

JOHN W. & CHOLITA T. HIX  
4182 HICKORY DRIVE  
MONTGOMERY, AL 36109-3007,

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayers,

§

DOCKET NO. INC. 06-587

v.

§

STATE OF ALABAMA  
DEPARTMENT OF REVENUE.

§

### **FINAL ORDER**

The Revenue Department assessed John W. and Cholita T. Hix (together “Taxpayers”) for 1999 income tax. 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 February 6, 2007. John Hix (individually “Taxpayer”) represented the Taxpayers. Assistant Counsel Keith Maddox represented the Department.

The Department received IRS information showing that the Taxpayers had failed to report \$13,889.97 on their 1999 federal income tax return. The Taxpayers had received that amount when they settled a lawsuit in that year. The Department determined that the Taxpayers had also failed to report the income on their 1999 Alabama return. It assessed the Taxpayers accordingly.

The Taxpayer sued General Motors, McConnell Automotive, Inc., and others in 1998 concerning a new Pontiac van he had purchased from McConnell in 1997. The complaint alleged (1) that GM had violated the Alabama Lemon Rights Law, Code of Ala. 1975, §8-20A-1 et seq., (2) that GM was guilty of breach of warranty, (3) that GM and McConnell had made fraudulent representations concerning the vehicle, and (4) that GM and McConnell had fraudulently suppressed various facts concerning the vehicle. The Taxpayer demanded unspecified compensatory and punitive damages concerning each of the above

counts.

The defendants and the Taxpayer settled the case in July 1999. The defendants paid the Taxpayer \$28,000 and the Taxpayer released the defendants from all existing and future claims concerning the vehicle. The Taxpayer netted \$13,889.97 from the settlement after costs and legal fees. He subsequently sold the vehicle to a dealership in July 1999 for \$14,500.

The Taxpayer contends that he should not be required to pay tax on the entire settlement proceeds because some of the proceeds constituted non-taxable compensatory damages. He determined that 62 percent was for emotional distress (taxable) and that 38 percent was for compensation under the Lemon Law (non-taxable). He computed those percentages based on his settlement offer to the defendants, which demanded \$21,662.02 for the Lemon Law violation and \$35,000 for emotional distress. He thus contends that only \$8,611.80, or 62 percent of the net amount he received, should be taxed.

The settlement proceeds are not exempt from income tax pursuant to Code of Ala. 1975, §40-18-14(3)e., which relates to compensation for injuries or sickness, because the Taxpayer's lawsuit did not involve personal physical injury, see generally *Pipitone v. U.S.*, 180 F.3d 859 (7th Cir. 1999). However, any amount received to compensate the Taxpayer for actual loss would not be taxable. The issue thus is whether any part of the settlement was to compensate the Taxpayer for an actual loss.

Under the Lemon Law, if applicable, the Taxpayer could have opted to return the vehicle to GM for a full refund of the purchase price, or \$28,128.16. See, Exhibit B at page 3. That amount would not have been taxable because it would have compensated the Taxpayer for returning the vehicle to GM. In actuality, however, GM did not compensate

the Taxpayer under the Lemon Law. Rather, the Taxpayer kept the vehicle in addition to receiving the settlement proceeds. The proceeds thus did not compensate the Taxpayer for the loss of the vehicle. The Taxpayer has otherwise failed to establish that some part of the settlement was compensatory in nature. Consequently, the Department correctly taxed the entire net settlement amount received by the Taxpayer.

The final assessment is affirmed. Judgment is entered against the Taxpayers for 1999 tax, penalty, and interest of \$1,049.77. Additional interest is also due from the date the final assessment was entered, May 26, 2006.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered April 19, 2007.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Keith Maddox, Esq.  
John W. Hix  
Tony Griggs