

INTERNAL REVENUE SERVICE

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December 14, 1999

Taxpayer =

State =

Statute A =

Statute B =

Dear

This responds to your letter of July 29, 1999, requesting a ruling on the proper Federal income tax treatment of certain disability benefits and additional compensation received by Taxpayer.

In the course of her employment, Taxpayer became physically disabled because of an on-the-job injury. Due to her injuries, she was awarded compensation, including future medical benefits, under Statute A. She was also awarded additional compensation under Statute B as the result of numerous delays or refusals to pay the awarded benefits.

Statute A is part of the State's Workers' Compensation law and provides that:

Compensation ... includes every benefit or payment conferred by [the Workers' Compensation law] upon an injured employee, including vocational rehabilitation, or in the event of his death, upon his dependents, without regard to negligence.

Statute B is also part of the State's Workers' Compensation law and provides that:

When payment of compensation has been unreasonably delayed or refused, either prior to or subsequent to the issuance of an award, the full amount of the order, decision or award shall be increased by 10 percent. The question of delay and the reasonableness of the cause therefor shall be determined by the appeals board in accordance with the facts.

In determining whether the payments made under Statute B are also to be considered

workmen's compensation benefits, the State Supreme Court has stated,

Although [Statute B] is denominated a penalty statute, it is considered to be both remedial and penal. ([Citations] [the remedial aspect is to facilitate return to work of the injured employee as quickly as possible, the penal aspect is to compel the employer to comply with the law fully and promptly].) The 10 percent increase "has been characterized as an increase in the compensation awarded to the injured worker" [Citation], and the statute itself requires that the award be amended to include the amount of the penalty imposed. [Citation].

With respect to Statute B, another State court has stated that,

Courts have said the "[Statute B] penalty is properly characterized as part and parcel of the original compensation award." [Citation]... "The 10 percent increase ... has been characterized as an increase in the compensation awarded to the injured worker. [Citation] This characterization seems appropriate in light of the definition of 'compensation' in [Statute A]. [Citation] "Every payment conferred by [the Workers' Compensation law] is to be considered compensation. [Statute B] falls in [the Workers' Compensation law] and the penalty it authorizes must be considered compensation... .

Section 61(a) of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to the employee for personal injury or sickness incurred in the course of employment.

Based on the information submitted, representations made and authorities cited above, we conclude as follows:

Because the purpose of Statute B is, in part, to facilitate the return to work of the injured employee and is therefore related to the employee's personal injury or sickness, both the compensation received by Taxpayer under Statute A and the additional amounts received under Statute B are excludable from Taxpayer's gross income under section 104(a)(1) of the Code.

Except as specifically ruled upon above, no opinion is expressed or implied with respect to the application of any other provisions of the Code or the regulations to the benefits described.

This ruling is directed only to the Taxpayers who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
Harry Beker
Chief, Branch 6
Office of the Associate Chief Counsel
(Employee Benefits and Exempt Organizations)

Enclosures

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