United States Tax Court

Washington, DC 20217

TROY CHRISTOPHER KEENAN, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent	Docket No. 29299-21S

ORDER

Pursuant to Rule 152(b), Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioner and to respondent a copy of the pages of the transcript of the trial in the above case before Special Trial Judge Diana L. Leyden at Washington, DC, on March 15, 2023, containing her oral findings of fact and opinion rendered at the trial session at which the case was heard.

In accordance with the oral findings of fact and opinion, a decision will be entered for respondent as to the deficiency and for petitioner as to the accuracy-related penalty under section 6662(a).

(Signed) Diana L. Leyden
Special Trial Judge

Served 06/12/23

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3/29/23

IN THE UNITED STATES TAX COURT

In the Matter of:	)	
TROY CHRISTOPHER KEENAN,	)	Docket No. 29299-21S
Petitioner,	)	
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

Pages: 1 through 10

Place: Washington, DC

Date: March 15, 2023

IN THE UNITED STATES TAX COURT

In the Matter of:	
TROY CHRISTOPHER KEENAN, Petitioner,	Docket No. 29299-21S
v.	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	

United States Tax Court
400 Second Street, NW
Room 400
Washington, DC 20217

March 15, 2023

The above-entitled matter came on for bench opinion, pursuant to notice at 4:21 p.m.

BEFORE: HONORABLE DIANA L. LEYDEN
Special Trial Judge

APPEARANCES:

For the Petitioner:

No Appearance

For the Respondent:

No Appearance

P R O C E E D I N G S

(4:21 p.m.)

(Whereupon, a bench opinion was rendered.)

Bench Opinion by Judge Diana L. Leyden

March 15, 2023

Troy Christopher Keenan v. Commissioner of Internal Revenue

Docket No. 29299-21S

THE COURT: The Court has decided to render oral findings of fact and opinion in this case and the following represents the Court's oral findings of fact and opinion. The oral findings of fact and opinion shall not be relied upon as precedent in any other case. The oral findings of fact and opinion are made pursuant to the authority granted by section 7459(b) of the Internal Revenue Code and Tax Court Rule 152. Rule references in this opinion are to the Tax Court Rules of Practice and Procedure, and section references are to the Internal Revenue Code, in effect at all relevant times.

This proceeding was heard as a Small Tax Case pursuant to the provisions of section 7463 and Rules 170 through 174. The Court uses the term "Internal Revenue Service" or "IRS" to refer to administrative actions taken outside these proceedings. The Court uses the term "respondent" to refer to the Commissioner of Internal Revenue, who is the head of the IRS and is respondent in this case, and to refer to actions taken in connection with this case.

The trial of this case was conducted on March 15, 2023, at a Remote Special Trial session. Petitioner appeared on his behalf. Julia Kapchinskiy appeared on behalf of respondent. After concessions (respondent has conceded the accuracy-related penalty under section 6662(a)), the only issue for decision is whether a payment of $70,966 received by petitioner in 2018 was taxable non-employee compensation or excludable from gross income under section 104(a)(2) as damages received on account of personal physical injuries or physical sickness.

On the evidence before us, and using the burden-of-proof principles explained below, the Court holds that the payment was taxable as non-employee compensation in 2018.

Background

Some of the facts have been stipulated and are so found. Petitioner resided in California at the time he filed his petition in this case.

On November 3, 2021, petitioner timely filed a Petition in this case seeking review of a Notice of Deficiency for 2019 dated August 9, 2021. The Notice of Deficiency proposed a deficiency due to unreported non-employee compensation in the amount of $70,966 issued to petitioner from Rancho Santa Fe Association.

Petitioner signed a Confidential Settlement

Agreement and Mutual General Release of All Claims (the agreement) naming both he and Rancho Santa Fe Association on August 30, 2018. The copy of the agreement in the record does not bear the signature of Christy Whalen, named as a manager of Rancho Santa Fe Association. Both the parties agree that the agreement was binding.

Petitioner was employed by Rancho Santa Fe Association as a ranch manager until June 30, 2018. Petitioner had some disagreements with some of the clients of Rancho Santa Fe Association and he stopped showing up to work. Petitioner filed a complaint in the San Diego Superior Court in August 2018 alleging wrongful termination of employment. Rancho Santa Fe Association filed a complaint in the San Diego Superior Court alleging unlawful detention against petitioner.

Under the terms of the agreement, Rancho Santa Fe Association agreed to pay petitioner (1) $65,966 for "emotional distress damages and relocation assistance", (2) to continue to pay petitioner's health care coverage premiums from September 1, 2018, through March 30, 2019, valued at $4,032, and (3) $5,000 if petitioner signed and did not revoke an ADEA Agreement. The Court takes judicial notice that "ADEA" refers to the Age Discrimination in Employment Act of 1967. At the time petitioner was terminated from his employment he was older

than 40 years old.

Discussion

Gross income generally includes all income from whatever source derived. I.R.C. § 61(a). The definition of gross income is broad in scope, while exclusions from gross income are narrowly construed. *Commissioner v. Schleier*, 515 U.S. 323, 327-328 (1995).

The exclusion from gross income upon which petitioner relies on as a basis for excluding the payments made under the settlement agreement is section 104(a)(2). It provides that gross income does not include "the amount of any damages (other than punitive damages) received (whether by suit or agreement * * *) on account of personal physical injuries or physical sickness." I.R.C. § 104(a)(2). Congress intended this exclusion to cover damages that flow from a physical injury or physical sickness. *See* H.R. Conf. Rept. No. 104-737, at 301 (1996), 1996-3 C.B. 741, 1041.

For damages to be excluded under this provision, the underlying cause of action must be based in tort or tort-type rights, and the proceeds must be damages received on account of personal physical injury or physical sickness. *Schleier*, 515 U.S. at 337. Emotional distress is not treated as a personal physical injury or physical sickness, except for damages not in excess of the

cost of medical care as described in section 213(d)(1)(A) or (B) attributable to emotional distress. I.R.C. § 104(a) (flush language).

When damages are received under a settlement agreement, the nature of the claim that was the actual basis for the settlement determines whether the damages are excludable under section 104(a)(2). *United States v. Burke*, 504 U.S. 229, 237 (1992). The nature of the claim is typically determined by reference to the terms of the agreement. *See Knuckles v. Commissioner*, 349 F.2d 610, 613 (10th Cir. 1965), *aff'g* T.C. Memo. 1964-33; *Robinson v. Commissioner*, 102 T.C. 116, 126 (1994), *aff'd in part, rev'd in part*, and remanded on another issue, 70 F.3d 34 (5th Cir. 1995). The "key question" is: "In lieu of what were the damages awarded?" *Robinson v. Commissioner*, 102 T.C. at 126-127 (quoting *Raytheon Prod. Corp. v. Commissioner*, 144 F.2d 110, 113 (1st Cir. 1944), *aff'g* 1 T.C. 952 (1943)). If the agreement does not explicitly state which claims the payment was made to settle, the "dominant reason for [the payor's] making the payment" is critical. *Green v. Commissioner*, 507 F.3d 857, 868 (5th Cir. 2007), *aff'g* T.C. Memo. 2005-250; *Bent v. Commissioner*, 87 T.C. 236, 244 (1986), *aff'd*, 835 F.2d 67 (3d Cir. 1987).

The intent of the payor is determined by taking

into consideration all of the facts and circumstances, including the amount paid, the circumstances leading to the settlement, and the allegations in the injured party's complaint. *Green v. Commissioner*, 507 F.3d at 868. "[T]he nature of underlying claims cannot be determined from a general release that is broad and inclusive." *Ahmed v. Commissioner*, T.C. Memo. 2011-295, at *8-9, *aff'd*, 498 F. App'x 919 (11th Cir. 2012).

Petitioner does not dispute that he received the payments. While petitioner testified that he had surgery for several physical injuries after the year in issue (hip and shoulder surgeries) he did not provide any evidence that any of the proceeds were used to pay for such surgeries or that any of the payments were used to pay for medical care attributable to emotional distress. The assertion that some of the payment was paid to continue health care coverage is not specific enough for the Court to conclude that the payments were used to pay for medical care for emotional distress as opposed to other general health needs. While petitioner has credibly testified that he suffered physical and mental health injuries that he believes are attributable to his job at the Rancho Santa Fe Association, pursuant to the settlement agreement and based on the record in this case and the testimony the Court finds that general nature of the agreement under

which the payments were made was to settle an employment dispute, not a personal physical injury action nor to pay for medical care attributable to emotional distress.

To reflect the foregoing, decision will be entered for respondent with respect to the proposed deficiency and decision will be entered for petitioner with respect to the accuracy-related penalty under section 6662(a). This concludes the Court's bench opinion.

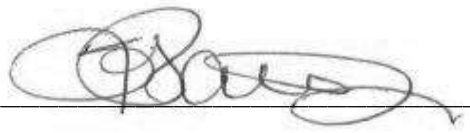
(Whereupon, at 4:32 p.m., the above-entitled matter was concluded.)

CERTIFICATE OF TRANSCRIBER AND PROOFREADER

CASE NAME: Troy Christopher Keenan v. Commissioner

DOCKET NO.: 29299-21S

We, the undersigned, do hereby certify that the foregoing pages, numbers 1 through 10 inclusive, are the true, accurate and complete transcript prepared from the verbal recording made by electronic recording by Christopher Kauffmann on March 15, 2023, before the United States Tax Court at its session in Washington, DC, in accordance with the applicable provisions of the current verbatim reporting contract of the Court and have verified the accuracy of the transcript by comparing the typewritten transcript against the verbal recording.



Susan Patterson, CDLT-174 3/22/23

Transcriber Date

Lori Rahtes, CDLT-108 3/22/23

Proofreader Date