a physical sickness. Thus, when a law suit is based on a physical injury or sickness, then all damages (other than punitive damages) flowing from that injury or sickness are treated as payments received on account of a physical injury or sickness, whether or not the recipient of the damages is the injured party. As a result, these damages are excludable from gross income.

For purposes of this exclusion, emotional distress is not considered a physical injury or physical sickness. So, an award under state law which is meant to compensate for emotional distress caused by age discrimination would have to be included in gross income. However, if you required medical care for treatment of the consequences of emotional distress, then the amount of damages not exceeding those expenses would be excludable from gross income. Punitive damages for any personal injury claim, whether or not physical, aren't excludable from gross income unless awarded under certain state wrongful death statutes that provide for only punitive damages.

The law doesn't consider back pay and liquidated damages received under the Age Discrimination in Employment Act (ADEA) to be paid in compensation for personal injuries. Thus, an award for back pay and liquidated damages under ADEA must be included in gross income.

To a limited extent, attorney fees (whether contingent or non-contingent) or court costs paid by, or on behalf of, the taxpayer in connection with an action involving a claim under ADEA, are deductible from gross income to determine adjusted gross income (AGI). Specifically, the amount of this above-the-line deduction is limited to the amount includible in your gross income for the tax year on account of a judgment or settlement resulting from the ADEA claim, whether by suit or agreement, and whether as lump sum or periodic payments. Attorneys fees in excess of the amount includible in your gross income for the tax year may be deductible as a below-the-line, or "miscellaneous itemized" deduction. Thus, these excess fees are deductible only to the extent that they, together with your other miscellaneous itemized deductions, exceed 2% of your adjusted gross income.

Please keep in mind that while you want the best tax result possible from any age discrimination action you are considering, non-tax legal factors together with the tax factors discussed above will determine the amount of your after-tax recovery. You should consult with your attorney as to the best way to proceed, and then I will be happy to provide any additional tax guidance that you may need.

If you have any questions regarding the above discussed topic or any other tax matter, please feel free to give me a call at (562) 698-9891.

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