

STATE OF WISCONSIN
TAX APPEALS COMMISSION

ROBERT AND KATHY STREMCHA
703 Kavanaugh Street
Elroy, WI 53929,

DOCKET NO. 02-I-319

Petitioners,

vs.

DECISION AND ORDER

WISCONSIN DEPARTMENT OF REVENUE
P.O. Box 8907
Madison, WI 53708,

Respondent.

THOMAS M. BOYKOFF, COMMISSIONER:

This case came before the Commission for trial on July 15, 2003 in Madison, Wisconsin.

Attorney Jared Redfield of Redfield Law Offices, LLC, Stevens Point, Wisconsin, represents petitioners. Attorney Donald J. Goldsworthy represents respondent, Wisconsin Department of Revenue ("Department"). Both parties submitted post-hearing briefs.

Based on the testimony and evidence received at the trial, the submissions of the parties, and the entire record, the Commission finds, concludes, and orders as follows:

FINDINGS OF FACT

Jurisdictional Facts

1. Under date of November 12, 2001, the Department issued an assessment to petitioners for \$12,314.64, consisting of income tax and interest for tax years 1999 and 2000. Petitioners had filed an amended 1999 Wisconsin income tax return claiming that \$103,220 which they had initially reported as income was not taxable because "These funds were received in lieu of workers compensation and are to compensate taxpayer [Mr. Stremcha] for an injury received in his employment. . . ." (Attachment 1 to petitioners' 1999 amended Wisconsin income tax return, p.3.) The Department's assessment for 2000 added to petitioners' income the \$175,000 settlement of a lawsuit between Mr. Stremcha and his former employer.

2. Under date of January 10, 2002, petitioners filed a petition for redetermination with the Department.

3. Under date of September 10, 2002, the Department denied petitioners' petition for redetermination.

4. On October 3, 2002, petitioners filed a timely petition for review with the Commission.

Additional Facts

5. Mr. Stremcha began working for the United States Postal Service ("USPS") in 1983 in New Lisbon, Wisconsin.

6. In 1985,¹ Mr. Stremcha sustained an on-the-job injury to his foot, for which he had two surgeries performed. After the surgeries, his daily physical activities were restricted to 2 to 2.5 hours of walking, 3 hours of standing, and a 20-lb. maximum of lifting.

7. From 1988 to 1995,² Mr. Stremcha was assigned a full-time day shift, which included a part-time (5 to 5.5 hour) letter carrier route in Mauston, Wisconsin. For the remainder of the 8-hour day, he did clerical work in the office where he could be seated. In January 1995, the route was eliminated.

8. From January to August 1995, Mr. Stremcha reported to work each workday but was assigned few, if any, duties. He testified that "there was no duties assigned. I basically sat in the corner and even the clerical work I did before that, I wasn't even doing. I basically slept in the corner for nine months". (Transcript p. 15, ll. 7-10.) During a visit to his work site by the USPS' postmaster, Mr. Stremcha told him "I can't be sitting back here doing nothing. It's driving me crazy." (Transcript p. 16, ll. 23-34.) The postmaster, however, did not propose a change of his non-job duties.

9. In September 1995, Mr. Stremcha worked as a 2-hour per day letter carrier in Elroy, Wisconsin. At his employer's directive, he spent the remaining 6 work hours per day at home and received Office of Workers Compensation Program ("OWCP") payments (similar to workers compensation).

¹ During his testimony at the hearing, Mr. Stremcha was uncertain of the year of his injury (" . . . I got injured in like '84 or '86, somewhere in that area") Hearing Transcript, p. 11, ll. 10-11 ("Transcript"). The U. S. Equal Employment Opportunity Commission ("EEOC") issued a December 11, 1998 Decision ("EEOC Decision"), in a lawsuit brought by Mr. Stremcha against the USPS, which stated the injury year as 1985. (Exhibit 6.) We find that the injury occurred in 1985.

10. In July 1996, the USPS offered Mr. Stremcha a position in Portage, Wisconsin, approximately 50 miles from his home. He declined the offer because it was not within his grade level or assigned tour of duty and was two grades below his pay level. Mr. Stremcha then filed a retaliation complaint with the USPS.

11. On October 11, 1996, the USPS terminated Mr. Stremcha's employment.

12. Mr. Stremcha filed a formal complaint with the EEOC, asserting that the USPS discriminated against him on the basis of his disability. In his complaint, he stated that from January 1995 to July 1996, at least three part-time flexible ("PTF") clerk positions were created in the Mauston facility, and from February 1995 to August 1996, several such positions were filled within commuting distance of his residence in Elroy, Wisconsin. He was not considered for any of these positions, and the USPS did not consider reasonably accommodating any of the positions for him. An EEOC Administrative Judge ("AJ") conducted a hearing and recommended that the EEOC find disability discrimination under the Rehabilitation Act of 1973, as amended, 29 U.S.C. § 791, *et seq.*

13. The AJ's recommended findings of fact and conclusions of law, finding disability discrimination, were presented to the USPS for consideration. In a final decision received by Mr. Stremcha on February 8, 1997, the USPS rejected the AJ's disability discrimination finding (EEOC Decision, p. 1).

14. On March 7, 1997, Mr. Stremcha appealed to the EEOC. On

² The record is unclear as to what Mr. Stremcha did from the time of his injury in 1985 to 1988. He may

December 11, 1998, the EEOC issued its decision, concluding that the USPS's July 1996 job offer in Portage, Wisconsin, was not a reasonable accommodation, and that the USPS had discriminated against Mr. Stremcha under the Rehabilitation Act of 1973. Among several orders, the EEOC directed the USPS to: (a) offer Mr. Stremcha the next available PTF clerk position in the commuting area with reasonable accommodation for his disability; (b) award Mr. Stremcha "any back pay, interest [on back pay], and all other benefits he would have received absent discrimination . . . for the time period from the date after January 14, 1995 on which the first PTF clerk position became available" in his commuting area to the date he enters employment in such position or the date he declines such position (EEOC Decision p. 7); and (c) pay Mr. Stremcha's reasonable attorney's fees (EEOC Decision, p. 9).

15. Pursuant to the EEOC order, the USPS conducted a supplemental investigation and, on June 10, 1999, issued a decision "relative to [Mr. Stremcha's] assertion that he is entitled to an award of compensatory damages" and awarded him \$2,500.

16. On June 18, 1999, the USPS issued Mr. Stremcha a \$3,513.16 check for the "undisputed amount of back pay, interest and other benefits." On August 25, 1999, the USPS issued Mr. Stremcha a \$3,902.56 check for the "back pay award 11/09/96 to 3/03/99."³ (Complaint, p. 4.)

17. On September 1, 1999, Mr. Stremcha appealed to the U. S. District Court for the Western District of Wisconsin ("Federal District Court"), asking the Court

have spent some or all of this time recuperating from his two surgeries.

to enforce the EEOC's December 11, 1998 decision, and to order appropriate

³ The record does not state whether Mr. Stremcha retained these moneys.

compensatory damages, costs, and attorney's fees. His itemization of those elements totaled \$892,653.

18. The parties entered into a "Settlement Agreement and Release of Claims" ("Agreement"), docketing it with the Federal District Court on November 30, 1999, the same date on which Federal District Judge John C. Shabaz approved it. Among its provisions, the parties settled "all claims, issues, complaints, or actions arising out of" the discrimination and retaliation complaints which Mr. Stremcha filed with the EEOC. (Agreement, p. 1.) Mr. Stremcha acknowledged that he would receive a lump sum amount of \$175,000 "in full accord and satisfaction of all claims and counts which were, or could have been, raised" (Id., p. 2.) Another provision states that the parties "acknowledge that [Mr. Stremcha] has been separately and fully compensated for all backpay [sic], lost wages, and related benefits (including but not limited to retirement, health insurance, sick leave and annual leave)." (Id., p. 2.) Further, Mr. Stremcha agreed "that he will not seek or accept employment with the United States of America, including employment, reemployment, or reinstatement with the" USPS. (Id., p. 5.)

19. In 1999, Mr. Stremcha received \$119,394 from the USPS. This was shown as "Wages, tips, other compens." on the 1999 W-2 form issued to him by the USPS. Petitioners reported this amount on their 1999 Wisconsin income tax return.

20. Under date of March 28, 2001, petitioners filed an amended 1999 Wisconsin income tax return. An attachment stated that Mr. Stremcha received \$119,394 during 1999 from his employer, of which \$16,174 was interest; that the

payment included \$103,220 which they had paid tax on in the original income tax return but were now deducting from income because the \$103,220 was "received in lieu of workers compensation . . . to compensate [Mr. Stremcha] for an injury received in his employment and . . . [has] therefore been excluded from his income pursuant to IRC Section 104. Taxpayer originally reported this amount as taxable income because the payment was reported on Form W-2, but believes that this was done improperly." (Exhibit 4.) The Department disagreed and stated that the \$103,220 was taxable. However, in reviewing the tax return, the Department determined that petitioners had overpaid \$1,325.85 of tax, on which the Department owed them interest of \$208.92. This totaled \$1,534.77, which was offset against the Department's assessment for 2000.

21. Under date of March 28, 2001, petitioners filed a Wisconsin income return tax for 2000. Attached to it was IRS Form 8275, titled "Disclosure Statement." The document stated that Mr. Stremcha was injured on the job and received workers compensation benefits; that he entered into a settlement agreement with his employer "whereby he received a lump sum in both 1999 and 2000. In conjunction with this settlement, workers compensation was reimbursed for amounts paid to taxpayer"; that Mr. Stremcha's "position [was] that the amounts received in both 1999 and 2000 pursuant to the settlement are on account of his injury and in lieu of workers compensation and therefore not taxable pursuant to IRC Section 104." (Exhibit 5.) The \$175,000 received in 2000 was not included on the tax return as income.

ISSUE AND CONCLUSION OF LAW

ISSUE: Have petitioners met their burden of proving that any part of the

\$103,220 Mr. Stremcha received in 1999 and the \$175,000 he received in 2000 from the USPS are excludable from Wisconsin income taxation?

CONCLUSION OF LAW: No.

APPLICABLE INTERNAL REVENUE CODE PROVISION

Sec. 104. COMPENSATION FOR INJURIES OR SICKNESS

(a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

* * *

(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;

* * *

OPINION

Burden of Proof

The Wisconsin Supreme Court has long recognized that a Department assessment is presumed to be correct and that a petitioner has the burden of proof to show that an assessment is incorrect. *Department of Taxation v. O. H. Kindt Mfg. Co.*, 13 Wis. 2d 258, 268 (1961), and *Woller v. Dep't of Taxation*, 35 Wis. 2d 227, 233 (1967). The Wisconsin Supreme Court has stated: "Failure to present any evidence showing error means that the case must be decided against the taxpayer." *Woller, supra*, at 233.

Further, it has been axiomatic that "tax exemptions, deductions and privileges are matters purely of legislative grace and tax statutes are to be strictly construed against the granting of the same, and one who claims an exemption must . . . bring himself clearly within the terms thereof." *Comet co. v. Dep't of Taxation*, 243 Wis.

117, 123 (1943). Also see *Estate of Thomas*, 1 Wis. 2d 402, 405 (1957).

Taxability of the \$175,000 Received in 2000

For the 1999 and 2000 income tax years involved in this case, § 104 of the Internal Revenue Code ("I.R.C.") is incorporated into Wisconsin's income tax law by Wis. Stat. §§ 71.01(6)(n) and (o). The pertinent language of I.R.C. § 104 is set out above.

The seminal case in determining the tax status of funds asserted to be received for injuries or sickness is *Commissioner v. Schleier*, 95-1 USTC ¶ 50-309, p. 88,112, 115 S. Ct. 2159 (1995). In *Schleier*, United Airlines, Inc. ("United"), under its policy to terminate an employee who reached age 60, fired Mr. Schleier at age 60. He filed a claim in federal district court on the basis of violation of the Age Discrimination and Employment Act of 1967 ("ADEA").

After litigation, the parties settled the case. The IRS and Mr. Schleier disagreed on the taxability of the settlement amount. The U. S. Supreme Court reversed the U. S. Tax Court and the Court of Appeals (5th Circuit), and held that the settlement amount was received under the ADEA for settling an age discrimination dispute, and not on account of personal injuries under I.R.C. § 104(a)(2). It was, therefore, taxable.

In *Schleier*, the U. S. Supreme Court adopted a 2-part test set out in Treas. Reg. § 1.104-1(c), 26 CFR § 1.104-1(c) (1994). *Schleier*, at p. 88,116. The Court stated that, for an award or settlement to be exempt from income taxation under I.R.C. § 104(a)(2): (1) the amount must be through prosecution or settlement of an action based upon tort or tort type rights, and (2) the amount must be received on account of personal injuries or sickness.

In *Schleier*, the Court concluded that the settlement (1) was not based upon a tort or tort-type right, but was based upon age discrimination under the ADEA, and (2) was not received on account of injuries or sickness, but was based upon age discrimination.

In the case before the Commission, the \$175,000 settlement presents a similar situation. Mr. Stremcha's employment problems with the USPS began when he sustained an on-the-job foot injury. However, Mr. Stremcha's settlement (1) was not based upon a tort or tort type right, but was based on the USPS's noncompliance with the Rehabilitation Act of 1973, and (2) was not based upon his admittedly severe personal injuries requiring two surgeries, but was based upon the USPS's disability discrimination, its failure to offer him a job comparable to his pre-injury job with reasonable disability accommodation, and its retaliation after Mr. Stremcha filed an appeal with the EEOC.

Petitioners assert that the Agreement did not limit the settlement to any particular type of claim. (Petitioner's initial brief, p. 3.) Evidently, this assertion would allow petitioners to argue that the settlement was based solely on Mr. Stremcha's personal injuries. But this is not accurate. The Agreement provides that the parties "settle all claims, issues, complaints, or actions arising *out of the complaint* filed by Plaintiff *in the Actions*" (Agreement, p. 1, ¶ 1; emphasis supplied.) In the introductory language in this document, "Actions" is defined as the disability discrimination, the retaliation, and matters arising from them before the EEOC. (*Supra*, p. 1.)

Both parties cite *Greer v. U. S.*, 207 F. 3d 322 (Ct. App. 6th Cr., 2000), to support their assertions. In *Greer*, the Circuit Court found that a settlement between Mr. Greer and his former employer was based on a tort type claim, satisfying the first part of the *Schleier* test. However, Mr. Greer failed to comply with part 2 of the *Schleier* test by failing to demonstrate, with concrete evidence demonstrating a causal connection between personal injuries and damages, that the settlement was "on account of personal injuries or sickness." I.R.C. § 104(a)(2).

Petitioners interpret *Greer* to mean that a formal complaint does not have to be made in order for a settlement to meet the first part of the *Schleier* test. However, petitioners' assertion is covered by the language of I.R.C. § 104(a)(2) ("damages . . . received (whether by suit or agreement)") which *Greer* cites. The Department correctly recognizes *Greer's* conclusion that both parts of the *Schleier* 2-part test must be proven. In the case before us, petitioners have not established that the settlement was premised on account of personal injuries.

Petitioners also cite *Knuckles v. Commissioner*, 349 F 2d 610 (10th Cir. 1965), for their assertion that a settlement agreement does not have to state the physical injuries with particularity. (Reply Brief, p. 4.) The Court, however, concluded that Mr. Knuckles' suit against his former employer was under an employment contract, not based upon on-the-job personal injuries. That holding parallels our conclusion that Mr. Stremcha's agreement was not for personal injuries, but was to release the USPS from claims of disability discrimination and retaliation under the Rehabilitation Act of 1973.

Taxability of the 1999 Payments

In 1999, prior to the Agreement on November 30, 1999, Mr. Stremcha received moneys from the USPS. Petitioners included \$103,220⁴ of these funds on their 1999 Wisconsin income tax return, then filed an amended return and asserted that the funds are not taxable, with the following justification:

These funds were received in lieu of workers compensation and are to compensate [Mr. Stremcha] for an injury received in his employment and . . . [are] excluded from his income pursuant to IRC Section 104. [Petitioners] originally reported this amount as taxable income because the payment was reported on Form W-2, but believes this was done improperly.

Three payments to Mr. Stremcha are under review here.⁵ From each payment, the USPS withheld funds for federal income tax withholding, Wisconsin income tax withholding, and Medicare.

Information which accompanied each of the three contested payments is in the record. The checks are dated June 18, August 24, and October 7, 1999. Besides tax withheld, additional funds were withheld as follows:

- June 18, 1999 check: retirement amounts for 1995 and 1996 were withheld. \$13,756.55 was withheld as "OWCP Earnings." (Exhibit C.) Petitioners' initial brief describes this as "Repayment of OWCP benefits." (P. 1.)
- August 24, 1999 check: \$3,902.56 is described as "Back pay award 11/09/96 to 3/03/99." (Exhibit D, p. 1.) An explanation reads: "This check represents the second payment of your EEOC

⁴ After amounts were withheld from this \$103,220, Mr. Stremcha received \$14,930. Petitioners' initial brief states that the settlement was based on his employment "for which he was most shabbily treated." (P. 3.) Petitioners' reply brief characterizes the USPS's actions as "extremely odd behavior" (P. 1.) These may be understatements in this case.

⁵ A fourth check, for \$8,765, was received on March 30, 1999 and was repaid to the USPS in 2000, at its request. That amount is not being contested.

settlement and covers 11/09/96 to 3/03/99. Your outside earnings of \$24,828.39 and annuity monies of \$29,800.00 have been deducted from this payment." (*Supra*, p. 2.)

- October 7, 1999 check: the explanation is: "This check represents payment of your terminal leave of 640.000 hours at \$37831. Paying over the max due to EEOC settlement." (Exhibit E.)

Mr. Stremcha admits receiving the above checks. Petitioners have not proven that these payments are exempt from income taxation. It is not sufficient to assert that the payments were "on account of [Mr. Stremcha's] physical injury and in lieu of workers compensation and are therefore excludible from gross income under IRC Section 104. . . ." (Petitioners' initial brief, first page.) Petitioners have not overcome the presumptive correctness of the Department's denial of their claim for refund of 1999 income tax.

IT IS ORDERED

That the Department's action on petitioners' petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 16th day of April, 2004.

WISCONSIN TAX APPEALS COMMISSION

Don M. Millis, Commission Chairperson

Thomas M. Boykoff, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"