

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 202

June 29, 1957

GROSS INCOME: SICK LEAVE BENEFITS

Syllabus:

For periods prior to 1955 all sick leave benefits are excludible from gross income if they are paid under a formal plan. For 1955 and later years only benefits resulting from employee contributions are deductible. For all years no exclusion is allowable as to benefits attributable to medical expense deductions claimed in prior years.

Section 22(b)(5) of the 1939 Internal Revenue Code provides that gross income does not include ". . . amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness . . ." In *Haynes v. U.S.*, 353 U.S. 81, 77 S.Ct. 649, L. ed., the United States Supreme Court held that Section 22(b) (5) authorized the exclusion from gross income of amounts received as compensation for personal injury or sickness irrespective of whether the payments were made under an accident or health plan maintained or financed entirely by the employer or whether they were paid by a private company under a conventional insurance plan. This decision overrules the Internal Revenue Service position that payments from a self-insured plan of the employer did not qualify for the exclusion. See I.T. 4107, C.B. 1952-2, pg. 73; Press Release I.R. 047.

Since Section 17127 of the 1953 Personal Income Tax Law is identical with Section 22(b)(5) of the 1939 Internal Revenue Code, the *Haynes* decision is fully applicable to it. *Appeal of Mary Ann Lydon*, State Board of Equalization, decided June 12, 1957. In the case of employer-maintained plans, there is no requirement that employer maintain a definite fund out of which payment is made, however, there must be a formal written health or disability plan requiring the payments in existence at the time of the sickness or personal injury. Benefit payments which are discretionary on the part of the employer do not qualify for the exemption.

Effective for taxable years beginning on and after January 1, 1955, Sections 17138(a)(3) and 17140 of the Personal Income Tax Law make the following provision for the exclusion of sick leave payments:

Section 17138(a)(3):

Amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such

amounts (A) are attributable to contributions by the employer which were not included in the gross income of the employee, or (B) are paid by the employer);

Section 17140:

Gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for personal injuries or sickness.

These sections are the equivalent of Sections 104(a)(3) and 106 of the 1954 Internal Revenue Code. Section 106 (our Section 17140) excludes employer contributions from the employee's gross income. Section 104(a)(3) (our Section 17138(a) (3)) accordingly, removes employer financed health and accident plans entirely from the operation of the section. This was done so that under Federal law the benefits payable in such cases could be treated uniformly under Section 105. Since the California Legislature did not adopt a section equivalent to Federal Section 105, the only exclusion in our law is that contained in Section 17138(a) (3).

Federal Regulation 1.104-1(d), which interprets Section 104(a)(3), shall be used to determine the area in which Section 17138(a)(3) operates. In brief for 1955 and later years only benefits resulting from contributions by the employee are excludible. For all years no exclusion can be allowed for benefits attributable to medical expense deductions claimed in prior years.