

Letters to the Editor

DECEMBER 5, 94

THE TAX TREATMENT OF 'GOLDEN HANDSHAKES.'

To the Editor:

I read with interest Lee Sheppard's article concerning age discrimination recoveries, and particularly the situation involving IBM's "golden handshakes." See Sheppard, "The Tax Treatment of IBM's Golden Handshakes," Tax Notes, Nov. 21, 1994, p. 946. Ms. Sheppard correctly notes that the substantive question of whether ADEA recoveries are included within the section 104 exclusion is slated to be decided by the Supreme Court. What concerns me is her suggestion that the consensual element of the IBM situation (or any other situation not involving a lawsuit) makes a claim of age discrimination by former employees somehow suspect.

I am not involved in any way with the IBM situation. However, I have seen employees depart other employers receiving either a negotiated or a "take it or leave it" payment where a release is signed. Ms. Sheppard suggests that "[i]t is imperative that the former IBM employees establish that the surrounding circumstances show age discrimination outside of the release." *Id.* at p. 949. Actually, it should be sufficient to show that: (1) the employer perceives that it might have ADEA exposure; (2) the employee perceived that he or she has an age discrimination claim; and (3) the payment (or at least part of it) would not have been made but for the risk of ADEA exposure. The same kind of analysis can be made for wrongful termination or Title VII claims.

The first two elements of this obviously go toward perceptions, not toward whether a claim actually exists. On the other hand, from both employer and employee perspectives, there presumably would be no perceptions about ADEA claims unless there was some evidence of the claims. I think this is a lower standard, though, than the substantive presence of a claim. To put it another way, if a lawsuit actually is filed for an ADEA violation, and a small settlement eventually is paid because of the nuisance value of the suit even though a strong ADEA claim is not present, there seems no principled reason why that recovery should be treated any differently than a large settlement for a more glaring ADEA violation. In both cases, the settlement agreement almost certainly will assert that the employer admits no liability.

Returning to the first and second elements above, I think both parties' perceptions are important because the case law (concerning the taxability of ADEA recoveries as well as the tax treatment of a variety of other types of payments) has stressed that the intent of the payor and the payee is relevant. This may well be one of the reasons that courts often pay close attention to what a settlement document says, even though (as Ms. Sheppard points out) there often are no adverse tax interests between payor and payee.

As to my third element above, I would apply a kind of causal analysis to why the payment is made. In the case of IBM, Ms. Sheppard notes that IBM had no severance policy. In my experience, this is a critical element. If one looks to causation, it cannot be said that a payment is made on account of an ADEA claim if the employer's normal severance policy would require that the payment be made in any case. Since apparently there was some evidence that IBM was concerned about ADEA exposure (and in fact, as Ms. Sheppard points out, IBM had lost an ADEA suit previously), the critical element well may turn out to be this third point. Just how much employees received -- even employees who had no shred of an ADEA claim -- would be important. Even if there is not a formal severance policy, payments to nonclaimants could help support the IRS.

Ms. Sheppard makes the point in conclusion that "[c]ourts cast a jaundiced eye on self-serving settlement agreements." I disagree. Whether settlement agreements generally are self-serving probably could be debated. However, I think most courts have given substantial weight to settlement agreements, inasmuch as the language in the settlement agreement manifests the intent of the parties. While neither the IRS nor the courts are bound by the language in the settlement agreement or the parties' characterization of the payments, the settlement agreement goes a long way toward resolving the issue, both at the agent level, in appeals, and in the courts.

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Unfortunately, even after the Supreme Court determines whether ADEA damages are excludable, there will be many controversies in this inherently factual area. For example, although the excludability of Title VII damages for gender and racial discrimination now has been resolved, day-to-day controversies about whether someone has a claim when he settles with his employer and sign a release continue to arise. There probably is no formula for dealing with all of these issues.

Very truly yours,

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[Editor's note: Mr. Wood is the author of Taxation of Damage Awards & Settlement Payments (Tax Institute 1991, with 1994 Supplement).]