Unraveling The "In Lieu of What" Test: Title VII Employment Discrimination Damages and the Personal Injury Exclusion

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UNRAVELING THE "IN LIEU OF WHAT" TEST: TITLE VII EMPLOYMENT DISCRIMINATION DAMAGES AND THE PERSONAL INJURY EXCLUSION


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I. INTRODUCTION

The Internal Revenue Code excludes from gross income damages received for personal injuries.1 However, neither the tax code nor its legislative history define what "personal injury" means in this context. The only guidance provided to courts when applying the personal injury exclusion is a treasury regulation that interprets personal injury damages as "an amount received through prosecution of a legal suit or action based on tort or tort type rights."2

The Tax Court has used one of two tests to determine whether

damages received by a taxpayer were for personal injuries. One test looks at the nature of the recovery and asks, "in lieu of what were the damages awarded?"\(^3\) The other test looks at the nature of the injury and asks whether the damages received redress a tort-type, personal injury.\(^4\)

In *United States v. Burke*,\(^5\) the United States Supreme Court chose to apply the first test to a settlement received for a Title VII claim. The majority held that back pay received by employees in a gender discrimination suit was not received as damages for personal injuries. The Court reasoned that if the wages had been properly paid in the ordinary course of business, they would have been fully taxed.\(^6\)

The dissent in *Burke* applied the second test and examined whether the employees' claim was based on a tort or tort-like cause of action. The dissent concluded that the damages received should be excluded from gross income because Title VII offers a tort-like cause of action to employees who suffer employment discrimination.\(^7\)

This Comment focuses on the scope of and the justification for the tax code's personal injury exclusion and its application to specific cases. This Comment then briefly describes Title VII and the amendments made by the Civil Rights Act of 1991. This Comment criticizes the Supreme Court's decision in *United States v. Burke* and proposes that the proper analysis for determining whether the personal injury exclusion applies is to examine the underlying claim so that injured taxpayers are treated similarly and tax policies are followed consistently.

## II. BACKGROUND OF INTERNAL REVENUE CODE § 104(a)(2)

### A. Scope and Justification of the Personal Injury Exclusion

The passage of the Sixteenth Amendment in 1913\(^8\) gave the federal government the power to assess taxes on individuals and corporations without regard to apportionment among the states.\(^9\) Tax

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6. *Id.* at 1874.
7. *Id.* at 1881 (O'Connor, dissenting).
9. The Sixteenth Amendment confers on Congress the power to tax United States citizens on the basis of income: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

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assessments are measured according to income and rely on the premise that income is an adequate basis for estimating one’s ability to contribute to the cost of providing public services such as national defense, poverty relief, and public parks. What actually constitutes income has been an issue since the first tax was assessed, and the controversy over income tax assessment continues today.

The Internal Revenue Code (Code) includes in gross income “all income, from whatever source derived.” Courts define gross income as all “undeniable accessions to wealth, clearly realized, over which the taxpayers have complete dominion.”

Yet some sources of income are excepted from the broad umbrella of “gross income.” For example, the Code does not include in gross income interest earned on state and local bonds, or the value of property acquired by gift, bequest, devise, or inheritance. Also excluded from gross income is “the amount of any damages received on account of personal injuries or sickness.” Under § 104(a)(2), personal injury damages are tax free whether they are received from a judgment or settlement, in a lump sum or by peri-

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10. See generally Klein, et al., Federal Income Taxation 16-18 (8th ed. 1990) (offering other possible methods on which to base taxation and discussing why income is used as the basis for imposing a tax rather than some other measure).

11. A tax based solely on income was controversial because the Constitution disallowed a direct tax on the people. See U.S. Const. art. I, § 2, cl. 3.

The first income tax was passed as an emergency measure to raise revenue following the Civil War but was repealed in 1872. Jerold L. Waltman, Political Origins of the U.S. Income Tax 3 (1985). The second income tax was passed as an amendment to a tariff bill and was subsequently ruled unconstitutional in 1894 in Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 637 (1895). The Pollock Court traced the income tax to a tax on land. Equating a land tax to a direct tax, the Court ruled that the income tax had to be apportioned among the states to be valid. Id. at 637. With the ratification of the Sixteenth Amendment in 1913, all constitutional barriers were removed and the income tax became purely a political issue. See John F. Witte, The Politics and Development of the Federal Income Tax 79 (1985); see generally Scott G. Crowley, Note, The Effects of the Sixteenth and Seventeenth Amendments in Changing the Role of the States in the Federal System 1989 B.Y.U. L. Rev. 145 (1989).


odic payments. If received in a settlement, the nature of the underlying claim determines whether the payment is excluded.

Personal injuries can result in physical harm such as a broken leg or nonphysical harm such as damage to one's reputation. If a personal injury results in physical harm all compensatory damages—including lost wages—are excludable. Thus, if a taxpayer is involved in an automobile accident and recovers damages for lost wages, pain and suffering, and medical bills, the entire amount is excludable.

Even though the Code makes no distinction between physical and nonphysical personal injuries, the application of § 104(a)(2) has been problematic where a personal injury results in nonphysical harm. Damages for nonphysical personal injuries such as breach of a contract to marry, alienation of affections or surrender of custody of a minor child, loss of consortium, wrongful death, and improper termination of employment have been excluded from income. Courts have difficulty with claims for defamation, alternately denying and allowing damages to be excluded. Whether damages resulting from civil rights violations may be excluded has also been a troubling issue for courts.

By excluding from income damages received for personal injuries, Congress continues a policy it began in 1918. The exclusion is not based strict tax logic, which assumes that all income, however real...

18. Id.
19. Seay v. Commissioner, 58 T.C. 32, 37 (1972) (holding that the nature of the claim settled and its validity determines whether a settlement payment is exempt from taxation).
27. See Roemer v. Commissioner, 79 T.C. 398, 408 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983); see also infra text accompanying notes 44-48.
28. See Church v. Commissioner, 80 T.C. 1104, 1110 (1983); see also infra text accompanying notes 49-52.
29. See infra notes 72-76.
30. See Revenue Act of 1918, Pub. L. No. 65-254, § 213(b)(6), 40 Stat. 1057, 1066 (1919). As the predecessor of the current § 104(a)(2), § 213(b)(6) excepted from gross income "[a]mounts received ... as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness." Id.; see generally Daniel C. Knickerbocker, Jr., The Income Tax Treatment of Damages: A Study in the Difficulties of the Income Concept, 47 Cornell L.Q. 429 (1962).

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ized, is taxable. Rather, the rationale for the personal injury exclusion rests on the humanitarian desire to not further burden those already injured.

Precisely because this exception rests on public policy and because public policy is susceptible to a myriad of interpretations, the provision has resulted in difficult and inconsistent applications to claimants. *United States v. Burke* illustrates the inconsistency and the interpretive dilemmas faced by the Tax Court and circuit courts on the issue.

**B. The Tax Court’s Application of the Personal Injury Exclusion**

Neither the tax code nor its legislative history defines when a claimant is deemed to have received damages for a “personal injury.” The treasury regulation interpreting the personal injury exclusion refers to those damages received for a violation of “tort or tort type rights.” Based on this interpretation, courts distinguish between tort-based and contract-based rights when applying the personal injury exclusion. For example, the Tax Court has held that whether damages received by an employee for wrongful termination are excluded depends on the basis of the claim. If based on contract rights, the damages are included in gross income, but, if based on tort rights, the damages are excluded.

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32. See Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429 (1955). The idea that if based on strict tax logic all damages would be taxed as income is implicit in an early Solicitor’s opinion. See Sol. Op. 24-20-997, 1920-2 C.B. 71. This early opinion held that alienation of affections is not within the exemption (then § 213). *Id.* The opinion concluded that, although a personal injury, alienation of affections is not a reduction of the kind of capital one holds in the human body. (If the alienation of affections had resulted in sickness, the Solicitor would have awarded damages.) *Id.* at 72.

The Solicitor’s characterization of the section as an “exemption” for damages illustrates that tax logic would burden the damages with a tax. To “exempt” is to excuse something from its obligation. BLACK’S LAW DICTIONARY 571 (6th ed. 1990). Section 104(a)(2) excepts from income damages received for personal injury altogether, so they are never obligated to be taxed in the first place. I.R.C. § 104(a)(2) (1992).

33. Berkowitz, supra note 31, at 346; see also Roemer v. Commissioner, 716 F.2d 693, 696 (9th Cir. 1983) (citing with favor Bernard Berkowitz & Andrew M. Greenstein, Note, *Taxation of Damage Recoveries from Litigation*, 40 CORNELL L.Q. 345 (1955)). Other justifications for the personal injury exclusion include: the plaintiff is merely made whole by the receipt of damages; the damages constitute a return of capital; determining which portion of damages would be tax-free is too difficult; and the damages compensate the taxpayer for a loss of rights that could have been exercised tax-free. Robert J. Henry, *Torts and Taxes, Taxes and Torts: The Taxation of Personal Injury Recoveries*, 23 HOUS. L. REV. 701, 724-29 (1986); see also Jennifer J.S. Brooks, *Developing a Theory of Damage Recovery Taxation*, 14 WM. MITCHELL L. REV. 759, 763-86 (1988).


1. From the "In Lieu of What?" Test

Until the mid-1980s, the Tax Court's "in lieu of what" test served as the standard for determining whether damages received for non-physical personal injuries could be excluded from income.36 Under this test, damages received for a personal injury are included if received in lieu of lost income or wages.37 The Tax Court used this standard in cases involving defamation,38 breach of employment contracts,39 and cases involving Title VII employment discrimination.40

The Tax Court did not, however, consistently apply the "in lieu of what" test. In Roemer v. Commissioner,41 a taxpayer attempted to exclude from income damages received in a defamation suit. Roemer, who worked in the insurance industry, claimed a credit agency defamed him in a report sent to an insurance company as part of an application for an agency license.42 Roemer was not allowed to exclude the damages he received because the injury was to his professional reputation and hence was not a personal injury.43 The Tax Court reasoned that the damages were in lieu of lost professional compensation and thus should be included as income.44


37. Id. at 87-88. This tax inclusion test was historically used in the corporate setting. If damages received by a business were awarded in lieu of lost profits, they were taxed as regular earnings. Id. at 87. If damages were received for something other than lost profits, they were taxed at the more favorable capital gains rate. Id.

38. See, e.g., Roemer v. Commissioner, 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983).

39. See, e.g., Fono v. Commissioner, 79 T.C. 680 (1982) (holding that amounts received in lieu of a breached employment contract were includable because received in lieu of wages the employee would have received), aff'd, 749 F.2d 37 (9th Cir. 1984); Glynn v. Commissioner, 76 T.C. 116 (1981) (holding that damages received for breached employment contract were to be taxed because received in lieu of lost compensation), aff'd, 676 F.2d 682 (1st Cir. 1982).

40. See, e.g., Hodge v. Commissioner, 64 T.C. 616 (1975). Hodge involved a truck driver who was denied a promotion because of his race. Id. at 617. Under a Title VII claim, Hodge recovered the back pay he would have received absent the discriminatory conduct. Id. at 616. Because this back pay was received in lieu of wages, which would have been included in gross income and taxed, he had to include the damage award as well. Id. at 619.

41. 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983).

42. Id. at 399-401.

43. Id. at 405-06.

44. Roemer v. Commissioner, 79 T.C. 398, 410 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983). In a lengthy dissent, Judge Forrester offered an alternative method of analyzing whether the damages received by Roemer for defamation should be taxed.
That same year, a taxpayer with facts similar to Roemer was allowed to exclude damages received for a defamation claim. In Church v. Commissioner, the taxpayer was allowed to exclude all damages received for defamation despite the fact that at least part of the loss was to his professional reputation. The court distinguished Church from Roemer solely on the basis of Church's artfully drafted claim, which stated that the injury resulting from the defamation included "shattered dreams, ruined careers, and the mental anguish that . . . [is] just as personal as . . . loss of limb."

2. To the Underlying Claim Test

In 1986, the Tax Court in Threlkeld v. Commissioner rejected the "in lieu of what" test articulated in Roemer. Like Roemer, Threlkeld involved a defamation suit and injury to personal and professional reputation. Unlike Roemer, the Tax Court held that there was no valid distinction between damages received for injury to personal reputation and damages received for injury to professional reputation. Rather, the court looked at the origin and character of the claim to determine whether the underlying injury was personal. The court reasoned that this test more accurately reflected the plain meaning of the Code. Because defamation is a personal injury as defined by Judge Forrester argued that the "proper inquiry [was] whether the injury sought to be redressed [was] one to reputation, at all, or only to one's occupation." Roemer, 79 T.C. at 412 (Forrester, J., dissenting).

In determining whether an injury is to reputation or occupation, Judge Forrester outlined an eight factor approach:

(1) whether the statements made were directed at the person or the occupation; (2) the geographic region the statements were made in relation to the person's business; (3) the nature of the occupation; (4) the nature of the action under local law; (5) the relief sought; (6) the arguments presented to the jury; (7) the evidence presented to the jury; and (8) how the damages were classified (if at all).

Id. See also Palmer, supra note 37, at 101-03 (applying Judge Forrester's eight factor analytical structure to the facts in Threlkeld v. Commissioner, 87 T.C. 1294 (1986), and reaching the same result without the inherent structural weaknesses in the majority's opinion).

45. 80 T.C. 1104 (1983).

46. Id. The taxpayer in Church was the Attorney General for the State of Arizona. He claimed to have been defamed by the newspaper the Arizona Republic. Id. at 1105-06.

47. Id. at 1108. The disparate results from essentially the same complaints illustrates that using the "in lieu of what" test to analyze personal injury claims and § 104(a)(2) is inappropriate.

48. Id. at 1109.

49. 87 T.C. 1294 (1986), aff'd, 848 F.2d 81 (6th Cir. 1988).

50. Id.

51. Id. at 1298.

52. Id.
state law, the damages received were excluded from gross income.53

Again in 1986, the Tax Court focused on the underlying nature of the claim involved in Bent v. Commissioner.54 In Bent, a teacher was not rehired after publicly criticizing the school administration.55 The teacher alleged a violation of his First Amendment right to free speech and brought suit under 42 U.S.C. § 1983.56 Because Bent's claim involved a violation of personal rights resulting in personal injury, the back pay received as damages was excluded from Bent's gross income.57

One year later, the Tax Court examined the nature of the claim in a Title VII suit. In Metzger v. Commissioner,58 a college professor who was denied tenure alleged discrimination under Title VII and breach of contract.59 Using the Bent analysis, the Tax Court characterized a Title VII claim as a tort-type right and held that damages received were excludable under § 104(a)(2).60

3. And Back, in Part, to the "In Lieu of What?" Test

In the same year Metzger was decided, the Tax Court reverted to the "in lieu of what" test. In Thompson v. Commissioner,61 the taxpayer brought a sex discrimination suit against her employer under Title VII and the Equal Pay Act. The Tax Court held that back pay awarded under the Equal Pay Act was not in the nature of damages for a tort or tort-type right, but rather was in the nature of damages for a contract right.62 Because the employee received her damages as back pay in lieu of wages, which she would have earned absent the discrimination, the damages were included as taxable income.63

However, the Tax Court did allow Thompson to exclude liquidated damages received under the Equal Pay Act. The court found that the liquidated damages, measured by the back pay due, compensated the employee for the personal injury of sex discrimination.64

53. Id. at 1307-08.
54. 87 T.C. 236 (1986), aff'd, 835 F.2d 67 (3d Cir. 1987).
55. Id. at 238-39.
56. Id. at 240.
57. Id. at 249.
59. Id. at 837-39.
60. Id. at 851. The contract damages, however, were not excludable from Metzger's gross income. Id. at 857.
63. Thompson, 89 T.C. at 648.
64. Id. at 649-50.
Although intangible and difficult to measure, the court held the injury resulted from unfair wages and the damages were thus excludable.  

C. The Circuit Courts' Application of the Personal Injury Exclusion

Three circuit courts look at the underlying claim when determining whether damages received qualify for the personal injury exclusion. One circuit court uses the "in lieu of what test." The Third Circuit in 1987 affirmed the Tax Court's holding in Bent v. Commissioner and agreed that the issue of whether damages may be excluded requires the court to examine the nature of the underlying claim. The court held that because the nature of the injury in a § 1983 claim was personal, the entire amount of the award received could be excluded from the taxpayer's income. The court further held that even the portion of the amount that represented lost wages was excludable because "an award of damages for the violation of a constitutional right may be measured in whole or in part by the amount of lost wages."

The Sixth Circuit in 1988 adopted the underlying claim test and affirmed the Tax Court's decision in Threlkeld v. Commissioner. The Tax Court had based its inquiry on whether the underlying injury was personal in nature. The Sixth Circuit agreed that this was the proper inquiry and further found that the underlying injury was personal. Because all damages were received due to a personal injury, they could be excluded from the taxpayer's gross income.

The Ninth Circuit in 1983 also applied the underlying claim test

65. Id. at 650.
66. These circuits are the Third, Sixth, and Ninth Circuit Courts of Appeal.
67. See infra notes 85-87 and accompanying text.
68. 835 F.2d 67 (3d Cir. 1987).
69. Id. at 70.
70. The Tax Court and the Third Circuit looked to recent United States Supreme Court decisions where the fundamental nature of the claim also indicated that the injury was personal in nature and concluded that the § 1983 claim in Bent was for a personal injury. See Memphis Community Sch. Dist. v. Stachura, 477 U.S. 299 (1986) (holding that lost earnings are a portion of compensatory damages for personal injuries of mental anguish and emotional distress); Wilson v. Garcia, 471 U.S. 261 (1985) (determining that every cause of action under § 1983 results from personal injury); Mitchum v. Foster, 407 U.S. 225 (1972) (providing a historical overview of 42 U.S.C. § 1983).
71. Bent, 835 F.2d at 70.
72. 848 F.2d 81 (6th Cir. 1988).
74. Threlkeld, 848 F.2d at 84.
75. Id.
and overturned the Tax Court's decision in *Roemer v. Commissioner.* The court stated that the relevant distinction was whether the injury was personal or nonpersonal, not physical or nonphysical. Analyzing Roemer's defamation claim under relevant state law, the court found the claim to be one for a personal injury. Although lost future earnings—a nonpersonal consequence of the injury—was the measure of damages, the court refused to define the personal nature of the injury by the method used to measure its effect. The court held that because the resulting injury was personal, the damages were excludable under § 104(a)(2).

Departing from the approach of these three circuits, the Fourth Circuit in 1989 upheld the Tax Court's application of the "in lieu of what" test in *Thompson v. Commissioner.* The Fourth Circuit recognized that sex discrimination suits are tort actions and that damages received in such suits are received for a personal injury. The court went on, however, to conclude that because the back pay would have been taxed if received as wages, the award was taxable because the wages would have been taxable.

III. TITLE VII AND EMPLOYMENT DISCRIMINATION

A. Background of Title VII

Title VII of the Civil Rights Act provides a cause of action to an employee who has been the victim of an employer's discriminatory

76. 716 F.2d 693 (9th Cir. 1983).
77. Id. at 697.
78. Id. The court turned to California law because "there is no general federal common law of torts ... nor controlling definitions in the tax code." Id. (citations omitted).
79. Id. at 699.
80. Id. at 700.
81. 866 F.2d 709 (4th Cir. 1989).
82. Id. at 712.
83. Id.
Title VII provides that it is an unlawful employment practice:
(1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, condition, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or
(2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.

Id.
85. Title VII applies to an employer "engaged in an industry affecting commerce who has fifteen or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year." 42 U.S.C. § 2000e(b)
Congress intended Title VII to eliminate overt discrimination, as well as practices that appeared fair in form but were discriminatory in practice. It was Congress' intent that Title VII be the vanguard for eliminating employment discrimination throughout the nation.

Under Title VII, some discrimination by employers is allowed. Employers may discriminate using a system that measures earnings by quality or quantity of production, by using a professionally developed ability test, or because employees work in different locations. These discriminatory practices do not violate Title VII provided the employer has no intent to discriminate. Judicially created exceptions, such as a bona fide seniority or merit system, may also ease the employer's burden. One commentator warns, however, that these judicially created defenses "threaten to swallow Congress' antidiscrimination mandate" because the defenses are based on costs an employer must incur to avoid violating Title VII provisions.

Plaintiffs may pursue Title VII claims under several theories.

(1988). Tax exempt bona fide private organizations, such as nonprofit religious institutions, are exempt from Title VII. Id.

86. An employee must be the object of the discrimination in order to bring suit under Title VII. Patee v. Pacific Northwest Bell Tel. Co., 803 F.2d 476, 477 (9th Cir. 1986) (citing Waters v. Heublein, Inc., 547 F.2d 466, 469 (9th Cir. 1976), cert. denied, 433 U.S. 915 (1977)).

87. Griggs v. Duke Power Co., 401 U.S. 424, 432 (1971) (providing "good intent or absence of discriminatory intent does not redeem employment procedures ... that operate as 'built in headwinds' against minority groups.").


90. Id.

91. See International Bhd. of Teamsters v. United States, 431 U.S. 324, 353-54 (1977) (holding that a bona fide seniority system was allowed even though it perpetuated the effects of discrimination).


93. The prima facie test is derived from McDonnell Douglas Corp. v. Green where the plaintiff had to show that:

(1) he or she belonged to a protected minority; (2) he or she was qualified for the job the employer was seeking to fill; (3) he or she was rejected despite being qualified; (4) that the position remained open thereafter and the employer continued to seek qualified applications for the position.

McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 (1973). Once an employee establishes a prima facie case, the burden of production shifts to the employer to
common claim involves disparate treatment by an employer, where an employee feels he or she has been treated less favorably because of race, color, religion, or national origin.\textsuperscript{94} Retaliatory action by an employer\textsuperscript{95} and constructive discharge\textsuperscript{96} are also theories under which a Title VII suit may be brought.

\textit{Griggs v. Duke Power Co.}\textsuperscript{97} first established the disparate impact theory as a basis for a Title VII claim. A disparate impact claim arises when an employee is discriminated against by an employer's facially benign action.\textsuperscript{98} \textit{Griggs} held that an employer's practice of requiring applicants to possess a high school diploma (or its equivalent), while neutral on its face, discriminated in practice against persons of color.\textsuperscript{99} The Court further held that the criteria used to distinguish the employees had no "demonstrable relationship to successful performance of the jobs."\textsuperscript{100}

show a legitimate reason for the discrimination. \textit{Id.} The employer's defense varies according to the type of discrimination claim brought. \textit{See, e.g.}, Texas Dep't of Community Affairs \textit{v.} Burdine, 450 U.S. 248, 260 (1981) (allowing the defendant employer to show a legitimate nondiscriminatory reason for its disparate treatment of the complaining employee); \textit{Johnson v. Transportation Agency}, 480 U.S. 616, 626 (1987) (allowing an employer to advance a defense based on an affirmative action plan). If the employer offers a legitimate reason, the employee then has the opportunity to rebut the employer's evidence. \textit{See, e.g.}, \textit{Burdine}, 450 U.S. at 256 (holding that employee may still prevail by showing that the criterion used by the employer to advance a legitimate business purpose was merely a "pretext" rather than the actual reason for the decision).

\textsuperscript{94} \textit{See, e.g.}, \textit{McDonnell Douglas}, 411 U.S. at 796 (claiming that the employer failed to rehire employee because of his race). When bringing a Title VII suit under this theory, the plaintiff must show that the employer intended to discriminate against the employee because of a suspect classification. \textit{International Bhd. of Teamsters v. United States}, 431 U.S. 324, 335 n.15 (1977).

\textsuperscript{95} \textit{See, e.g.}, \textit{Jurado v. Eleven-Fifty Corp.}, 813 F.2d 1406 (9th Cir. 1987). To establish a discriminatory discharge, a plaintiff must show that "(1) he engaged in activity protected under Title VII, (2) his employer subjected him to an adverse employment action, and (3) the employer's action is causally linked to the protected activity." \textit{Id.} at 1411 (citing \textit{Yartzoff v. Thomas}, 809 F.2d 1371, 1375 (9th Cir. 1987), cert. denied, 498 U.S. 939 (1990); \textit{Miller v. Fairchild Indus.}, 797 F.2d 727, 731 (9th Cir. 1986), cert. denied, 494 U.S. 1056 (1990)).

\textsuperscript{96} \textit{See, e.g.}, \textit{Parrett v. City of Connersville}, 737 F.2d 690, 695 (7th Cir. 1984) (allowing a constructive discharge claim if the plaintiff could show that the employer intentionally rendered working conditions so intolerable the employee felt compelled to quit).

\textsuperscript{97} 401 U.S. 424 (1971).

\textsuperscript{98} The employees in \textit{Hutcheson v. Dean}, Civil Action No. 3-85-119 (E.D. Tenn. 1984), whose settlement payments were at issue in \textit{United States v. Burke}, brought a Title VII action under this theory.

\textit{See generally} Brodin, supra note 93, at 318-24 (exploring useful background information of Title VII); McGrath, supra note 88, at 201-11 (arguing that a 1989 case erroneously diminished the viability of disparate impact suits).

\textsuperscript{99} Griggs, 401 U.S. at 430.

\textsuperscript{100} \textit{Id.} at 431.
If a court finds that an employer has engaged (or is engaging) in an unlawful employment practice, it may enjoin the employer from using that practice and order appropriate affirmative action.\textsuperscript{101} Affirmative action may include, but is not limited to, reinstatement or rehiring of the employee (with or without back pay) or any other appropriate equitable relief.\textsuperscript{102} Only one circuit court has awarded a plaintiff compensatory and punitive damages based upon an employer’s discrimination.\textsuperscript{103}

Upon a finding of discriminatory conduct by an employer, an employee is presumed to be entitled to back pay, as well as retroactive promotion or reinstatement.\textsuperscript{104} Back pay may be denied only if denial “would not frustrate the central statutory purposes of eradicating discrimination throughout the economy and making persons whole for injuries suffered through past discrimination.”\textsuperscript{105} This remedy furthers the dual goals of Title VII: to make an injured employee whole and to deter employers from engaging in discriminatory practices in the first place.\textsuperscript{106}

\textbf{B. The Civil Rights Act of 1991}

The Civil Rights Act of 1991\textsuperscript{107} amended Title VII of the Civil Rights Act of 1964\textsuperscript{108} by significantly expanding the remedies available to aggrieved employees. Compensatory and punitive damages are now expressly available to employees who prove intentional discrimination by their employer.\textsuperscript{109} These expanded remedies are, however, not available to Title VII suits brought under a disparate impact theory.\textsuperscript{110}

Compensatory damages now available include future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses.\textsuperscript{111} Punitive

\textsuperscript{102.} \textit{Id.}
\textsuperscript{103.} Walker v. Ford Motor Co., 684 F.2d 1355, 1363-64 n.14 (11th Cir. 1982).
\textsuperscript{104.} Albemarle Paper Co. v. Moody, 422 U.S. 405, 422 (1975).
\textsuperscript{105.} \textit{Id.} at 421.
\textsuperscript{106.} \textit{Id.} at 422.
\textsuperscript{110.} \textit{Id.}
damages are available if the employer acted with malice or with reckless indifference to the employee's federally protected rights. The sum of any compensatory and punitive damages, however, cannot exceed specified maximum amounts, which are determined according to the number of persons employed by the offender.

Congress intended the 1991 amendment to facilitate proof of employment discrimination and to deter discriminatory conduct by employers. The legislation reversed five 1989 United States Supreme Court decisions that were viewed as unfavorable to those seeking relief from employment discrimination. Congress used the 1991 amendment to send a message to the Supreme Court that its views on civil rights were not as expansive as those on Capitol Hill.

Whether the 1991 amendment's expanded remedies apply retroactively has not yet been determined. Even though the United States Supreme Court has faced this question, the Court has declined to settle the issue. Several circuit courts, including the Eighth Circuit, have already ruled that the expanded remedies are not available retroactively. Commentators note that the question of retroactivity promises to be a "hotly debated" issue.

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112. Id. (to be codified at 42 U.S.C. § 1981a(b)(1)). It is interesting to note that government employers, including agencies and subdivisions, are exempted from this provision. Id.

113. For purposes of this limitation, compensatory damages do not include any amounts attributable to back pay. Id. (to be codified at 42 U.S.C. § 1981a(b)(2)).

114. Id. (to be codified at 42 U.S.C. § 1981a(b)(3)). The maximum amount in damages a plaintiff can receive is determined by the size of the employer, measured by the number of employees:

<table>
<thead>
<tr>
<th>Cap on Damages</th>
<th>Number of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>$50,000</td>
<td>15-100 employees</td>
</tr>
<tr>
<td>100,000</td>
<td>101-200 employees</td>
</tr>
<tr>
<td>200,000</td>
<td>201-500 employees</td>
</tr>
<tr>
<td>300,000</td>
<td>over 500 employees</td>
</tr>
</tbody>
</table>


117. Id.


119. See, e.g., Fray v. Omaha World Herald Co., 960 F.2d 1370, 1378 (8th Cir. 1992) (holding that the expanded remedies under the 1991 amendments are not available retroactively); see also Patrick v. Miller, 953 F.2d 1240 (10th Cir. 1992) (leaving open the issue of whether the expanded remedies are available retroactively).

120. Husband & Biggs, supra note 121, at 886.
IV. UNITED STATES v. BURKE

A. The Facts

In 1984, a group of employees filed a Title VII action against the Tennessee Valley Authority (TVA). The employees alleged that TVA engaged in unlawful gender-based discrimination in its payment of salaries. The complaint generally alleged that TVA's salary and wage structure intended to and resulted in disparate treatment of female employees. Specifically, the employees complained that in 1981 TVA had increased the salaries of employees in certain male-dominated positions and had decreased the salaries of employees in certain female-dominated positions. The employees sought to enjoin TVA from further wage discrimination and sought back pay in an amount sufficient to eliminate the discrimination.

The plaintiffs were employees of TVA and members of the Office and Professional Employees International Union, AFL-CIO (Union). The plaintiffs sought but were denied certification as a class. The court found that "[t]he presence of [the Union] in this action insures that the interests of the class will be protected." TVA filed a counterclaim against the Union alleging fraud, misrepresentation, breach of contract, conspiring with the intent to defraud, and interference with contractual relationships and sought approximately $30,000,000 in damages.

122. Id. at 1869. The Tennessee Valley Authority is a corporation created by Congress in 1933 to maintain and develop the Tennessee River and its tributaries in the interests of national defense, agricultural and industrial development, and navigation. 16 U.S.C. § 831 (1988).
124. Id. at 83,745. TVA employees were divided into six pay schedules: clerical and general services; custodial; public safety; administrative; engineering and scientific; and aid and technical. TVA determined each schedule's wage structure by surveying various private employers in the surrounding area. The survey results were used by TVA to bargain for wages and salaries with the union. Id.
125. Burke, 112 S. Ct. at 1869.
126. Id.; see also Burke v. United States, 929 F.2d 1119, 1120 (6th Cir. 1991), rev'd, 112 S. Ct. 1867 (1992). They also sought costs, attorneys' fees and other warranted relief. Id.
127. Burke, 90-1 U.S. Tax Cas. (CCH) at 83,745 n.1.
129. Burke, 929 F.2d at 1120.
On motion for summary judgment by TVA, the district court held for the employees, finding that they had "made a prima facie case of disparate impact by showing that TVA adopted a facially neutral course of conduct (by changing the method it used to fix salary schedules for certain employee groups) which had a significantly adverse impact on female employees." The district court further noted that there was significant evidence of discriminatory intent on the part of TVA.

The parties thereafter entered into a settlement agreement that provided for a lump-sum payment of five million dollars to those employees affected by the challenged salary schedule at the time of the discriminatory conduct. The settlement amount was to be distributed at the Union's discretion. When it proved administratively unfeasible for the Union to distribute the fund, the agreement was amended so that TVA was to distribute the money directly to the employees under a formula established by the Union. The formula took into consideration an employee's length of service in the affected salary schedule and rates of pay throughout that time period. TVA agreed to distribute the funds on the condition that it be allowed to withhold federal taxes.

TVA distributed the settlement amount to the employees according to the Union's formula and, as promised, withheld federal income tax and FICA taxes from each employee's share.

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131. Id.
133. Burke, 929 F.2d at 1120.
134. Id. It was anticipated that over 8000 employees were employed in the offending pay schedule and would be entitled to a portion of the settlement proceeds. Id.
135. Id.
137. Id. The Sixth Circuit pointed out that the union reluctantly agreed to this provision. The court also notes that TVA did not feel compelled to withhold taxes when it made its direct payment to plaintiff Hutcheson, nor when it turned over to the union the money leftover as undistributable. TVA only withheld taxes from employees included in the Hutcheson suit, who in turn filed the refund action. Id.
Challenging the propriety of the withholding, the employees filed a claim for a tax refund with the Internal Revenue Service.\(^{140}\) The Service denied their claim, and the employees brought suit in the United States District Court for the Eastern District of Tennessee to recover the amounts withheld.\(^{141}\) They claimed the amount they received according to the terms of the settlement agreement should be excluded from their respective gross incomes under § 104(a)(2) of the Internal Revenue Code because sexual discrimination resulted in personal injury.

\section*{B. The Courts' Analysis}

\subsection*{1. The District Court}

The district court identified the question presented as "whether the damages were excludable from income under § 104(a)(2) of the Internal Revenue Code."\(^{142}\) As foundation for its analysis, the court pinpointed the key issue as a determination of the nature of the underlying cause of action for which the damages were received.\(^{143}\) The court stated that the nature of a Title VII action "sounds basically in tort—the statute merely defines a new legal duty, and authorizes the courts to compensate a plaintiff for the injury caused by the..."
defendant's wrongful breach." The court recognized that injuries redressed under Title VII are personal injuries.

The district court then addressed the types of remedies available under a Title VII claim. Generally, Title VII discrimination provides employees with a claim for back pay, measured by what they would have received absent the employer's discriminatory conduct. Although payments of unpaid wages are not excludable under § 104(a)(2), the court stated that Title VII awards may be excluded to the extent they do not constitute back pay.

In analyzing whether the Title VII award at issue in Burke was excludable from income, the district court again returned to the nature of the underlying injury. The court recognized that the Title VII loss of income damage award may simply be the best measure of the loss incurred from the underlying personal injury. In the alternative, the court continued, the loss of income could be analyzed by asking the question "in lieu of what were the damages awarded?"

Apparently deciding that the "in lieu of what" alternative was the better of the two, the court first looked at TVA's intent in making the

144. Burke, 90-1 U.S. Tax Cas. (CCH) at 83,747 (quoting Curtis v. Loether, 415 U.S. 189, 195 (1974)).

145. The district court, although never conclusively stating this proposition, quoted without qualification several cases supporting this point. Id. (citing Thompson v. Commissioner, 866 F.2d 709, 712 (4th Cir. 1989) ("Sex discrimination actions in general are tort or tort-type actions and damages awarded for violation of that right are damages for personal injuries."); Metzger v. Commissioner, 88 T.C. 834 (1987) ("The injuries for which relief is sought under Title VII are 'personal injuries.' "); aff'd, 845 F.2d 1013 (3d Cir. 1988).

146. The Supreme Court stated in its opinion that "[r]emedial principles thus figure prominently in the definition and conceptualization of torts." United States v. Burke, 112 S. Ct. 1867, 1871 (1992). As support for this proposition, the Court noted that "'an action for damages' is 'an essential characteristic of every true tort,' and that, even where other relief, such as an injunction, may be available, 'in all such cases it is solely by virtue of the right to damages that the wrong complained of is to be classed as a tort.' " Id. (quoting Sir John William Salmond, SALMOND ON THE LAW OF TORTS 9 (R.F.V. Heuston ed., 12th ed. 1957)).

147. Burke, 90-1 U.S. Tax Cas. (CCH) at 83,748.

148. Id. (citing Hodge v. Commissioner, 64 T.C. 616, 619 (1975)).

149. Id. Because prior to the 1991 amendments back pay was the only remedy for Title VII and "'back pay is never excludable,'" this analysis is circular and hollow.

150. Burke v. United States, 90-1 U.S. Tax Cas. (CCH) ¶ 50,203 (E.D. Tenn. Mar. 20, 1990), rev'd, 929 F.2d 1119 (6th Cir. 1991), rev'd, 112 S. Ct. 1867 (1992). The district court stated "'excludability depends 'on what was the injury complained of ... ."' Id. at 83,748 (quoting Metzger v. Commissioner, 88 T.C. 834, 858 (1987), aff'd, 845 F.2d 1013 (3d Cir. 1988)).

151. Id. (quoting Metzger v. Commissioner, 89 T.C. 632 (1987)).

152. Id. (citing Church v. Commissioner, 80 T.C. 1104, 1107 (1983); Yates v. Commissioner, 58 T.C. 961, 972 (1972), aff'd, 480 F.2d 920 (3d Cir. 1973); Raytheon Prod. Corp. v. Commissioner, 144 F.2d 110, 113 (1st Cir.), cert. denied, 323 U.S. 779 (1944)).
payment. While back pay was never mentioned in the settlement nego-
tiations, the court found that the employees' complaint made it clear that “the very core of the case was the recovery of wage de-
fi ciencies.” Based on the language of the complaint, the manner in which the money was allocated, and the fact that the employees
agreed in the amended settlement to the sum “less any taxes which
TVA may be required to pay,” the court concluded the employees
accepted that the money was to be received in the nature of back
pay. Because the payments were back pay, the distribution must
be included in the determination of the employees’ gross income.

2. The Sixth Circuit Court of Appeals

The employees appealed to the Sixth Circuit Court of Appeals,
raising the question of whether the damages they received in settle-
ment for their sex discrimination claims could be excluded under § 104(a)(2). According to the Sixth Circuit, the answer depended
solely on whether the injuries the employees suffered were personal
and tort-like. The court refused to extend its inquiry further into
the nature of the damages received (as the district court had done) if
the injuries were personal and tort-like.

The court examined a long line of cases which held that injuries
from discrimination were injuries to the individual rights and dignity
of a person. The court concluded that such injuries are personal
in nature. The court rejected the government’s argument that the

154. Id.
155. Id.
156. Id.
158. Id. at 1121, 1123. The court relied on Threlkeld v. Commissioner, 87 T.C.
159. Burke, 929 F.2d at 1123.
160. Id. (citing inter alia Goodman v. Lukens Steel Co., 482 U.S. 656 (1987) (hold-
161. Burke, 929 F.2d at 1122 (citing inter alia Pistillo v. Commissioner, 912 F.2d

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damages available under Title VII distinguish Title VII injuries from other discrimination injuries. The court simply refused to look beyond the personal nature of the injury.

In addition to arguing that the damages were taxable back pay, the government also argued the exclusion would be unfair because excluding awards based on back pay places employees in a better position than they would have been had the discrimination not occurred. While acknowledging the superficial logic of this proposition, the court rejected the argument citing a decision from the previous year.

The court of appeals reversed the district court and held that the employees could exclude from gross income the amount received from the settlement of their Title VII claim as damages received for personal injury under § 104(a)(2). The court further held that a victim of discrimination who had recovered lost pay would not be treated differently than the victim of a physical tort who had recovered lost pay.

violation of the Age Discrimination in Employment Act are personal injuries for the purposes of I.R.C. § 104(a)(2); Rickel v. Commissioner, 900 F.2d 655, 662 (3d Cir. 1990) (holding that age discrimination is a tort-like personal injury for the purposes of I.R.C. § 104(a)(2)); Metzger v. Commissioner, 88 T.C. 834, 851 (1987) (holding that damages received for sex and national origin discrimination were excludable as damages for personal injuries under I.R.C. § 104(a)(2)), aff'd, 845 F.2d 1013 (3d Cir. 1988).


The government focused on the consequences of the employer's Title VII violation, not the injury that resulted to the employees. The government essentially argued that the "in lieu of what" test should apply and, thus, the back pay damages were purely economic rather than tort or tort-type. Implicit in this argument is the government's concession that the underlying injury is personal. Otherwise the damages could not be transformed from "personal" to "economic." Id.

163. Burke, 929 F.2d at 1122. The court stated that "the government misapprehends the proper inquiry for determining excludability under § 104(a)(2)." Id.

164. Id. at 1123.

165. Id.

166. See Pistillo v. Commissioner, 912 F.2d 145, 150 (6th Cir. 1990). Pistillo involved an age discrimination suit brought under the Age Discrimination in Employment Act (ADEA). Id. at 145. The court held that the employee was personally injured because he suffered his employers' indignities and insults. Id. at 150. As such, he was entitled to the same tax treatment as one who had suffered physical injuries despite any hypothetical tax unfairness. Id.

167. Senior Circuit Judge Wellford dissented. He distinguished the cases applied by the majority and argued that damages received under the settlement were includable because they were meant to compensate for lost earnings. Burke v. United States, 929 F.2d 1119, 1124-26 (6th Cir. 1991) (Wellford, J., dissenting), rev'd, 112 S. Ct. 1867 (1992).

168. Id. at 1122; see also Rickel v. Commissioner, 900 F.2d 655, 664 (3d Cir. 1990) ("We see no reason to treat one personal injury victim any differently than another.").
3. The United States Supreme Court

The United States Supreme Court granted certiorari to resolve the conflict among the circuit courts concerning the exclusion of Title VII back pay awards under § 104(a)(2). The Court first determined that the settlement awards constituted gross income within the broad reach of the Internal Revenue Service. It then focused on whether the awards fell within the personal injury damages exception. The Court turned to the 1960 Service regulation that identifies "personal injury" in reference to tort or tort-type principles. The Court identified a tort as a civil wrong, other than a breach of contract, for which a broad range of damages are available to compensate the plaintiff.

The Court stated that "[i]t is beyond question that discrimination in employment . . . causes grave harm to its victims." Yet the Court reasoned that remedies available to redress that injury are merely back pay, injunctions, and other equitable relief, in contrast to traditional tort remedies. The Court further reasoned that because Congress declined to compensate plaintiffs for anything more than the wages properly due them and that those wages would have been taxed, Title VII did not redress a tort-type injury within the meaning of § 104(a)(2) and its accompanying regulation. The majority reinstated the district court's decision and denied the exclusion of the damages received for Title VII violations from gross income.

In a concurring opinion, Justice Scalia suggested a common sense interpretation of personal injury rather than an interpretation based on the Service regulation because the "IRS's 'tort rights' formula-
Although the term "personal injuries" can be read to include any noncontractual interest, reference to the statute's entire phrase "personal injury or sickness" suggests the proper reading connotes only injuries to physical or mental health. Justice Scalia's approach would allow personal injury damages to be excluded only if the damages were received on account of injuries to the recipient's physical or mental health. He reasoned that because recovery under Title VII does not depend on a showing of an injury to one's physical or mental health, the only redressable legal injury is the antecedent economic deprivation that produced the violation in the first place. Thus, settlement payments in respect to back pay would not be received on account of personal injuries.

Justice Souter also concurred, but based his analysis on the broad dichotomy between contract and tort and the method by which statutes are generally interpreted. He recognized arguments placing Title VII damages on both sides of the line of the contract-tort debate but stopped short of endorsing either. Rather, Justice Souter proposed that the default rule of statutory interpretation determine the issue: exclusions from income are to be narrowly construed. Thus, because Title VII damages do not clearly fit into the personal injury exclusion, they are an accession to wealth.

Justice O'Connor, joined by Justice Thomas, dissented and argued that the remedies available do not fix the character of the right asserted. In contrast to Justice Scalia's position, the dissent deferred to the Service regulation interpreting the phrase "damages received" in reference to tort-type rights. Justices O'Connor and Thomas stated that whether Title VII claims are based on the same type of rights torts are based depends on the nature of the statute and the type of claim brought under it.

Functionally, the dissent argued that Title VII operates to provide...
a traditional tort-type right rather than a contractual right.\textsuperscript{190} Furthermore, back pay damages not only offset specific losses but, similar to tort damages, also serve the public purpose of dissuading employers from engaging in undesirable conduct.\textsuperscript{191}

The dissent also pointed to two United States Supreme Court decisions holding that other federal civil rights suits were analogous to personal injury suits because the law protected individuals against tort-type personal injuries.\textsuperscript{192} The dissent addressed and dismissed the majority's alternative reasons for denying that the settlement should be excluded.\textsuperscript{193} Rather, the dissent concluded that Title VII addressed tort-type rights and, therefore, damages awarded under it should be excluded from gross income.\textsuperscript{194}

V. ANALYSIS OF THE COURT'S DECISION

The result reached by the majority in \textit{Burke} has the effect of allowing the remedies available to fix the personal nature of an injury. Although neither the Code nor the legislative history provide guidance on this issue, the regulation clearly steers the analysis toward determining if the amount was received for a violation of a tort-type right. Here the majority looked not at the violation of the right at issue, but the nature of the damages plaintiffs could recover. The majority held that employment discrimination was not a personal injury simply because compensatory and punitive damages—traditional tort remedies—were not then expressly allowed as Title VII damages.\textsuperscript{195}

\textsuperscript{190.} \textit{Id.}
\textsuperscript{191.} \textit{Id.} at 1879. In support of its rationale, the dissent stated "'[i]t is the reasonably certain prospect of a back pay award that 'provide[s] the spur or catalyst which causes employers and unions to self-examine and to self-evaluate their employment practices and to endeavor to eliminate, so far as possible, the last vestiges of [discrimination].'" \textit{Id.} (quoting Albemarle Paper Co. v. Moody, 422 U.S. 405, 417-18 (1975)) (citation omitted).
\textsuperscript{193.} United States v. \textit{Burke}, 112 S. Ct. 1867, 1880-81 (1992) (O'Connor, Thomas, J.J., dissenting). The dissent addressed and dismissed the majority's analysis that: (1) the damages would have been taxable wages had there been no discrimination; (2) the unavailability of jury trial bears against the tort-like nature of the claim; and (3) Congress changed the purpose of Title VII with the Civil Rights Act of 1991. \textit{Id.}
\textsuperscript{194.} \textit{Id.} at 1881.
\textsuperscript{195.} \textit{Id.} at 1873. The language of Title VII does not specifically exclude compensatory and punitive damages; this is the Court's limitation. See Patterson v. \textit{McLean Credit Union}, 491 U.S. 164, 182 n.4 (1989) (noting that a plaintiff in a Title VII suit is limited to recovery of back pay). \textit{But cf.} Williams v. \textit{Trans World Airlines}, 660 F.2d 1267 (8th Cir. 1981) (stating that an award of compensatory damages is the proper remedy for a deprivation of constitutional rights).
By entering from the back door and fixing the nature of an injury according to available damages rather than the violation involved, the majority’s analysis is flawed in two critical areas. First, available remedies cannot transform a personal injury into a nonpersonal one. Second, the decision undermines the policy of tax fairness and the purpose behind the personal injury exclusion. Thus, the effects of Burke will reach far beyond the few hundreds of dollars at stake to the TVA employees in the case, and plaintiffs’ attorneys should take note.

A. It’s Either a Personal Injury or It is Not

The Code allows taxpayers to exclude from gross income damages received for personal injuries. The pertinent regulation, in effect for decades, clarifies “personal injury” with reference to violations of tort or tort-type rights. A tort is defined as a legal wrong committed upon a person or property independent of contractual obligations. The broad definition of a tort as a “civil wrong, other than breach of contract, for which the court will provide a remedy” was cited with approval by the majority in United States v. Burke.

In contrast, contractual liability is imposed to protect the singular interest of enforcing promises. One is generally free from entering into and may negotiate the specific terms of one’s contractual liability. Thus, contract and tort principles are in direct contrast to each other: the former protects voluntary, specific promises of the parties involved while the latter protects the common good.

The United States Supreme Court recognizes that Title VII, as part of the Civil Rights Act, defines a legal duty that sounds basically in tort. The preamble to Title VII states that “[t]he opportunity for employment without discrimination . . . is a right of all persons within the jurisdiction of the United States, and . . . it is the national policy to protect the right of the individual to be free from such discrimination.” Because Title VII sounds basically in tort, it is based on tort-like principles.

Courts have long held that unlawful discrimination based on those categories protected by Title VII results in an injury to the individual

rights of a person. Even if the resulting injury is not physical or tangible, it is still personal. The logical conclusion is that a victim of Title VII employment discrimination is personally injured. To suggest otherwise sends a message to employers that the federal government views broken legs more sympathetically than systematic employment discrimination.

The majority in *Burke* indeed acknowledged that employment discrimination results in personal injury by stating that "[i]t is beyond question that discrimination in employment . . . causes grave harm to its victims." Compensation to victims of grave harm certainly seems to be within the scope of "damages received for personal injury."

But the majority continued and looked at tort principles in reference to the remedies available—or not available in this case—to determine whether discrimination results in personal injury. Because the remedy was back pay received in lieu of taxable wages, the personal injury the employees suffered, which was based on a tort-like claim, was mysteriously transformed into something else.

The Court’s analysis proposes that, despite the personal nature of an injury, the remedy available may depersonalize it. Under this analysis, if a person breaks a leg due to another’s negligence, brings a personal injury suit against the tortfeasor, and is compensated for lost wages, the remedy transforms the broken leg into something other than a personal injury. Yet, in this situation, lost wages may be excluded under § 104(a)(2).

The nature of a personal injury does not change simply because its remedy is based on lost earnings. “Personal injury” should be defined according to the right being violated, not the currently available remedies. Title VII protects tort-type rights, and its violation results in personal injury. Thus, the damages received for that violation should be excluded from gross income under § 104(a)(2).

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204. See *Seay v. Commissioner*, 58 T.C. 32, 40 (1972) (holding that injury resulting from a breach of contract is personal in nature).


206. *Id.*

207. I.R.C. § 104(a)(2). The damages received are excludable in this situation regardless of whether received for lost earnings, medical expenses, or pain and suffering. LAWRENCE A. FROLIK, FEDERAL TAX ASPECTS OF INJURY, DAMAGE, AND LOSS 1 (1987).

B. Public Policy and Tax Fairness

The "in lieu of what" test used by the majority has certain logical appeal from a strict tax perspective that seeks to tax all income. The damages were received by the employees in lieu of the wages they would have received absent the discriminatory conduct. These wages would have been subject to tax. Thus allowing wages tax-free in the form of damages would provide an employee with a windfall. But the policy behind the personal injury exclusion specifically allows a plaintiff a windfall in this situation. Since 1918, income received as damages for personal injuries has been distinguished from other income.\(^{209}\) The exclusion rests on the humanitarian desire not to further burden those who have been injured.\(^{210}\) The logical "in lieu of what" test has no place in determining the applicability of this policy-driven exclusion.

The majority's "in lieu of what" test also results in an unfair application of § 104(a)(2) because the test produces different outcomes for different injuries. All damages, including lost wages, are excludable if the injury is physical.\(^{211}\) The exclusion applies even if the same amount in regular wages would have been taxed if received in the normal course of business. The lost wages merely represent an amount lost by the taxpayer because of the tortfeasor's conduct that resulted in the personal injury. Like lost wages, back pay also would be taxed if received in the ordinary course of business. Back pay is the amount lost by the employee because of the tortfeasor-employer's conduct that resulted in the personal injury. Section 104(a)(2) does not distinguish between physical and nonphysical injury, yet the Court makes this distinction in *Burke*. The decision treats two similarly situated taxpayers, both personally injured, differently and undermines the basic goal of tax fairness and horizontal equity.\(^{212}\) The *Burke* decision discriminates against a taxpayer who has already been the victim of employment discrimination.

C. Long-Term Effects on the Personal Injury Exclusion

After *Burke*, back pay received from Title VII claims must be included in income. If the additional remedies provided by the 1991 Amendment are available retroactively for a Title VII claimant, plaintiffs with pending cases may receive compensatory and punitive dam-
ages. These damages, because they are traditional tort remedies and are not received in lieu of taxable income, would be excluded. If the additional remedies are not available retroactively, plaintiffs with cases pending may receive only taxable back pay.

Future plaintiffs, with Title VII or any other claim where damages are received for personal injury, may take steps so that the personal injury exclusion is still available. First, complaints should be framed so that a tort or tort-type right is clearly implicated, and the result of its violation is a personal injury. Past Tax Court decisions have shown that the framing of the complaint may determine the outcome of the case.213 The amount sought to redress that claim should be characterized as compensatory damages, rather than back pay for a personal injury.

Second, settlement negotiations and documentation should clearly state that the amount received is for personal injury and not back pay. In Burke, the damages were never characterized as “back pay” during settlement negotiations, yet when TVA distributed the amount it withheld taxes.214 It was prudent of TVA to do this, because the burden of defending an action by the Service would otherwise fall on the TVA.215 By withholding, the burden shifted to the plaintiffs to prove that taxes should not have been withheld because they came within the exclusion.

If not expressly documented as damages received for personal injury, the district court will look at the intent of the payor to determine the purpose of the payment.216 In the employment setting this allows the employer to justify withholding on the ground that it intended the amount as back pay. Settlement documents should clearly state that Title VII claimants seek compensatory damages for the personal injury of employment discrimination.

Third, if the damages received are characterized as back pay, claimants may argue that the back pay is merely the best measure of the injury suffered, just as wages are a valid measure of compensatory damages when the injury is physical. The Tax Court embraced this argument in Threlkeld where an undeniably tort-type claim was at issue. It stated that the amount of lost wages in a defamation claim

213. See supra note 42 and accompanying text.
214. Burke v. United States, 90-1 U.S. Tax Cas. (CCH) ¶ 50,203 at 83,746 (E.D. Tenn., Mar. 20, 1990), rev’d, 929 F.2d 1119 (6th Cir. 1991), rev’d, 112 S. Ct. 1867 (1992). However, the employees sought back pay in their complaint because it was the only monetary relief available to Title VII claimants at that time. Burke v. United States, 929 F.2d 1119, 1120 (6th Cir. 1991), rev’d, 112 S. Ct. 1867 (1992).
215. It is interesting to note that Hutcheson’s claim was paid separately, and TVA did not withhold taxes. However, when TVA distributed the lump sum to the remaining employees, it withheld taxes. United States v. Burke, 112 S. Ct. 1867 (1992).
may be the best measure of the loss but, in no way, transforms the claim. With the expanded remedies now available under the 1991 amendment to the Civil Rights Act, the argument that damages received under Title VII redress tort-type rights is strengthened. Perhaps, then, Title VII claimants could receive parallel treatment and be allowed to characterize back pay as simply the best measure of their loss.

VI. Conclusion

The issue of what constitutes a "personal injury" for purposes of § 104(a)(2) of the Internal Revenue Code is left for courts to decide. Courts have applied one of two tests: either the underlying claim test or the "in lieu of what" test. The Court in United States v. Burke chose the "in lieu of what" test to determine whether damages received for an employment discrimination claim, brought under Title VII, may be excluded from income.

The analysis in Burke allows a remedy to transform a personal injury into something else. This undermines the public policy behind the personal injury exclusion and offends general principles of tax fairness. The decision creates ambiguities about the application of the personal injury exclusion now that Title VII has been amended to allow traditional tort remedies. It also leaves unanswered the question of whether back pay received in conjunction with compensatory or punitive damages would be excludable as it is with other personal injuries.

The Court could have resolved these ambiguities by focusing on the underlying claim rather than the type of remedy currently allowed to redress the claim. The Court could have found that because employment discrimination causes personal injury and because a Title VII claim is based on tort-type principles, the damages could be excluded. Examining the type of claim would have avoided the transformation of personal injury into nonpersonal injury, would have been fair and equitable, and would not have created more ambiguities. United States v. Burke did not resolve the issue of what constitutes a "personal injury" for the purposes of the § 104(a)(2) personal injury damages exclusion.


218. The majority's decision effectively proposes that what was not a personal injury for tax purposes in 1991 would be a personal injury in 1992 because of the new remedies available.