

CECIL AND DONITA L. PARKER
c/o MARK A. DUTTON, ESQ.
714 EAST STREET
MOULTON, AL 35560,

Taxpayers,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

§
§
§
§
§
§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. INC. 08-795

FINAL ORDER

The Revenue Department denied a 2003 income tax refund requested by Cecil and Donita L. Parker (together "Taxpayers"). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on February 26, 2009. Cecil Parker (individually "Taxpayer") and his attorney, Mark Dutton, attended the hearing. Assistant Counsel Lionel Williams represented the Department.

The Taxpayer was allegedly injured while working for the Alabama Department of Transportation ("ALDOT") in November 1988. He sued ALDOT in St. Clair County Circuit Court in July 1992 concerning the alleged injury. The case was transferred to Montgomery County Circuit Court in October 1992. The Taxpayer filed a pro se motion in the case in March 1993 in which he requested for the case to be ". . . binded (sic) with the case in federal court." The Circuit Court took no action concerning the motion, and instead put the case on its administrative docket in December 1993.

It is assumed that the above federal court case referred to in the Taxpayer's motion was a long-running racial discrimination class action lawsuit then pending in the United States District Court for the Middle District of Alabama, i.e., the *Reynolds* case.

The Taxpayer at some point became a plaintiff in the *Reynolds* case. The parties eventually settled the *Reynolds* case, and the Taxpayer received the settlement proceeds in 2003 by way of two checks issued to him by the plaintiffs' attorney in the case. One check was for back wages and the other was for damages, less federal taxes withheld. The Taxpayer subsequently dismissed his State court case in 2007.

The Taxpayer reported the back wages on his 2003 Alabama return, but failed to report the damages he received from the settlement. The Department determined that the damages were subject to Alabama income tax. It assessed the Taxpayer accordingly.

Lawsuit proceeds are subject to Alabama income tax unless exempted pursuant to Code of Ala. 1975, §40-18-14(3)(e). That statute excludes from Alabama gross income any income that is also excludable from gross income for federal purposes pursuant to 26 U.S.C. §104. That section excludes from income all lawsuit proceeds received due to personal physical injuries or physical sickness. *Dotson v. U.S.*, 87 F.3d 682 (1996); *Burge v. State of Alabama, Inc.* 07-336 (Admin. Law Div. 8/17/2007).

The Taxpayer in this case argues that the damages payment he received in 2003 pursuant to the *Reynolds* settlement was tax-exempt because it was based on or derived from the State court physical injury lawsuit he filed in 1992. He claims that his attorney told him that the State action relating to the alleged 1988 injury had been merged with the *Reynolds* lawsuit in federal court. He contends that the plaintiffs' attorney in the *Reynolds* case was authorized to distribute the *Reynolds* settlement proceeds as he saw fit, and that the attorney designated one of the Taxpayer's checks

as back wages, and the other check as damages for physical injuries relating to his State court action.

The burden is on a taxpayer to prove that he is entitled to a deduction or exclusion from tax. *C.I.R. v. Schleier*, 115 S. Ct. 2159 (1995). The burden was thus on the Taxpayer to prove that the lawsuit settlement proceeds he received in 2003 were exempt from Alabama tax pursuant to §40-18-14(3)(e). He failed to do so. Rather, the evidence clearly shows that the settlement proceeds were 100 percent derived from the *Reynolds* class action racial discrimination lawsuit, and thus not excludable from income pursuant to §40-18-14(3)(e).

It is undisputed that the income in issue was derived from the *Reynolds* settlement. The settlement agreement specifically excluded “individual lawsuits having a separate case number, and having been filed prior to July 7, 2000.” Department Ex. P at 42. The Taxpayer’s State court lawsuit obviously had a different case number than the federal *Reynolds* case, and was filed before July 7, 2000. The settlement further excluded “relief against agencies, departments, or employees of the State of Alabama, except for those claims against the Alabama Department of Transportation and the State Personnel Department as set forth in this Agreement relating to employment opportunities at the Alabama Department of Transportation.” Department Ex. P at 44. The Taxpayer’s State court action against the ALDOT for personal injury was thus clearly excluded from the scope of the *Reynolds* settlement agreement.

The fact that the plaintiffs’ attorney in the *Reynolds* case had leeway to payout the settlement proceeds as he saw fit also cannot change the source or nature of the settlement proceeds for tax purposes. To repeat, the proceeds received by the

Taxpayer in 2003 were clearly derived from the *Reynolds* racial discrimination lawsuit, and thus were not exempt from Alabama tax.

The Department's denial of the refund in issue is affirmed.

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

Entered May 6, 2009.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Lionel C. Williams, Esq.
Mark A. Dutton, Esq.
Kim Peterson