

JERRY & KAREN J. HAWKINS	§	STATE OF ALABAMA
816 MOUNTAIN VIEW DRIVE		DEPARTMENT OF REVENUE
ONEONTA, AL 35121,	§	ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 06-984
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

**FINAL ORDER**

The Revenue Department assessed Jerry and Karen Hawkins (together “Taxpayers”) for 1998 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 January 24, 2007. The Taxpayers’ representative submitted a brief and various documents in lieu of appearing. Assistant Counsel Gwendolyn Garner represented the Department.

Jerry Hawkins (individually “Taxpayer”) received \$297,960.06 as a lawsuit settlement in 1998. The Taxpayers did not report the settlement proceeds as income on their 1998 return.

The Department subsequently received IRS information indicating that the Taxpayers had received the settlement proceeds in 1998. It consequently entered a preliminary assessment against the Taxpayers for the additional tax due, plus the 5 percent negligence penalty and interest, on August 16, 2005. The Taxpayers had previously signed an “Agreement Extending Period of Limitation for Assessment or Refund,” i.e., a waiver, on January 10, 2005 extending the statute of limitations for assessing the 1998 tax year until December 10, 2005. The Department entered the final assessment in issue on August 28, 2006.

The Taxpayers argue that the Department failed to timely enter the preliminary assessment, as required by Code of Ala. 1975, §40-2A-7(b)(2). They also contend that the settlement proceeds were exempt from income tax pursuant to 26 U.S.C. §104, which Alabama has adopted by reference at Code of Ala. 1975, §40-18-14(3)(e). Section 104 exempts from income any amount received on account of personal physical injuries or physical sickness.

The Department claims that it timely assessed the Taxpayers pursuant to the 25 percent omission of income provision at Code of Ala. 1975, §40-2A-7(b)(2)b. That statute allows the Department six years to assess tax if a taxpayer omits more than 25 percent from the taxable base reported on a return. The amount of omitted income does not, however, include any amount “disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the department of the nature and amount of the item.” Section 40-2A-7(b)(2)b.2.

The Taxpayers contend that the 25 percent omission statute does not apply because they timely apprised the Department that they had received the settlement proceeds and had not reported the income on their 1998 Alabama return. Specifically, the Taxpayers claim they attached a 1099-MISC form concerning the income with their timely filed 1998 Alabama return, with a statement from their CPA stating that the income was exempt under IRC §104(a)(2).

If the Taxpayers had submitted the above-discussed 1099-MISC and a letter from their CPA with their 1998 return, the six year statute would not apply. The Department indicated at the January 24 hearing, however, that the 1099-MISC and the notice from the

CPA was not attached to the return. Consequently, without evidence supporting the Taxpayers' claim that the documents were attached or enclosed with the return, I cannot find that the Taxpayers notified or apprised the Department of the omitted income. The six year statute thus applies.<sup>1</sup>

Congress amended IRC §104(a)(2) in 1996 so that only damages received on account of personal physical injuries or physical sickness can be excluded from income.<sup>2</sup> The Taxpayers' representative argues that the settlement proceeds in issue "clearly related to and (were) the result of physical injuries sustained by" the Taxpayer. Taxpayers' Brief at 7. I disagree.

The settlement resulted from a lawsuit filed by the Taxpayer against his former employer for wrongful termination. The Taxpayer's complaint alleged that the Taxpayer was wrongfully terminated, which caused him emotional distress. The Settlement Agreement also specified that the \$297,960 represented payment for mental distress. The Taxpayer was physically injured on the job, but the lawsuit settlement was not on account of that physical injury. Rather, as indicated, it was for mental distress caused by the wrongful termination. The proceeds thus are not exempt under IRC §104(a)(2).

The final assessment is affirmed. Judgment is entered against the Taxpayers for 1998 tax, penalty, and interest of \$23,054.49. Additional interest is also due from the date the final assessment was entered, August 28, 2006.

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<sup>1</sup> Section 40-2A-7(b)(2)g.1. also allows the Department to assess tax within one year after it receives IRS information. The preliminary assessment in issue may also have been timely entered pursuant to that section.

<sup>2</sup> For a discussion of the pre-1996 statute, see *Dupree v. State of Alabama, Inc.* 99-119 (Admin. Law Div. O.P.O. 3/17/2000).

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

Entered January 30, 2007.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Gwendolyn B. Garner, Esq.  
Thomas B. Prickett, Esq.  
Tony Griggs