STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

RICHARD G. DELARDI and LINDA L. DIFONZO :

DETERMINATION

for Redetermination of a Deficiency or for Refund of : DTA NO. 814042
Personal Income Tax under Article 22 of the Tax Law
for the Year 1993. :

Petitioners, Richard G. Delardi and Linda L. DiFonzo, 248 Lawrence Place, New Rochelle, New York 10801, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1993.[1]

A hearing was held before Roberta Moseley Nero, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 6, 1997 at 1:15 P.M. Petitioner's reply brief was received on July 23, 1997, which date began the six-month period for the issuance of this determination. Petitioner appeared by Wood & Klarl (Thomas F. Wood, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Laura J. Witkowski, Esq., of counsel).

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[1]Petitioners were married during 1993, and filed a joint New York State tax return for 1993. However, the income in dispute pertains exclusively to Mr. Delardi's employment with International Business Machines. Therefore, all references to petitioner shall refer solely to Mr. Delardi, while references to petitioners shall refer to Mr. Delardi and Ms. DiFonzo.

ISSUES

I. Whether the lump sum payment received by petitioner from his employer upon cessation of his employment[2] is excludable from petitioners' 1993 New York State gross income as damages received due to personal injury or sickness pursuant to IRC § 104(a)(2).

II. Whether petitioners are entitled to an additional New York State resident tax credit for taxes paid to Connecticut for the 1993 tax year on the lump sum payment.

FINDINGS OF FACT

1. The Division of Taxation (hereinafter "Division") submitted 28 proposed findings of fact pursuant to 20 NYCRR 3000.15(d)(6) and sections 302(1) and 306 of the State Administrative Procedure Act. The proposed findings of fact have been incorporated into this determination, except as noted, as follows:

- Proposed findings of fact 1 through 8, 13 through 16, part of 17, and 18 through 26 have been substantially adopted into this determination with only slight changes in wording as findings of fact 16 through 28, and 32;

- Proposed findings of fact 9 through 13 and part of 17 were omitted as the same information was set forth in more detail in the determination by including the language of the actual documents; and,

- Proposed findings of fact 27 and 28 were omitted as conclusory.

Petitioners' individual objections to the Division's proposed findings of fact are noted and responded to with the corresponding finding of fact. Petitioners' objection that they "feel that the Findings of Fact, in many areas, go contrary to the facts presented at the hearing and should be

[2]As explained more completely in Finding of Fact "14", petitioner's employer actually made the "lump sum payment" in two separate payments, both for the period ending December 31, 1993.

modified" (Petitioners' reply brief, p. 1) is only addressed to the extent that it was found the following findings of fact were supported by the record.

Background - Petitioner's Employment With International Business Machines

2. Testifying on behalf of petitioner regarding the circumstances of both his employment with IBM and his departure from IBM were petitioner, Mr. Michael Silverman and Mr. John Reitter. Mr. Silverman began working for IBM in 1981 and continues to be employed by IBM. He has known petitioner through their mutual employment at IBM since 1988 or 1989. He worked either for or with petitioner from that time until apparently the time petitioner left IBM. Mr. Reitter has known petitioner through their mutual employment at IBM since 1968. It appears he also worked with petitioner from 1989 through December of 1993, when Mr. Reitter also left his employment at IBM. Mr. Reitter currently has a petition pending with the Division of Tax Appeals involving the same issue as the present matter. The testimony of Mr. Silverman and Mr. Reitter primarily corroborated petitioner's testimony regarding his employment with IBM. Therefore, the testimony of all three witnesses has been combined and appears in Findings of Fact "3" through "14".

3. Petitioner was employed by IBM for approximately 28 years. In 1989 he was a "second line manager in the financial area for the IBM Corporation" (tr., p. 12). Petitioner was responsible for the "financial requirements associated with reporting the operations" (tr., p. 13) for the ROLM Telephone Company (hereinafter "ROLM"). At that time ROLM was a division within IBM. While he occupied this position petitioner had an office, a conference room and a personal secretary. There were 4 managers that reported directly to petitioner, with a total of approximately 70 employees under petitioner's supervision.

4. During 1989 IBM determined to sell off the manufacturing operation and one-half of the marketing aspects of ROLM. Petitioner had previously been dedicated to integrating ROLM into IBM and now worked on reversing the steps previously taken in order to make ROLM an attractive stand alone company for sale. Once the divestiture of ROLM was completed, IBM requested that petitioner leave IBM and go to work for ROLM. Petitioner, not wanting to give up his tenure with IBM, refused and attempted to find a new position within IBM. Petitioner located an assignment within IBM. The responsibility of this position was to work with those ROLM employees remaining with IBM towards total divestiture of ROLM (i.e., the sale of the remaining piece of the marketing operations). In this position petitioner no longer held any supervisory responsibilities; no employees reported to petitioner and petitioner reported directly to a director. Petitioner had to commute to the location of this new position.

5. Petitioner explained that IBM had two separate means of evaluating jobs within the organization. The first was by job rank. This was an evaluation of a position and the importance it held within the organization. The second was a performance evaluation, which evaluated the performance of the specific individual currently holding a given position. Petitioner testified that prior to 1989 he had always held a high ranking and his appraisals were always at the highest or next to the highest level obtainable.

6. Maintaining a high rank was difficult in petitioner's new position because he no longer had supervisory responsibilities. Petitioner, therefore, worked diligently in his new assignment in an attempt to keep a high ranking. He received several awards and accommodations for this work. Introduced into evidence was a Distinguished Contribution Award in petitioner's name dated May 18, 1992 "in appreciation for: Your Outstanding Efforts in the Sale of ROLM to Siemens" (Petitioners' Exhibit 1). Petitioner testified that he received a monetary award together

with this certificate in the amount of $10,000.00. This monetary award was included in petitioner's gross income for 1992, he paid taxes on this amount and IBM allowed deferred compensation contributions and stock purchases to be made from this amount.

7. After the total divestiture of ROLM from IBM petitioner received another assignment. This position was physically located in Norwalk, Connecticut and was with the Pennant organization.[3] Petitioner's initial task in this assignment was to try and divest IBM of Pennant, or parts thereof, or obtain outside investors for Pennant. His territory consisted of the United States, Canada, Mexico, Argentina and Brazil. This position necessarily involved frequent job related travel. The person petitioner reported to in this assignment spent most of his time in Paris, France, as did the other four or five people in this department. Most of the department meetings were held in Paris. Petitioner was never requested to appear personally in Paris and was told that it was not necessary that he report on his activities to the Paris office. Petitioner's office accommodations were also changed when he moved to the new position in Norwalk. He did not receive an office, but was assigned a cubicle in an area that was primarily occupied by hourly or contract employees. Petitioner voiced his objections to his working conditions based on IBM guidelines as to what office accommodations are given to what level employee. Petitioner was eventually provided with an office in the Norwalk location. 8. Prior to petitioner's assignment to Pennant, he had attempted on his own to find other assignments within IBM. He did actually locate a finance assignment in Tampa with someone he had previously

[3]The witnesses used Pennant organization and printing organization interchangeably throughout their testimony. The function of the Pennant or printing organization (hereinafter referred to as "Pennant") was to "design, develop, build and sell computer printers" (tr. p. 62).

worked with and who expressed to petitioner that he would be happy to have petitioner in the financial position. However, petitioner was not allowed to interview for the Tampa position.

9. While working for Pennant petitioner learned of an open financial assignment within Pennant. Petitioner expressed an interest in this position but was not allowed to interview for it. It is petitioner's belief, based on what his director told him, that it had been determined that the position would be given to a female employee. A female employee was appointed to this position. Petitioner expressed his opinion on cross-examination that this person had less financial experience than he had. However, petitioner also admitted that this person was the same "label" as he was, presumably referring to job title or ranking.

10. The circumstances of petitioner's employment with IBM from 1989 on, as outlined above, caused stress in petitioner's life. Petitioner believes that these circumstances, particulary not being able to be home because of commuting time and job-required travel, eventually caused the breakup of his marriage. While going through a divorce petitioner did see a psychiatrist. Petitioner's divorce became final in 1992. Petitioner was again married in 1993.

11. At some point in 1993 petitioner determined that he would speak with someone at IBM about what would be available to him should he leave. Petitioner was motivated by his working conditions and his belief that "something was going to happen" (tr., p. 31).[4] It was petitioner's

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[4]There was no more specific testimony at the hearing explaining what the something was that was going to happen. However, petitioner stated in the petition filed in this matter that IBM was attempting to force him out, and specifically with regard to the year 1993:

> "IBM AGAIN PRESENTED A TERMINATION PACKAGE WHICH INCLUDED A GENERAL RELEASE NOT TO SUE FOR TORT OR CONTRACT CLAIMS. AGAIN, AGE BOUNDARIES WERE PUBLISHED, WITH MANAGEMENT EMPHASIS THAT THOSE NOT ACCEPTING THE OFFER COULD SUBJECT THEMSELVES TO LOSS OF PENSION BENEFITS. *I WAS TOLD BY MY MANAGER THAT SENIOR MANAGEMENT HAD FOCUSED ON ME AS A TARGET CANDIDATE."* (Division's Exhibit

belief that IBM did not any longer appreciate older experienced employees, which he expressed by stating that "gray hair experience was no longer welcome" (tr., p. 41) at IBM. Petitioner had considered filing legal claims against IBM but determined that it was probably not cost effective. Petitioner approached a Mr. Dennis Garcia who was an attorney for IBM located at the Norwalk, Connecticut facility. He related his concerns with his working conditions to Mr. Garcia, which included being denied job opportunities, lack of job protection since he was working virtually alone and the territory he covered which required constant travel. The negotiations with Mr. Garcia began in the late summer of 1993.

12. At the time of petitioner's negotiations with Mr. Garcia, there were apparently no special retirement incentive programs available at the Pennant organization. Furthermore, on November 29, 1993, IBM issued an IBM News Bulletin entitled "CHANGES TO IBM'S SEPARATION ALLOWANCE PLANS ANNOUNCED," curtailing certain benefits under normal separation plans, which provided:

> "IBM's separation allowance plans, which provide a transition payment to individual employees upon their termination of employment, are changed as follows, effective today:
>
> "-- Payments to employees under the Normal Separation Allowance Plan will now require a Release and Covenant Not To Sue. Employees who elect not to sign the release upon their departure may receive only a base payment of up to two weeks' pay. As previously announced, the maximum normal separation allowance payment has changed, effective July 1, 1993, to 13 weeks' pay.
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> "-- The maximum payment provided to employees under IBM's individual separation allowance plans is changed from 52 weeks' pay to 26 weeks' pay. This change is being made to be consistent with the maximum payment which is being provided under resource reduction programs announced after July 1, 1993.

B, Schedule B; emphasis added.)

> "In addition, payment under the terms of certain modified separation plans may now be made in conjunction with the Retirement Bridge Leave of Absence.
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> "For details regarding IBM's separation allowance plans, please refer to the publication 'About Your Benefits: Employee Retirement Income Security Act', available on the Online Personnel Reference Library (OPRL) or from your manager." (Division's Exhibit E.)

13. Petitioner testified that the result of these negotiations was that if he agreed not to institute legal action against IBM he would receive a payment equal to 52 weeks salary upon separation from service. Petitioner also testified that he would have received only two weeks pay had he refused to sign the release pursuant to the November 29, 1993 IBM News Bulletin. Petitioner determined to accept the offer. In furtherance of this determination, petitioner executed the "GENERAL RELEASE AND COVENANT NOT TO SUE" (hereinafter "Release") that is at issue in these proceedings on December 30, 1993. The relevant portions of the Release provide:

> "*In exchange for the sums and benefits which you will receive pursuant to the terms of the Pennant Systems Opportunity Program* (PSOP), **RICHARD G. DELARDI** (hereinafter 'you') *agrees to release International Business Machines Corporation* (hereinafter 'IBM') and its benefits plans *from all claims, demands, actions or liabilities you may have against IBM of whatever kind*, including but not limited to those which are related to your employment with IBM, the termination of that employment or other severance payments or your eligibility or participation in the Retirement Bridge Leave of Absence. You agree that this also releases from liability IBM's agents, directors, officers, employees, representatives, successors and assigns (hereinafter 'those associated with IBM').
>
> "You agree that you have voluntarily executed this release on your own behalf, and also on behalf of any heirs, agents, representatives, successors and assigns that you may have now or in the future. You also agree that *this release covers, but is not limited to , claims arising from the Age Discrimination in Employment Act of 1967, as amended, Title VII of the Civil Rights Act of 1964, as amended, and any other federal, state or local law dealing with discrimination in employment, including but not limited to discrimination based on sex, race, national origin, religion, disability, veteran status or age. You also agree that this release includes claims based on theories of contract*

or tort, whether based on common law or otherwise. This agreement covers both claims that you know about and those that you may not know about which have accrued by the time you execute this release. This release does not include your nonforfeitable rights to your accrued benefits (within the meaning of Sections 203 and 204 of the Employee Retirement Income Security Act of 1974, as amended), as of the date of your retirement from IBM under IBM Retirement Plan and the IBM Tax Deferred Savings Plan, which are not released hereby but survive unaffected by this document.

"You agree that you will never institute a claim of any kind against IBM, or those associated with IBM, including but not limited to, claims related to your employment with IBM or the termination of that employment or other severance payments or your eligibility or participation in the Retirement Bridge Leave of Absence. If you violate this release by suing IBM or those associated with IBM, you agree that you will pay all costs and expenses of defending against the suit incurred by IBM or those associated with IBM, including reasonable attorneys' fees.

"You acknowledge and agree that:

"1. *The payment and benefits provided pursuant to the terms of the PSOP constitute consideration for this release, in that they are payments and benefits to which you would not have been entitled had you not signed this release.*

"2. You have been given the opportunity to take a period of at least forty-five (45) days within which to consider this release and *to review: (a) the terms of the PSOP, (b) a list of the job titles and ages of employees eligible to participate in the PSOP, and (c) a list of employees in your job classification or organization unit, if any, who were not eligible to participate in the PSOP.*

"3. This release does not waive any claims that you may have which arise after the date you sign this release.

"4. *You have not relied on any representations, promises, or agreements of any kind made to you in connection with your voluntary decision to accept the PSOP except for those set forth in the PSOP Summary Plan Description* and other official plan documentation, including all the materials in the Employee Information Package.

"5. *In the event of rehire by IBM* or any of its subsidiaries as a regular employee, you understand that *IBM reserves the right to require repayment of a prorated portion of the PSOP payment. The amount of repayment will be calculated as one week of pay at the rate used to calculate the PSOP payment,* multiplied by the difference between the number of weeks used to calculate the

PSOP payment and the number of weeks away from IBM, less associated payroll taxes withheld by IBM.

"6. If at the time of executing this release you are on a leave of absence, this release also waives any rights that you may have regarding your leave of absence - - including but not limited to return rights, whether or not statutory." (Division's Exhibit F; emphasis added.)

Petitioner also executed a leave of absence agreement on December 30, 1993, which in the relevant parts provided:

"PENNANT SYSTEMS OPPORTUNITY PROGRAM (PSOP)
PRE-RETIREMENT LEAVE OF ABSENCE AGREEMENT

"DATE: **August 4, 1993**

"TO: **RICHARD G. DELARDI** SERIAL: **123514**

Your request for a Pennant Systems Opportunity Program (PSOP) Pre-Retirement Leave of Absence without pay under the provisions of the PSOP has been approved. Your leave will begin **JANUARY 01, 1994** and will end April 30, 1994. Based on your committed plan to retire immediately following your leave, your effective date of retirement will be May 1, 1994. Once your leave begins, the committed retirement date may not be changed to a later one; however, you may advance your retirement to an earlier date upon which you are retirement eligible."[5] (Division's Exhibit H; emphasis added).

14. Petitioner testified that when he left IBM he did receive payment of a year's salary. This payment was made in two payments of approximately six months' salary each. Petitioner further testified that he was not allowed to make any 401(k) contributions or stock purchases from either of these payments. In support of his testimony petitioner introduced copies of three statements of earnings and deductions (i.e., pay stubs, payments were made electronically). The first of these statements was for the period ending December 15, 1993 and represents what would have been petitioner's normal salary. There are indications on the face of the statement that

[5]The dates April 30, 1994 and May 1, 1994 were handwritten in the spaces provided for that purpose.

stock purchases were made and compensation was deferred. The other two statements are for the period ending December 31, 1993 and obviously represent the payment petitioner received upon leaving IBM. One is in the amount of $38,908.11 and one is in the amount of $39,007.43. There are no deductions, stock purchases or any other adjustments appearing on the face of either of these statements. The amounts of each payment are listed on each statement as "OTHER". The bottom left hand corner of each statement indicates that the payments were listed as salary advances.[6] Submitted with these statements was an additional statement showing the calculations of these two payments. This statement indicates that no gross amount would be indicated on the statements of earnings and deductions, but that Federal and State income taxes and FICA were deducted prior to arriving at the net amount listed on such statements. $109,321.98 is listed as the total amount and appears to the right of the notation "SEP PAY 52 wks",[7] indicating separation pay.

Background - Audit Program

15. The Division introduced the affidavit of David Brocca, a Tax Technician II in the Audit Division, to provide both general background on an audit program relating to claims similar to petitioner's, and to provide details about the processing of petitioner's return, including the resulting Notice of Deficiency. The background of the audit program is set forth below. While this information does not relate specifically to petitioner's case, it is helpful in understanding the processing of petitioner's return.

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[6]The copies of the statements introduced by petitioner were somewhat cut off on the left hand side. The actual letters appearing were "LARY ADVANCE".

[7]It is unclear whether this is 52 or 55 weeks, but petitioner testified that he received two payments totaling a year's salary.

16. During the 1994 tax year, the Division received large numbers of claims for refund of personal income tax from former IBM employees who had received lump-sum payments upon their separation from service during the 1990 through 1993 tax years. The basis for the refund claims was as follows: When the taxpayers had originally filed their New York State personal income tax returns for the years in question, they had included in both their Federal and New York State adjusted gross income the lump-sum payments that had been received upon their separation from service pursuant to the execution of a General Release and Covenant Not To Sue. This income was included in the taxable income set forth on the taxpayers' Wage and Tax Statements (W-2s). The taxpayers now sought to have this income excluded from both Federal and New York State adjusted gross income pursuant to IRC § 104(a)(2), claiming that the money had been received pursuant to a settlement of claims for personal injuries based on tort-type rights.

17. Due to the large numbers of taxpayers involved, the Division's Audit Division established a special audit program to handle the aforementioned refund claims. This audit program was known as the "CIAM" program ("C" = Central Office Audit Bureau; "IA" = Amended Returns; "M" = former IBM employees claiming nontaxable severance pay).

18. Due to the fact that these refund claims were based upon an exclusion provided for in the Federal tax law, the Audit Division contacted the Internal Revenue Service (hereinafter "IRS") to see if that agency had received similar refund claims and to ascertain its position with respect to such claims.

As a result of the Audit Division's discussions with the IRS, and a review of internal IRS documents, the Division determined that the IRS had also received similar refund claims and that

its policy was to deny such claims on the basis that the payments did not qualify for the exclusion provided by IRC § 104(a)(2).

19. The Audit Division subsequently determined that the refund claims of the former IBM employees must be denied. As a result, on or about November 24, 1995, the Audit Division issued Notices of Disallowance to the approximately 2,300 former IBM employees that had filed refund claims to date.[8]

20. Following the Audit Division's issuance of the statutory notices of disallowance in these matters, the Division received many telephone calls and letters from taxpayers, their representatives and their elected officials. As a result the Commissioner of Taxation and Finance, Mr. Michael H. Urbach, sent a letter to various New York State Senators, wherein it was explained that the taxpayers who had received the notices of disallowance were not required to take any additional action with New York State while they pursued their Federal claims. It was decided that the Division would treat the filings as protective refund claims and that it would grant the same relief that the taxpayers received at the Federal level.[9]

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[8]Petitioners object to this finding of fact by stating that they never received the November 4, 1995 Notice of Disallowance. Petitioners did not receive a Notice of Disallowance because they excluded the income in question on their tax return when filed. They did not submit a refund claim at a later date as the approximately 2,300 employees being discussed here did. Therefore, there is no basis for petitioners' objection.

[9]Petitioners object to this finding of fact by stating that the IRS was notified of petitioners' situation and further that "in fact, counsel for the Department, indicated that IRS had no desire to pursue any remedies against this taxpayer" (Petitioners' reply brief, p. 1). Petitioners did not specifically reference where the Division made this statement. It is assumed they are speaking of footnote 8 in the Division's brief which explains that it is likely petitioners' return was not audited by the IRS because of the manner in which petitioners claimed the exclusion from income on their return, and should not indicate any substantive decision by the IRS. Again, this finding of fact refers to the 2,300 employees who filed refund claims and therefore does not apply to petitioners (*see*, footnote 6).

On or about April 1, 1996, the Audit Division sent letters to the approximately 2,300 individual taxpayers involved to inform them of the policy outlined by the Commissioner's letter.[10]

Petitioners' 1993 New York State Personal Income Tax Return

21. Prior to April 16, 1994, petitioners filed a 1993 New York State Resident Income Tax Return (form IT-201). Attached to the return was a Wage and Tax Statement (form W-2) which indicated that petitioner had received $219,143.00 in total state/local wage income from IBM during 1993.

On line #16 of the IT-201, petitioners excluded $105,120.00 of the $219,143.00 in total IBM W-2 wage income. The explanation given by petitioners on the return for excluding this income was that it constituted "payment for covenant." The calculation of the income excluded showed a lump sum payment of $109,325.00[11] minus $4,205.00 listed as payment without covenant. The $4,205.00 of the lump-sum payment received by the petitioner for signing the Release was included in petitioners' New York State adjusted gross income, due to the fact that this amount represents the amount that he would have received (i.e., two weeks pay) had he not signed the document, according to his understanding of IBM's policy. Attached to petitioners' IT-201 was a copy of the November 29, 1993 IBM News Bulletin.

22. Petitioners' 1993 return also claimed a refund of $8,760.00 on line #77.

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[10]Petitioners object to this finding of fact by stating that they never received this letter. There is no basis for petitioners' objection (*see*, footnote 6).

[11]It should be noted that there is a $3.00 discrepancy between the gross amount of the lump-sum payment listed on the attachment to the petitioners' 1993 return and the amount set forth on the IBM calculation submitted by petitioners. Due to the small amount of the discrepancy, and since petitioners have not raised this issue, the figure as listed on petitioners' return is deemed correct.

23. At the time petitioners' return was filed, the CIAM audit program was not yet in existence. Therefore, because petitioners listed all of their W-2 income on line #1 (the exclusion was not taken until line #16), the return was simply reviewed by Division personnel who process incoming returns (non-audit personnel) by key-punching the numbers listed on selected lines of the return to verify only that the calculations had been done correctly by the taxpayer. Once the calculations were so verified, the refund claim was approved and forwarded to the New York State Comptroller's Office for payment.

24. The Comptroller's Office generally has three options when it receives a request for a refund from the Division: (1) it can issue the refund outright; (2) it can issue the refund but refer the matter back to the Division for further investigation into the validity of the claim; or (3) it can refuse to issue the refund based upon its own investigation into the legality of the taxpayers' claims. In this particular case, the Comptroller's Office issued the refund check, but referred the matter back to the Division for further investigation regarding the validity of the taxpayers' exclusion of a large portion of W-2 income (lump-sum payment from IBM) on line #16. This referral is evidenced by the "OSC - Stratified Audit" stamp located on the first page of petitioners' return.

25. The Comptroller's Office issued the aforementioned refund check on or about March 24, 1994 and petitioners cashed said check on or about March 30, 1994.

26. Although the CIAM audit program was not yet in place when petitioners' matter was referred back to the Division, the Audit Division applied the same principles to petitioners' case. As a result, the Audit Division subsequently issued a Statement of Proposed Audit Changes to petitioners (notice number L-009146269) on July 11, 1994, wherein it disallowed the subtraction of the W-2 income claimed on line #16, thereby increasing both petitioners' Federal adjusted

gross income and their New York State adjusted gross income. Based upon these adjustments, petitioners were calculated to have a 1993 tax liability of $8,842.11, plus interest.

27. The Division issued a Notice of Assessment Resolution (notice number L-009146269) on September 30, 1994. This document indicated that the Audit Division's adjustments were confirmed to be appropriate and that petitioners failed to provide any substantiation of the claimed exclusion under IRC § 104(a)(2).[12]

28. The Division issued a Notice of Deficiency (notice number L-009146269) on October 31, 1994, asserting that petitioners owed $8,842.11 in additional New York State personal income tax, plus interest, for the 1993 tax year.

29. The Division issued a second Notice of Assessment Resolution (notice number L-009146269) on December 9, 1994. This document indicated that petitioners had not provided any additional information which would warrant a change in the Audit Division's adjustments.[13]

30. Petitioners filed a Request for Conciliation Conference and on April 21, 1995 an order was issued sustaining the statutory notice. On July 7, 1995 the present petition was received by the Division of Tax Appeals.

31. Petitioners filed a Federal return and a Connecticut nonresident return for 1993 both excluding the IBM lump sum payment, to the extent of approximately 50 weeks' salary, from

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[12]Petitioners object to this finding of fact by stating that they provided substantiation of their claim at the conciliation conference in this matter and thereafter. There is no basis for petitioners objection in that the statement correctly reflects what appeared on the Notice of Assessment Resolution.

[13]Petitioners object to this finding of fact by stating that they provided substantiation of their claim at the conciliation conference in this matter and thereafter. There is no basis for petitioners' objection in that the statement correctly reflects what appeared on the second Notice of Assessment Resolution.

their adjusted gross income. Neither the IRS nor the state of Connecticut has informed petitioner of any outstanding tax liability for 1993 based on this issue.

32. At no time has petitioner ever commenced an employment related lawsuit of any kind against IBM.

SUMMARY OF THE PARTIES' POSITIONS

33. Petitioners argue that the lump sum payment petitioner received from IBM was excludable from his income as an amount paid in settlement of a tort like claim against IBM and was not severance or separation pay. Petitioners argue that if petitioner had not signed the Release he would have received only 2 weeks pay when he left IBM and, therefore, he was correct in deducting 50 weeks pay from his income for tax purposes (i.e., since he would have received 2 weeks pay in any event he deducted the 2 weeks from the 52 weeks salary received to determine the amount of the payment that was in consideration of signing the Release).

Petitioners argue that the Division has refused to review their claim individually and instead has denied their claim because it was Division policy to deny all claims involving lump sum payments by IBM to now separated employees who claimed the payments were excludable from gross income pursuant to IRC § 104(a)(2). Petitioners argue that petitioner was in a different position than most other IBM employees since he was never notified that his position was being "surplused" or abolished due to downsizing. Furthermore, he approached IBM regarding his claims based upon his treatment during the last four years of his employment, and based on those discussions he was offered 52 weeks of salary if he agreed not to sue IBM. It is asserted by petitioners that IBM employees were no longer able to receive 52 weeks separation pay, so that the payment received by petitioner must have been in settlement of any claims he had against IBM.

Petitioners also argue that IRC § 104(a)(2) does not require that an actual legal action be initiated to have a claim and that it is the judgement of the parties that determines the amount of any settlement. Furthermore, petitioners argue that IRC § 104(a)(2) does not require that the injuries suffered be physical injuries.

Petitioners note that neither the IRS nor the State of Connecticut have pursued any claims against them based on excluding this income from their Federal and Connecticut nonresident tax returns for 1993.

In their petition, petitioners assert that in the event the Division prevails, the Division erred by not calculating an additional resident tax credit for taxes paid to Connecticut on the lump sum payment.

34. The Division argues that IRC § 61(a) defines gross income as "all income from whatever source derived" and is to be broadly construed, and that the exclusion from income set forth in IRC § 104(a)(2) is to be narrowly construed. Furthermore, the Division argues that: petitioners have the burden of proving that the payment petitioner received was excludable; they must show that their interpretation of the statute is the only reasonable one, or that the Division's interpretation is unreasonable; and the notice of deficiency issued by the Division is entitled to a presumption of correctness.

The Division argues that petitioners have alleged no tort or tort type action. First, amounts recovered through age discrimination claims filed pursuant to the Age Discrimination in Employment Act (hereinafter "ADEA") have been held not to be excludable from income. Second, amounts recovered through sex discrimination claims filed pursuant to Title VII of the Civil Rights Act are only excludable from income after the effective date of the Civil Rights Act of 1991, and petitioners have made no attempt to prove when the alleged sex discrimination

occurred. The Division also argues that petitioner has not proven any injury in that while petitioners assert that the treatment of petitioner by IBM caused his divorce and required visits with a psychiatrist, they have not provided any evidence of actual injury such as doctors' bills, nor proven that any injury was caused by the tortious actions of IBM. Furthermore, several of petitioner's complaints were remedied prior to his leaving IBM, since he was given an office and he had remarried.

The Division argues that where a petitioner seeks to exclude income received on account of a settlement of possible claims, it is the intent of the payor that controls. It argues IBM treated the income as taxable by withholding Federal, State and FICA taxes. Furthermore, the Release signed by petitioner is general in nature and similar to the type of release signed by other IBM employees, evidencing that IBM did not intend petitioner's release to be a specific settlement of any possible claims he may have had against IBM. In support of its conclusions that IBM intended the payment to be separation pay the Division also points to the facts that: the payment made by IBM was equated to 52 weeks salary, not any calculation based on injury; the calculations note that the payment was 52 weeks separation pay; and, should petitioner be rehired by IBM, he could be required to pay back a prorated portion of the payment.

The Division argues that the Tax Court has addressed the issue of payments made to employees by IBM, all of whom executed releases very similar to that signed by petitioner. All of these cases have been decided in favor of the Commissioner. The Division argues that both the general and broad terms of the Release executed by petitioner, and its similarity to those reviewed by the Tax Court, contravene petitioners' argument that this case is distinguishable because the payment received by petitioner was specific to him and in settlement of his particular claims.

Finally, the Division argues that where, as here, the Release by its terms releasing IBM from various types of claims (some excludable from income and some not), it is imperative that petitioner prove the correct allocation of the asserted settlement payment between tort like and non-tort actions. Therefore, since petitioners have not attempted to prove how the payment was apportioned between those actions in the release that might have been tort like claims and those that were not, the entire amount of the payment must be included in petitioners' gross income.

35. In reply petitioners argue that petitioner's testimony was sufficient regarding his "perception of the various rights of his that were violated by his employer" (Petitioners' reply brief, p. 2.). Petitioners again emphasized that petitioner was in a different situation from the other IBM employees involved in previous cases because he was not being forced to retire, nor was his position being abolished. Petitioners argue that they cannot control the types of forms that IBM used to memorialize their agreements, and that the forms used are not relevant to the present determination. Finally, petitioners argue that petitioner's award was not calculated based on any plan available to IBM employees since he received 52 weeks pay which was more than that allowed by any IBM program available at the time.

CONCLUSIONS OF LAW

A. Petitioners have the burden of proving that the lump sum payment received by petitioner should be excluded from their gross income (Tax Law § 689[e]). Furthermore, when the issue to be decided is whether the taxpayer is entitled to an exclusion from tax, the exclusion must be narrowly construed (*see*, *Commissioner v. Schleier*, 515 US 323, 328, 132 L Ed 2d 294, 301, citing *Commissioner v. Burke*, 504 US 229, 248, 119 L Ed 2d 34, 52) and the taxpayer is required to prove that his interpretation of the statute is the only reasonable interpretation, or that the Division's interpretation is unreasonable (*Matter of Blue Spruce Farms v. State Tax Commn.*,

99 AD2d 867, 472 NYS2d 744, *affd* 64 NY2d 682, 485 NYS2d 526; *Matter of Grace v. State Tax Commn*., 37 NY2d 193, 371 NYS2d 715).

As relevant to this proceeding, Tax Law § 612(a) provides that New York State adjusted gross income is equal to Federal adjusted gross income. Federal adjusted gross income is defined by IRC § 62(a) as gross income (with certain deductions not relevant to the current inquiry). The definition of gross income in IRC § 61(a) is simply "all income from whatever source derived" (IRC § 61[a]), and is broad in scope (*see*, *Commissioner v. Schleier*, *supra*; *Commissioner v. Burke*, *supra* 119 LEd2d at 42).

Petitioners assert that the lump sum payments received from IBM in 1993 should be excluded from their gross income pursuant to IRC former § 104(a)(2)[14] which provides that gross income does not include:

> "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness. . . ."

IRS regulations further define this exclusion as follows:

> "*Damages received on account of personal injuries or sickness*.-Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term 'damages received (whether by suit or agreement)' means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." (26 CFR 1.104-1[c].)

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[14]IRC § 104(a)(2) has been amended since the tax year in question and now provides that the amount of damages does not include punitive damages and the injuries or sickness suffered must have seen physical injuries or sickness. These amendments do not affect the present case, since the legislative history is clear that no inference was intended regarding situations prior to the enactment of the bills (2 Stand Fed Tax Rep [CCH] ¶6660.136).

In order for petitioners to prove that the payment petitioner received from IBM is excludable from gross income pursuant to the statute and the regulation, petitioners must:

> "establish two independent requirements . . . . First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is 'based upon tort or tort type rights'; and second, the taxpayer must show that the damages were received 'on account of personal injuries or sickness'" (*Commissioner v. Schleier*, *supra,* 132 LEd 2d 294, at 307).

B. Petitioners claim that the lump sum payment at issue was received in settlement of possible claims petitioner had against IBM based on "tort or tort type rights" (26 CFR 1.104-1[c]). In order to establish this they need not prove that petitioner had a valid or sustainable claim against IBM, but only that the nature of the underlying claim involved a tort type action (*see*, *Robinson v. Commissioner*, 102 TC 116, 126, *affd in part and revd in part* 70 F3d 34; *Hamm v. Commissioner*, 74 TCM 279, citing *Taggi v. United States*, 35 F3d 93, 96; *Phillips v. Commissioner*, 74 TCM 187).

A tort is a type of legal action that consists of the following three basic elements:

> "Existence of a legal duty from defendant to plaintiff, breach of duty, and damage as a proximate result." (Black's Law Dictionary 1335 [5th ed 1979].)

While not having to prove petitioner's claims were sustainable, petitioners must provide some evidence "that the personal injuries of which he [petitioner] complains actually existed" (*Knuckles v. Commissioner*, 23 TCM 182, 184, *affd* 349 F2d 610), and that such injuries were the result of the tortious actions of IBM (*see*, *Knuckles v. Commissioner*, supra at 185). I find that petitioner has not proven with sufficient specificity the nature of these possible claims.

Petitioners have not set forth with any particularity the tort or tort like action or actions they believe petitioner might have brought against IBM. Petitioners, do however, set forth the actions of IBM that would have been the basis of such claims by stating that since 1989 IBM:

placed petitioner in nonsupervisory positions; made petitioner commute to work; made petitioner travel extensively for his job; refused to let petitioner interview for other positions he wanted to apply for; gave petitioner a cubicle instead of an office; and gave petitioner an assignment where he was not allowed to interact with other people in his group and indeed was told by his supervisor he needn't bother to report to him on his activities. Petitioner believes that these circumstances, in particular the commuting and job related travel, eventually lead to his divorce and seeing a psychiatrist during his divorce.

Petitioners then apparently assert that these actions breached a duty IBM had to petitioner because the actions were based on age and sex discrimination. With regard to the age discrimination allegations, petitioner stated that "gray hair experience was no longer welcome" at IBM (Finding of Fact "11") . It is noted that if petitioner commenced an action and recovered under the ADEA, such damages would be includable in gross income (*Commissioner v. Schleier*, *supra*). With regard to the sex discrimination allegations, the Division is correct in stating that for the tax year in question, the crucial question regarding whether a recovery under Title VII of the Civil Rights Act of 1964 based on a sexual discrimination claim, was includable in gross income, was when the actions that formed the basis of the complaint took place. If the actions took place prior to the effective date of the Civil Rights Act of 1991, petitioners could not have excluded any such recovery from gross income (*see*, *Commissioner v. Burke*, *supra*). If the actions took place after the effective date of the Civil Rights Act of 1991, which expanded the scope of recovery available to plaintiffs to allow for a jury trial and compensatory damages for tort like injuries, petitioners might have been able to exclude the lump sum payment from gross income (*see*, *Commissioner v. Burke*, *supra*, footnote 12). Petitioners did not attempt to prove

the dates involved in the allegations of sex discrimination and have therefore not met their burden of proof if they were alleging a Title VII claim.

Since neither of the two statutory remedies described above are of assistance to petitioners in this matter, and since petitioners have asserted that petitioner suffered mental stress and anguish over the actions of IBM, it is assumed that petitioners are arguing that the underlying tort like claim that was settled is something akin to intentional infliction of emotional distress, where: IBM would be under a duty not to discriminate on account of age or sex; they would have violated that duty based on their actions; and, the stress in petitioner's life, including his divorce, would have been the damages resulting from IBM's actions.

Assuming for purposes of this discussion,[15] that petitioners had asserted facts sufficient to show that IBM may have had a duty to petitioner and may have violated that duty, petitioners have not sufficiently alleged, much less proven, any damages. Keeping in mind that petitioners are not required to prove petitioner's tort like claim was sustainable, they were required to at least show some damages (*see*, *Knuckles v. Commissioner, supra*). The only allegation made by petitioner was that IBM's actions resulted in stress. This allegation is backed up by petitioner's belief that this stress caused his divorce and he also saw a psychiatrist. This is all based solely on petitioner's testimony. There were no witnesses to petitioner's mental state during this time, either professional or even personal acquaintances. Without more, I cannot hold that petitioner has met his burden in proving that there were any damages suffered and therefore has not proven

[15]Petitioners' evidence on these points is sufficient with regard to the allegations of age discrimination. It does not appear that petitioners have shown a breach of duty on the part of IBM with regard to the sex discrimination claim, since petitioner admitted the woman employee who received the position he had wanted to apply for was the same job level as he was.

that the payment he received was for settlement of a tort like action (*see*, *Knuckles v. Commissioner, supra*).[16]

C. In any event, petitioners have not proven the second requirement as enunciated in *Commissioner v. Schleier* (*supra,* 132 L Ed 2d at 307) in that they have not proven that the payment was made by IBM to petitioner on account of personal injuries. As outlined above, petitioner has not proven what his injuries were. However, assuming petitioner was injured by an act of IBM, the evidence is overwhelming that the payment was for retirement or severance pay and not for settlement of a tort or tort type claim.

It is true that petitioner need not have actually filed any legal actions against IBM to prove that the lump sum payment was received in settlement of a tort type claim so that the income fits within the IRC § former 104(a)(2) exclusion (*see*, *Hamm v. Commissioner*, *supra*; *Phillips v. Commissioner*, *supra*). In such instances the settlement agreement controls and the most important factor to consider when attempting to determine the purpose of the lump sum payment is the "express language [in the agreement] that the payment was made on account of personal injury" *(Bagley v. Commissioner*, 105 TC 396, 406, *affd* 121 F3d 393, citing *Glynn v. Commissioner,* 76 TC 116, 120, *affd* 676 F2d 683). There is no such express language in any of the documents submitted. Where there is no written agreement specifically stating that the payment was in settlement of petitioner's claims, the intent of the payor in making the payment must be discerned from all of the facts and circumstances surrounding the payment (*see*, *Stocks v. Commissioner*, 98 TC 1, 10*; Robinson v. Commissioner*, *supra* at 126, 127).

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[16]Many of the tax court cases determined that there may have been a tort like action. However, those cases were motions by the government for summary determination, where the court was required to look at the facts in a light most favorable to petitioner. In this matter petitioners have the burden of proof.

The Tax Court has issued numerous decisions regarding payments made by IBM under similar circumstances with similar documents in evidence, and has held in every case that the payment was not excludable from income because it was in the nature of severance pay.[17] Petitioners' argument in response to these cases is that in petitioner's particular circumstances he was not told that his position was being eliminated because of downsizing (i.e., since he could have continued to work for IBM the payment could not have been in the nature of severance pay), and that he had instituted discussions with IBM towards reaching a settlement individually on the basis of his possible legal claims and was not part of a retirement program.

Bearing in mind petitioner's arguments, it is appropriate to review in detail one of the Tax Court cases that contains facts similar to the facts in this case. In *Phillips v. Commissioner* (*supra*), Mr. Phillips had been employed by IBM for 28 years. He traveled throughout the world and had been regularly promoted. When he ceased his employment with IBM he was 50 years old. Mr. Phillips had heart problems and at least three major heart attacks which caused him to be absent from work from October of 1971 to March of 1972, January of 1981 until May of 1981, and September of 1989 for ten days. After the last of these heart attacks, Mr. Phillips received no more foreign assignments or promotions. Prior to the end of July in 1982, IBM denied his request to participate in an executive training program which he believed would have been a way for him to have stayed with IBM at the same or a higher level. In May of 1992 Mr. Phillips met with his supervisor and renewed his request for the training program. The

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[17]*See*, *Carey v. Commissioner*, 74 TCM 705; *Hamm v. Commissioner*, *supra*; *Adams v. Commissioner*, 74 TCM 277; *Thorpe v. Commissioner*, 74 TCM 219; *Lubart v. Commissioner*, 74 TCM 223; *Gajda v. Commissioner*, 74 TCM 228; *Phillips v. Commissioner*, supra; *Brennan v. Commissioner*, 74 TCM 69; *Morabito v. Commissioner*, 74 TCM 62; *Keel v. Commissioner*, 73 TCM 3092; *Sodoma v. Commissioner*, 71 TCM 3178; *Webb v. Commissioner*, 71 TCM 2004.

supervisor stated that he would support Mr. Phillip's request but that he was not hopeful it would be approved. Furthermore, he stated that Mr. Phillip's position would likely be eliminated or downgraded and perhaps Mr. Phillips would consider participating in the ITO II Program (Extended Individual Transition Option Program). The supervisor stressed the importance of Mr. Phillips's maintaining his health insurance coverage which he could not promise should he not participate in the retirement program and then have his position terminated after the end of the retirement program. Mr. Phillips, as a condition of receiving his lump sum benefit, also signed a release containing the same provisions as those at issue in the present matter. At the time he signed the release he did not have any pending legal claims against IBM. He did however, believe he had valid claims under the Americans with Disabilities Act (hereinafter "ADA") for emotional distress because of the alleged discriminatory manner in which IBM treated him due to his medical condition. Petitioner reported his grievances orally to his supervisor. The court held that it could be that Mr. Phillip's act of informing his supervisor was some evidence of an existing claim, and that the ADA did provide a range of tort type remedies. Therefore, the court held that for the purpose of the motion petitioner had established a tort type action.[18] However, the court concluded that petitioner had not proven that the payment was made on account of the injuries. The General Release and Covenant Not to Sue released IBM from liability from both tort and contract claims, but did not specifically state that the payment received was in settlement of a personal injury claim. Furthermore, the release appeared to be a standard form for all those participating in the retirement program and the payment was calculated based on Mr. Phillips's length of service and salary. Mr. Phillips, if rehired by IBM, could be required to repay some of

[18]See footnote "16".

the lump sum payment. For all of these reasons the court determined that the payment received by petitioner was more in the nature of severance pay than payment of a settlement claim. Finally, the court stated that in any event the terms of the release did not allocate the payment between tort or contract claims, and Mr. Phillips had made no effort to do so.

As in the *Phillips* case, the question to be decided is whether the payment from IBM to petitioner was in settlement of petitioner's possible personal injury claim or something more resembling severance pay. Like Mr. Phillips, petitioner informed IBM that he was not happy with the conditions of his employment, and based on those conditions he believed he had valid legal claims against IBM. He then began negotiations with IBM with the goal of obtaining a mutually satisfactory agreement that would allow him to leave IBM. Petitioner contends that since his position was not in jeopardy at the time of these negotiations he is in a different situation than other former IBM employees. I disagree. IBM management suggested to Mr. Phillips that he participate in the retirement program available to him because his position would likely be eliminated or downgraded, and if he did not participate in the program and his position was eliminated, he could lose his medical insurance. Petitioner went to IBM to voice his concerns with the treatment he was receiving from IBM and to negotiate a settlement. According to petitioner he initiated these discussions because he knew something was going to happen and had been told that IBM senior management had targeted him for the purpose of attempting to force him out. So, while technically petitioner was not surplused, neither was Mr. Phillips and I can see no major difference between the position petitioner was in and that of Mr. Phillips.

The result of petitioner's negotiations was that petitioner took a leave of absence without pay from January 1, 1994 through March 31, 1994 and retired from IBM on April 1, 1994. He signed the Release stating that he would not file any claims against IBM, and IBM provided

petitioner with a payment equal to a years salary. The results of petitioner's negotiations are not distinguishable from those reached in the *Phillips* case.

Where the documentary evidence does not indicate that a payment is made for purposes of settling a claim, or does not attempt to allocate in any fashion what part of a payment is in settlement of a claim, it is the intent of the payor that controls *(see*, *Stocks v. Commissioner*, *supra* at 10; *Robinson v. Commissioner*, *supra* at 126, 127). As in the *Phillips* case the documents evidencing the payment in the present matter clearly indicate that the payment was more in the nature of severance pay than a payment in settlement of a personal injury claim.

The Release specifically states that the consideration for signing the Release is the benefits received pursuant to the terms of the PSOP. The Release is general in nature in that it includes tort and contract type claims and appears to be the Release IBM required all employees participating in the PSOP to sign. The Release states that petitioner had the opportunity to review the actual terms of the PSOP, a list of job titles and ages of employees eligible to participate in the PSOP and a list of those with the same job classification or organization unit as petitioner who were not eligible to participate. The Release provides that IBM retained the right to repayment of a portion of the lump sum payment should petitioner be rehired by IBM. Petitioner signed a pre-retirement leave of absence where he agreed to retire on April 1, 1994 pursuant to the terms of the PSOP package. The checks received by petitioner indicate that they were a salary advance and both State and Federal taxes were taken out. The calculation sheet submitted by petitioner clearly indicates that the payment was based on 52 weeks salary and was separation pay.[19] There is no indication in the documents that the amount of the payment was in

[19]The exact formula utilized to calculate this payment is unknown, since the actual PSOP plan is not in evidence. However, the provision of the Release requiring repayment of a portion

any way calculated based upon petitioner's personal injuries. There is nothing in any of the documents submitted to indicate that petitioner did anything more than retire under the terms of the PSOP plan. All of these facts indicate that the payor, IBM, understood the payment made to petitioner to be a type of severance pay and not a payment in settlement of a tort type claim. Furthermore, these facts are indistinguishable from those before the Tax Court in the *Phillips* case, and indeed are the facts relied on by that court in reaching the determination that the payment received by Mr. Phillips was not in settlement of a personal injury claim and therefore not excludable pursuant to IRC former § 104(a)(2).

Petitioners argue that they should not be bound by the documents IBM chose to utilize in that they had no control over IBM's choice of documents. However, in attempting to determine the intention of IBM in making the payment at issue, the documents submitted are the only evidence of IBM's intention. The testimony offered, while helpful in determining petitioner's understanding of the lump sum payment, is not helpful in determining IBM's intentions. Furthermore, the Release petitioner signed provides that he relied on nothing more than the terms of the PSOP plan in reaching his determination to execute the Release, making any evidence presented from outside the parameters of that plan even less valuable. Finally, the documents in the record are almost identical to those utilized by the Tax Court in Phillips and the other similar cases. Petitioners did not attempt to explain why such documents should not be utilized in the same manner in this case.

Petitioners presented the circumstantial argument that had petitioner not signed the release pursuant to IBM policy he would only have been able to collect two weeks pay. Therefore, 50

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of the payment upon rehire, indicates that the original payment was calculated using a number of weeks, presumably related to service time.

out of the 52 weeks pay he received must be determined to be payment in settlement of a claim. Petitioners further argue that since petitioner received 52 weeks pay, which was no longer available to IBM employees under separation plans, the payment must have been something other than severance pay. The document petitioners base these arguments on is an internal IBM memorandum. They contend that pursuant to this memorandum, a 52-week separation pay was no longer available and that therefore, petitioner's payment was in settlement of his claim. I am not convinced from reading this memorandum that a 52-week payment was no longer available. The memorandum seems to refer to three types of separation plans. The first is the "Normal Separation Allowance Plan." Effective November 23, 1993 employees retiring pursuant to this plan were required to sign the general release or receive a separation payment equal to only two weeks pay. (It had been previously announced in July that the maximum allowable payment under this plan was the equivalent of 13 weeks pay). The second type of separation plan referred to was individual separation plans. It appears that these were not plans but arrangements made with individuals under some type of general guidelines. As of November 23, 1993 the maximum payment allowable for these individual plans was reduced from 52 weeks salary to 26 weeks. In addition what seems to be a third type of separation plan is mentioned, "certain modified separation plans". Payments made under these plans as of November 23, 1993 could now be "made in conjunction with the Retirement Bridge Leave of Absence." There is no mention of the maximum payment available to those leaving service pursuant to a modified separation plan. Petitioner left IBM pursuant to PSOP. This appears to be a separation plan available to employees of Pennant Services, the Division within which petitioner worked. Since the actual PSOP plan is not in the record, it is not possible to determine whether PSOP was a "Normal Separation Allowance Plan," an individual arrangement, or a modified plan. It appears possible

that payments under a modified plan could have been for more than 26 weeks of pay. It is also possible that the memorandum might not have been applied to those already negotiating a plan prior to its adoption.[20] Petitioners ask that the conclusion be drawn that he could not have left IBM under any plan since he received 52 weeks of salary. However, the documents clearly indicate he retired pursuant to the PSOP plan. Furthermore, petitioners have not proven that the memorandum, as explained, operates as a bar to a 52-week payment.

Petitioner also argues that unlike other salary he received he was not allowed to contribute to his deferred compensation plan or purchase IBM stock and that therefore IBM recognized this was not income. There is no evidence in the record as to IBM payroll procedures, the only evidence is that taxes were withheld. Therefore, whatever the reason that IBM did not allow participation in deferred compensation or stock purchases, it is clearly the understanding of IBM that these payments were subject to tax.

Petitioners allude to the facts that neither the IRS or the State of Connecticut has pursued them for taxes due on the lump sum payment, and that indeed, the Division originally sent them a refund check. The Division provided a detailed explanation as to the background regarding former IBM employees and petitioners' return in particular. The Division received a large volume of refund requests (approximately 2,300) in 1994 from former IBM employees who had received lump sum payments from 1990 through 1993, paid tax on them and were now claiming that the income was excludable from gross income pursuant to IRC former 104(a)(2). The Division contacted the IRS and was informed that the IRS considered these payments includable

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[20]It is noted that while petitioner signed the leave of absence agreement in December of 1993, the date appearing at the beginning of the document is August 4, 1993, which was prior to the date of the memorandum.

in gross income. The Division disallowed all of these refund claims. The Division then determined that it would grant the same relief to these taxpayers as granted on the Federal level. Petitioners in this case followed a different procedural route. Petitioners never had to file a refund claim because they excluded their income on their tax return for 1993. The problem is that petitioners included this income in their gross income and then deducted it when arriving at adjusted gross income. Since petitioners are claiming that the income is excludable from gross income pursuant to IRC former 104(a)(2), it should never have been included in their gross income as reported on their return. Since it was included, their gross income matched their W-2 income and the refund claimed on their 1993 return was issued. It was not until further examination that it was discovered petitioners had deducted an amount equivalent to 50 weeks of the 52-week payment. That discovery led to the issuance of the Notice of Deficiency. I agree with the Division that because of the mistake in petitioners' return, the lump sum payment may have gone unnoticed by the other taxing jurisdictions. In any event, without addressing what if any effect determinations of the other two jurisdictions would have in this matter, petitioners simply failed to prove that either the IRS or the State of Connecticut has made a substantive determination that the lump sum payment at issue was excludable from gross income pursuant to IRC former § 104(a)(2). With regard to the refund originally issued to petitioners by the Division, it is a well established principal that in the interests of efficient tax return processing, it is an acceptable practice to issue refunds prior to an actual audit of the return the refund is based upon (*see*, *Gordon v. United States*, 757 F2d 1157; *Warner v. Commissioner*, 526 F2d 1; *Keel v. Commissioner*, *supra*).

In conclusion, petitioners have failed to prove that petitioner had an underlying tort type claim prior to signing the general release or that the lump sum payment he received was on

account of such claim. Therefore, the lump sum payment must be included in petitioners' gross income for 1993 and is not excludable pursuant to IRC former 104(a)(2) (*see*, *Commissioner v. Schleier*, *supra)*.

D. Finally, even if petitioners had been able to prove a tort type claim and that part of the payment was in settlement of the tort type claim, petitioner has failed to prove any allocation of the payment. The Release signed by petitioner includes certain types of actions where any recoveries or settlements would definitely be required to be included in gross income, such as any recovery under ADEA (*see*, *Commissioner v. Schleier*, *supra*; *Commissioner v. Burke*, *supra*; *Phillips v. Commissioner*, *supra*). That being the express language in the Release, petitioners were required to prove what portion of the claimed settlement payment was made on account of tort like actions that could be excluded from gross income (*see*, *Taggi v. United States*, supra at 96; *Phillips v. Commissioner*, supra).

E. In their petition, petitioners claimed that the Division had not given them proper credit for taxes paid to the State of Connecticut. Petitioners are entitled to a credit for taxes paid to another state (Tax Law § 620). It is again petitioners' burden to prove first of all that taxes were actually paid to the other state. Since petitioners have asserted throughout this matter that they did not pay taxes to the State of Connecticut on the lump sum payments petitioner received from IBM in 1993, petitioners have clearly failed to prove that any such taxes were paid.

F. The petition of Richard G. Delardi and Linda L. Difonzo is denied, and the Notice of Deficiency dated October 31, 1994 is sustained.

DATED: Troy, New York
January 21, 1998

/s/ Roberta Moseley Nero
ADMINISTRATIVE LAW JUDGE