Beware of the Tax Bump

By Captain Samuel F. Wright, JAGC, USN (Ret.)

1.8—Relationship between USERRA and other laws/policies
6.0—Military service and tax laws

Q: I am the Army National Guard Captain that you discussed in Law Review 13104, the immediately preceding article.¹ My attorney used your points and the authorities you cited to persuade the defendant Daddy Warbucks Industries (DWI) to increase the offer from $100,000 to $200,000, plus DWI agreed to pay my attorney fees, so I got the whole $200,000. (I used $600 of that money to become a life member of ROA.) I took the settlement and rejoiced, but then I visited my Certified Public Accountant (CPA). He told me that because I received the $200,000 in calendar year 2013 I will have to pay federal income tax on the entire amount in this year.

This is not fair. The $200,000 (on top of my other 2013 income) puts me in the very top tax bracket. As you pointed out in Law Review 13104, I am receiving this money in 2013 in lieu of money that I should have received over the last four years and the next 20.

There ought to be a law that permits me to average out this $200,000 payment over past and future years, so that I don’t take this huge tax hit for a one-time payment that will not recur.

A: Yes, there ought to be a law, but there is a big difference between “there ought to be a law” and “there is a law.” Under the Internal Revenue Code as currently written, you are going to have to pay federal income tax on the entire $200,000 payment in 2013, and this will put you in a much higher tax bracket.

On June 26, 2013, Representative John Lewis of Georgia introduced H.R. 2509, the proposed Civil Justice Tax Fairness Act of 2013. The bill has seven cosponsors so far, and it was referred to the House Ways & Means Committee. On the same date, Senator Benjamin Cardin (Maryland) introduced an identical bill (S. 1224) in the Senate. Senator Cardin’s bill has one cosponsor so far and was referred to the Senate Finance Committee.

¹ We invite the reader’s attention to www.servicemembers-lawcenter.org. You will find 928 articles about laws that are especially pertinent to those who serve our country in uniform, along with a detailed Subject Index and a search function, to facilitate finding articles about very specific topics. Captain Wright initiated this column in 1997, and we add new articles each week. We added 122 new articles in 2012, and we have added another 105 articles so far in 2013.
Here is the Congressional Research Service (CRS) summary of these bills: “Amends the Internal Revenue Code to allow: (1) an exclusion from gross income for amounts received (whether by judgment or settlement, as lump sums or periodic payments) on account of a claim of unlawful discrimination; (2) income averaging for backpay and frontpay amounts received from such claims; and (3) an exemption from the alternative minimum tax (AMT) for any tax benefit resulting from the income averaging of amounts received from an unlawful discrimination claim.”

We favor these bills, and we will push for enactment. If enacted, these bills would favorably affect the tax treatment of settlements and judgments under many different federal and state statutes that regulate the employer-employee relationship, but USERRA is definitely on that list.

**UPDATE March 2017**

Please see [Law Review 17022](March 2017) for further developments on this issue.