

## NEW § 104 PROPOSED REGS<sup>1</sup>

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In September 2009, the Treasury Department issued Proposed Regulations under Section 104, attempting to reflect the 1996 Act statutory changes. See Prop. Treas. Reg. § 127270-06, available at [http://www.taxinstitute.com/pdfs/Proposed\\_Treasury\\_Regulation\\_Section\\_127270-06.pdf](http://www.taxinstitute.com/pdfs/Proposed_Treasury_Regulation_Section_127270-06.pdf). The Proposed Regulations state that it is not necessary to satisfy the first the test enunciated in *Commissioner v. Schleier*, 515 U.S. 323 (1995). They also state that it is no longer relevant whether the remedial scheme under which the damages were awarded is tort-like in scope.

In effect, the Proposed Regulations say they are reversing the result in *United States v. Burke*, 504 U.S. 229 (1992). According to the Preamble to these Proposed Regulations, after *Burke*, the *Schleier* Court sought to verify the presence of tort or tort-type rights. The effort, said the IRS, was to attempt to ensure that the damages were paid for *personal* injuries.

Since the 1996 Act (post-*Schleier*) made clear that the injury must be *physical* (which by definition must be personal), the Proposed Regulations take the view that there is *no need* for the first part of the *Schleier* test. The Proposed Regulations are proposed to apply to damages received after they are published as Final Regulations. However, taxpayers are allowed to apply these Proposed Regulations currently, generally for damages received after August 20, 1996. Claims for refund for such tax years may even be allowed.

**Comment:** Although this is a liberalizing change which is welcome, the practical impact may not be too significant. In fact, few taxpayers were tripped up by the tort or tort-type rights test. If taxpayers have a problem, it is usually with the “on account of” and “physical” issues. Unfortunately, the Proposed Regulations do not seek to explain what constitutes a physical injury or physical sickness.

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<sup>1</sup> Excerpted from *Taxation of Damage Awards and Settlement Payments* (4th Ed. 2009) by Robert W. Wood, available at [www.taxinstitute.com](http://www.taxinstitute.com).