

# Government Rescues Emergency Responders

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***Abstract:** This case provides introductory tax students with the opportunity to research tax authorities and to apply a new provision of the Tax Code to compute a client's taxable income.*

## BACKGROUND

Our memories of the professional firefighters and other emergency personnel who responded to the September 11 disaster remain vivid. Although emergency service providers have always been appreciated, the current climate is for Americans to express our gratitude in tangible ways. We have honored emergency responders with many tributes, including parades, memorials, and plaques, as well as financial awards.

Section 61 of the Internal Revenue Code, as amended, provides that, “[E]xcept as otherwise provided in this subtitle, gross income means all income from whatever source derived....” This section of the Code is a powerful force which operates to classify all benefits as taxable unless Congress authorizes a legislated exclusion.

Section 74 of the Internal Revenue Code, as amended, provides that, as a general rule, except as otherwise provided in the Code, gross income does include amounts received as prizes and awards. Those exceptions occur in the case of a qualified scholarship or when the prize is in recognition of “religious, charitable, scientific, education, artistic, literary, or civic achievement, but only if –”

1. The recipient was selected without any action on his part to enter the contest;
2. The recipient is not required to render substantial future services; and
3. The prize or award is transferred directly to a qualifying charitable organization.

Applying the language of Section 61, compensation and awards paid to professional responders as compensation for services are clearly taxable. However, when localities reward their *volunteer* emergency service workers (e.g. firefighters, EMTs) by providing discounts on their tax bills, the question arises as to whether or not these benefits are taxable.

## LEARNING OBJECTIVES

After completing this project successfully, you will have demonstrated the following abilities:

1. To locate primary authorities in the Internal Revenue Code;
2. To evaluate how multiple sections of the Code relate to each other;
3. To develop a tax position for your client; and
4. To compute your client's tax liability for the year.

## CLIENT MEETING

The following is a transcript of the conversation during a meeting between client Susan Fast and yourself (J. Wright, CPA) at the offices of your accounting firm.

**J. Wright:** “Good morning, I’m J. Wright. Thank you for meeting with me today.”

**Susan Fast:** “Susan Fast. I’m pleased to meet you. You were recommended to me by one of the doctors at the hospital.”

**J. Wright:** “Tell me how I can help you.”

**Susan Fast:** “I am looking for help with filing my taxes this year. I’ve always completed the returns myself, but this year I have received benefits that I don’t know how to report.”

**J. Wright:** “Do you have information regarding those benefits with you?”

**Susan Fast:** “Yes. The information is in a letter from Rocktown County. The County has provided a \$500 abatement on my \$3,000 annual property tax bills as a reward for my serving as an EMT in the County. In addition, I have received \$25 per month as reimbursement from the County for fuel costs for my car to travel to the station and emergency calls.”

**J. Wright:** “Tell me what you do for the County.”

**Susan Fast:** “I am a volunteer Emergency Response Technician. Some of the other nurses at the hospital asked me to join the team at the local fire station. Because my mother has moved to Florida, I find I have the time to help out in this way.”

**J. Wright:** “It’s good to know folks like you are on call for our emergencies. Let me personally thank you for those services. I had a car accident in town last year. There were no serious injuries, but the response time was great. Susan, I need a few minutes here to look over this letter. [J takes the time to look over what Susan has given him and buzzes for his assistant to come into his office.] Susan, we will make some copies of the paperwork you have brought with you today. The tax abatement question will take a little research. I’ll also need more information from you for the rest of the return. Do you have any sources of income in addition to your salary?”

**Susan Fast:** “Yes. I have a savings certificate that I purchased on line.”

**J. Wright:** “That bank will either send you a Form 1099 or post one on line for you to access. We will need to report interest income earned on that account.”

**Susan Fast:** “The certificate earned \$2,000 last year. I can get you a copy of my December statement showing interest for the year.”

**J. Wright:** “This notice of an abatement that you brought with you today is for your real estate taxes. So, you own your own home? Is it a single-family home? Did you pay mortgage interest expense this year?”

**Susan Fast:** “Yes, it’s a single family home in the residential community out by the lake. I do have a mortgage that I assumed from my mother when I purchased the property from her after my father passed away. The interest payment is automatically deducted from my checking account each month. I have a Form 1098 with me stating that interest expense paid

last year was \$12,000. I also paid \$2,400 for utilities this year for my home and \$30 per month for snow removal and lawn care.”

**J. Wright:** “Running a household can be very expensive, can’t it? Susan, what other paperwork do you have with you today?”

**Susan Fast:** “I have my Form W2 from the hospital reporting \$50,000 in wages, Federal income tax withholdings of \$4,000, and \$1,200 in state income tax withholdings.”

**J. Wright:** “Did you get a state refund last year?”

**Susan Fast:** “No, unfortunately I had to send the state an extra \$100.”

**J. Wright:** “Give me a minute to run through my checklist here. Did you make any charitable contributions this year in addition to your volunteer services for the County?”

**Susan Fast:** “Yes. I wrote out two checks. One for \$500 to my church and another for \$500 to the hospital’s capital fund drive for new equipment.”

**J. Wright:** “Do you own any other property besides your car and home?”

**Susan Fast:** “No. But I do provide more than 50 percent of the support for my mother who is living in a small apartment in a retirement community in Miami. My mother’s only source of income is her Social Security benefit and \$2,400 of interest from a savings account.”

**J. Wright:** “Do you have any additional questions or concerns at this point?”

**Susan Fast:** “No. I do have to get back to the hospital. I’ll drop off the information you requested sometime next week.”

**J. Wright:** “If you prefer to leave your check register with me for a couple of days at the same time, I will scan it for other possible deductible items. A copy of last year’s return would be extremely helpful, as well. Also, any letters from the two charities acknowledging your contributions should be kept along with your other documents for this tax year.”

**Susan Fast:** “Thank you. You certainly have given me a lot of homework!”

**J. Wright:** “I look forward to seeing you again, Susan. We’ll give you a call in a few weeks.”

### SUMMARY OF CLIENT FACTS

Ms. Fast’s question to you as her tax advisor is whether or not she has to pay Federal income tax on the property tax exemption (abatement) she receives from the County on her tax bill. Her real estate and personal property taxes would total \$3,000 (\$2,850 for real estate property taxes and \$150 for personal property taxes on her car) if she did not receive a \$500 discount on her real estate taxes as a reward for her services to the County. In addition, the County pays her \$25 per month as reimbursement for out-of-pocket expenses, including the costs of fuel for her car to travel to the station and respond to emergencies. Susan Fast is unmarried and works as a nurse at the local hospital. She provides more than 50 percent of the financial support of her mother who lives in a studio apartment in Florida and receives Social Security benefits.

### STUDENT REQUIREMENTS

This is a two-part research project. To complete the project, you must research the Tax Code to determine whether or not certain benefits received by your client are taxable. Once this determination is made, you must compute the taxpayer's taxable income for the year based on the facts revealed during the client meeting. Please report these amounts in the following template:

INCOME (ALL INCLUSIVE CONCEPT)	\$	_____
EXCLUSIONS		_____
GROSS INCOME		_____
DEDUCTIONS FOR ADJUSTED GROSS INCOME		_____
ADJUSTED GROSS INCOME		_____
DEDUCTIONS FROM AGI		_____
EXEMPTIONS		_____
TAXABLE INCOME	\$	_____

### REFERENCES

All references are to the Internal Revenue Code of 1986, as amended.

*Teaching Note/Instructor Manual available from the Journal of Business Cases and Applications.*