

Internal Revenue Service**Department of the Treasury**

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:ITA:1 – PLR-122136-00
Date: February 16, 2001

In Re:

LEGEND:

Taxpayer =
Husband =
State =
Statute 1 =
Statute 2 =
Statute 3 =
Statute 4 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =

Dear ,

This responds to your undated letter received October 2, 2000, requesting a ruling on Taxpayer's behalf. Pursuant to our request, you submitted additional information received November 27, 2000, and December 28, 2000.

STATEMENT OF FACTS

The represented facts are as follows: In Year 1, after working thirty three years as a sheetrocker, *i.e.*, installing drywall, Husband was diagnosed with cancer of the lining of the lung, a disease generally associated with inhalation of asbestos fibers. In Year 2, Taxpayer and Husband filed an action in State court against numerous defendants engaged in the business of producing asbestos, including research, manufacturing, labeling, selling, installing, repairing, packaging and advertising of asbestos. This action was consolidated with a class action pending in Superior Court of State. Taxpayer and Husband alleged as a result of exposure to asbestos, Husband

contracted and suffered asbestos-related lung cancer and other asbestos-related lung disease. In the complaint, Taxpayer and Husband sought to recover compensatory and punitive damages (according to proof) for personal injuries and loss of consortium because of above-described diseases.

After Husband died in Year 3, Taxpayer and the other legal heirs of Husband filed an amended complaint in Year 4 setting forth a survival action, a wrongful death action and a loss of consortium claim. Therein, the plaintiffs alleged that decedent's exposure to asbestos and asbestos-containing products was the proximate cause of the diseases causing his death. Jurisdiction of the court was invoked under Statute 2.

In Year 5, prior to trial, the parties executed a settlement agreement releasing most of the manufacturers from liability and containing the following language:

4. Terms of Settlement:

The total settlement involves payment of and 00/100 dollars () to the Releasors by the Settling Defendant, that sum to be apportioned among Releasors' claims as follows:

- % To the survival action, and of this amount one hundred percent (%) to economic damages.
- % To the existing loss of consortium claim; and of this amount one hundred percent (%) to non-economic damages.
- % To the wrongful death action of the heirs, and of this amount twenty percent (%) to economic damages and eighty percent (%) to non-economic damages.

In Years 5, 6 and 7, Taxpayer received substantial sums pursuant to the terms of the agreement.

RULING REQUESTED

Specifically, you request the following ruling:

Economic and non-economic damages received by Taxpayer during Years 5, 6 and 7 allocated in the settlement agreement to the survival action, the wrongful death action and the loss of consortium claim are excludable from gross income under section 104(a)(2) of the Internal Revenue Code as damages received on account of personal physical injuries or physical sickness.

Law and Analysis:

Under State law, survival claims and wrongful death claims are distinct grounds for recovery against a tortfeasor. State law allows a decedent's heirs or successors to recover damages resulting from the loss or damage decedent sustained or incurred before death, including any penalties or punitive or exemplary damages decedent would have been entitled to recover had decedent lived. Statute 1. Statute 1, however, specifically excludes a survivor's recovery of damages for pain, suffering, or disfigurement suffered by the decedent.

State law provides, in addition to the recovery by the representative of the estate on the decedent's cause of action, a wrongful death action by the decedent's heirs in their own right. Statutes 2 and 3. State law provides further that a court may award damages that, under all the circumstances of the case may be just but may not include damages recoverable under Statute 1. Statute 3. Under Statutes 2 and 3, designated surviving relatives may recover pecuniary losses caused by the decedent's death, including pecuniary support the decedent would have provided them, and noneconomic damages for being deprived of the decedent's society and comfort but may not recover punitive or special damages. Finally, State law permits the joinder of survival and wrongful death actions. Statute 4. In a case containing facts similar to those presented, a State Court of Appeals held, together, the State Statutes provide for plenary tort relief.

Except as otherwise provided, gross income means "all income from whatever source derived." I.R.C. § 61(a). The Supreme Court has long recognized that Congress, through the enactment of section 61(a), intended to exert "the full measure of its taxing power." *Commissioner v. Schleier*, 515 U.S. 323, 327 (1995); *Helvering v. Clifford*, 309 U.S. 331, 334 (1940). Accordingly, any receipt of funds by a taxpayer is presumed to be gross income unless the taxpayer can demonstrate the accession fits into one of the exclusions created by other sections of the Code. See *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

Applicable to the tax years in issue, section 104(a)(2) permits a taxpayer to exclude from gross income any damages (other than punitive damages) received on account of personal *physical* injuries or *physical* sickness. A fundamental principle of statutory interpretation is that exclusions from gross income, such as section 104(a)(2), must be narrowly construed. *United States v. Burke*, 504 U.S. 229, 248 (1992)(Souter, J. concurring). See, also, *United States v. Centennial Savings Bank FSB*, 499 U.S. 573, 583-84 (1991). By its express terms, punitive damages are not excludable from gross income under section 104(a)(2). See, also, *O'Gilvie v. United States*, 519 U.S. 79, 84-90 (1996)(former versions of section 104(a)(2) did not exclude punitive damages from gross income).

The legislative history of the 1996 amendment to section 104(a)(2) provides explicitly:

If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as damages received on account of personal physical injuries or physical sickness

whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim of loss of consortium due to the physical injury or physical sickness of such individual's spouse are excludable from gross income.

H.R. Conf. Rep. No. 104-737, at 300 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1474, 1793.

The Supreme Court has stated section 104(a)(2) and the accompanying regulations allow a taxpayer to exclude from gross income the proceeds of a settlement when two requirements are met: First, the taxpayer must prove the cause of action giving rise to the recovery is based upon tort or tort type rights, and second, the taxpayer must demonstrate the tortfeasor paid the proceeds on account of personal injuries or sickness. *Schleier*, 515 U.S. at 337. If the taxpayer fails either requirement, section 104(a)(2) will not allow exclusion of the disputed amounts from the taxpayer's gross income. *Schleier*, 515 U.S. at 333-334.

In formulating the test for exclusion, the Supreme Court employed a hypothetical where, as a result of a physical injury, a taxpayer incurs medical expenses, loses wages, *i.e.*, suffers economic damages, and experiences pain, suffering and emotional distress. Assuming the taxpayer settled a lawsuit brought to recover for his damages, the Supreme Court held, *inter alia*, the recovery for lost wages is excludable from gross income so long as the lost wages resulted from the time the taxpayer was out of work because of the personal injuries. Accordingly, economic damages may be excludable from gross income if received as a direct result of and to compensate for a personal physical injury. It cannot be gainsaid death is the ultimate personal physical injury.

Husband contracted physical diseases from exposure to asbestos. These diseases were the proximate cause of the circumstances giving rise to Taxpayer's loss of consortium claim, survival action and wrongful death action. Because there exists a direct link between the physical injury suffered and the damages recovered, Taxpayer may exclude from gross income any economic damages compensating for such injury. These would include damages received for the survival action, loss of consortium and wrongful death of Taxpayer's spouse.

Based on the facts and representations made, we conclude Taxpayer may exclude from gross income in Year 7 the entire amounts received in settlement of her claims against the manufacturers. Because tax returns have been filed for those years, the IRS will not rule on the tax consequences of the payments received in Years 5 and 6. Rev. Proc. 2001-1, § 5.01, 2001-1 I.R.B. 1, 12.

CAVEATS:

No opinion is expressed on whether the allocations contained in the settlement agreement are proper for federal income tax purposes. Rev. Proc. 2001-3, § 4.01(7), 2001-1 I.R.B. 111, 116.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent.

Sincerely,
Associate Chief Counsel
(Income Tax & Accounting)
By: Clifford M. Harbourt
Senior Technician Reviewer, Branch 1

CC: