

SAM, SR. AND ELLA M. ERVIN 2656 Carver Avenue Mobile, AL 36617-1705,  Taxpayers,  v.  STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION  DOCKET NO. INC. 03-102
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**FINAL ORDER**

The Revenue Department assessed 1994 Alabama income tax against Sam, Sr. and Ella M. Ervin (“Taxpayers”). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 9, 2003 in Mobile, Alabama. The Taxpayers’ representative was notified of the hearing by certified mail, but failed to appear. Assistant Counsel Duncan Crow represented the Department.

The Taxpayers received approximately \$333,000 from a lawsuit settlement in 1994. They failed, however, to report the income on their 1994 Alabama return. The Department adjusted the return, and entered the final assessment in issue based on net income of \$166,573.<sup>1</sup> The Taxpayers appealed, claiming that (1) the settlement proceeds represented nontaxable compensatory damages for personal injury, and (2) Mr. Ervin should receive innocent spouse status. Both claims are rejected.

Code of Ala. 1975, §40-18-14(3)e. adopts by reference the federal exclusion at 26 U.S.C. §104(a)(2) relating to compensation for injuries and sickness. Section §104(a)(2) excludes from income damages received on account of tort or tort-like injuries. *Dotson v. U.S.*, 87 F.3d 682 (1996). However, the U.S. Tax Court has ruled that the settlement

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<sup>1</sup>The legal fees paid by the Taxpayer were not included as gross income.

proceeds received by the Taxpayers was not excludable under §104(a)(2). *Ervin v. C.I.R.*, T.C. Memo 2002-134. The law in the federal Eleventh Circuit, which includes Alabama, is clear that legal fees paid in such cases should not be included in the taxpayer's income. *Davis v. C.I.R.*, 76 T.C. Memo 1998-248. Consequently, the Department correctly did not include the legal fees paid by the Taxpayers as income.

A taxpayer is allowed innocent spouse status pursuant to Code of Ala. 1975, §40-18-27(e). The Taxpayers failed, however, to appear at the June 9 hearing and present evidence that innocent spouse status should apply. Without such proof, innocent spouse status must be denied.

The final assessment is affirmed. Judgment is entered against the Taxpayers for 1994 tax, penalty, and interest of \$13,481.52. Additional interest is also due from the date of entry of the final assessment, December 2, 2002.

Entered June 11, 2003.