ORAL ARGUMENT SCHEDULED FOR APRIL 23, 2007

No. 05-5139

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

MARRITA MURPHY, *et al.*,

Plaintiffs/Appellants,

v.

INTERNAL REVENUE SERVICE, *et al.*,

Defendants/Appellees,

On appeal from the United States District Court
for the District of Columbia

BRIEF OF APPELLANTS

Respectfully submitted by:
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Date: January 29, 2007

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

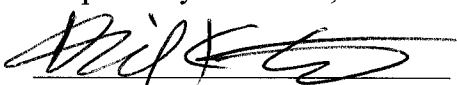
Pursuant to D.C. Circuit Rule 28(a)(1), Appellants' counsel makes the following certification as to parties, rulings and related cases.

(A) Parties and Amici: The following is a list of all parties who have appeared before the district court and in this court: (1) Marrita Murphy, Plaintiff-Appellant; (2) Daniel J. Leveille, Plaintiff-Appellant; (3) Internal Revenue Service, Defendant-Appellee; and (4) United States of America, Defendant-Appellee. There are no intervenors. There is an amicus curiae party, the No Fear Coalition, previously admitted, and other amici join in No Fear Colation's brief: The National Employment Lawyers Association, Andrew Jackson Society, National Taxpayers Union, Liberty Coalition, and Innocence Project.

(B) Rulings Under Review: The rulings under review are: (1) the Order, dated March 22, 2005, granting Defendant's motion for summary judgment and denying Plaintiff's cross-motion for summary judgment [Joint Appendix ("J.A."), p. 36]; (2) the Memorandum Opinion, dated March 22, 2005 [J.A., p. 19]. Both the Memorandum Opinion and Order under review in this case are published at the following official citation: *Murphy v. Internal Revenue Service,* 362 F.Supp.2d 206 (D.D.C. 2005).

(C) Related Cases: Counsel is not aware of any other related cases as that term is defined in D.C. Circuit Rule 28(a)(1)(C).

Respectfully submitted,



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REFERENCE TO ORAL ARGUMENT

Oral Argument is scheduled to take place on April 23, 2007.

JURISDICTIONAL STATEMENT

The basis for the district court's subject-matter jurisdiction is 28 U.S.C. §1346, which provides for district court jurisdiction over Plaintiffs-Appellants' tax refund claim. Ms. Murphy received an award of "make whole" compensatory damages after prevailing on her claims of whistleblower retaliation against her former employer, the New York Air National Guard ("NYANG") and the Secretary of the Air Force, pursuant to six federal environmental whistleblower statutes. Ms. Murphy paid taxes on the compensatory damages and requested a tax refund. After exhausting all available remedies before the IRS, an action was filed in U.S. District Court for the District of Columbia seeking a tax refund pursuant to 28 U.S.C. §1346. The basis for this court's appellate jurisdiction is 28 U.S.C. §1291. On March 22, 2005, the district court entered a final decision dismissing Plaintiffs' claims with prejudice. *See* J.A., pp. 19-37. The Notice of Appeal was timely filed on April 6, 2005. *See* J.A., p. 4.

STATEMENT OF THE ISSUES

(1) Did the district court err when it granted the Defendants' motion for summary judgment on Plaintiff's tax refund claim?

(2) Can Congress tax "make whole" emotional distress personal injury or sickness compensatory damage awards when such a tax would be on compensation for a loss (or restoration of human capital) as opposed to income or any accession to wealth?

(3) Is the tax on Ms. Murphy's compensatory damages permitted by the Sixteenth Amendment to the Constitution, by 26 U.S.C. §61(a), or by any other section of the tax code?

(4) Should compensatory damages awarded to Ms. Murphy based on evidence, including, among other physical injuries permanent damage to her teeth and physical manifestations of stress, resulting from the violation of her legally cognizable federal statutory rights be excluded from gross income based on Internal Revenue Code ("IRC") §104(a)(2)?

STATUTES AND REGULATIONS

Pursuant to D.C. Circuit Rule 28(f), Appellants set forth the pertinent portions of statutes and regulations in the addendum.

STATEMENT OF THE CASE

This action was commenced in the district court seeking a tax refund from the United States for the wrongful assessment of a tax on "make whole" compensatory damages awarded to Marrita Murphy for physical injuries and physical sickness that she sustained as a result of illegal retaliation by her former employer. J.A., pp. 6-13. This refund action seeks $20,865.00, plus interest, in Federal income taxes paid on April 11, 2001, for the year 2000. After paying the tax, Ms. Murphy filed three separate amended tax returns requesting a tax refund with the Internal Revenue Service ("IRS"). J.A., pp. 6, 8, Complaint, ¶¶ 8-10; J.A., pp. 14-16, Answer, ¶¶ 8-10. On December 18, 2002, the IRS disallowed the claim for a tax refund. J.A., p. 47.

Defendants moved for summary judgment on the grounds that the compensatory damages awarded to Ms. Murphy were taxable. Ms. Murphy opposed Defendants' motion for summary judgment and filed a cross-motion for partial summary judgment. As part of the summary judgment record, Ms. Murphy submitted the affidavits of two doctors who testified that the injuries for which she was awarded compensatory damages included bruxism, permanent damage to her teeth, and other physical injuries. These affidavits were not controverted by Defendants.

The district court granted Defendants' motion for summary judgment and dismissed the Complaint, with prejudice. *Murphy v. IRS,* 362 F.Supp.2d 206 (D.D.C. 2005). Despite finding that Ms. Murphy sustained permanent physical injuries in the form of bruxism and permanent teeth damage, and that she "suffered from other 'physical manifestations of stress,'" the district court erred by concluding that Ms. Murphy's damages fell outside the scope of the personal injury exemption because they were "attributable to" emotional distress. *Murphy,* 362 F.Supp.2d at 215. Additionally, the district court erred by concluding that the taxation of Ms. Murphy's damages pursuant to 26 U.S.C. §61(a) was permissible under the statute, and constitutional under the 16th Amendment, and the district court erred by holding that anything falling outside a specific statutory exclusion is taxable as income regardless of whether it should be considered as compensation for a loss or a return of capital. *Id.*.

STATEMENT OF FACTS

Ms. Murphy filed complaints with the U.S. Department of Labor ("DOL") on January 6, 1994, alleging violations of the whistleblower protection provisions of six federal environmental laws. *Leveille v. New York Air National Guard,* Case Nos. 94-TSC-3 and 94-TSC-4, Decision and Order of Remand, p. 7, 1995 WL 848112 (Dec. 11, 1995).[1] On July 18 and 19, 1994, the DOL held an administrative hearing before an Administrative Law Judge ("ALJ").

On December 11, 1995, the Secretary of Labor issued a Decision and Order finding that it was "proved that [NYANG] retaliated against" Ms. Murphy. *Leveille,* Decision and Order of Remand, p. 22, 1995 WL 848112 (Dec. 11, 1995). The Secretary ordered affirmative relief in

[1] Marrita Murphy is also known as Marrita Leveille in portions of this litigation.

favor of Ms. Murphy and remanded the case to the ALJ for findings on compensatory damages. [2] *Id.*

In un-rebutted expert testimony presented at the July 1994 administrative hearing, Dr. Edwin Carter, testified both as Ms. Murphy's treating and expert psychologist. J.A., pp. 38-42, Affidavit of Dr. Edwin N. Carter (Oct. 11, 2004). Dr. Carter testified that as a result of NYANG's illegal retaliation, Ms. Murphy suffered physical injuries and physical sickness in the form of "somatic references and body references." J.A., p. 39, Carter Aff., ¶ 7. The definition of "somatic" means of, relating to, or affecting the body, as distinguished from the mind. J.A., p. 39, Carter Aff., ¶ 8.

At the July 1994 DOL hearing, Dr. Carter testified about Ms. Murphy's physical problems in addition to the severe panic attacks she suffered, and the Department of Labor later found, based on this testimony, that Ms. Murphy suffered severe anxiety attacks and emotional distress as well as physical injuries as a result of NYANG's acts of illegal retaliation. *See,* J.A., p. 39, Carter Aff., ¶ 6. Dr. Carter concluded, without contradiction, that Ms. Murphy's physical injuries and emotional distress were a direct reaction to and the direct result of NYANG's illegal acts. J.A., pp. 39-40, Carter Aff., ¶¶ 6, 9.

In order to reach these conclusions, Dr. Carter reviewed Ms. Murphy's medical and dental records related to her complaints of physical pain and physical injuries during the relevant time period. J.A., pp. 39-40, Carter Aff., ¶¶ 5, 7, 9, 11.

[2] Each of the federal environmental whistleblower statutes under which Plaintiffs filed their claims with the DOL provide for "compensatory damages." *See* Toxic Substances Control Act, 15 U.S.C. §2622; Safe Drinking Water Act, 42 U.S.C. §300j-0(1); Clean Air Act, 42 U.S.C. §7622; Solid Waste Disposal Act, 42 U.S.C. §6971; Clean Water Act, 33 U.S.C. §1367; Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §9610.

Dr. Carter concluded at the July 1994 hearing that Ms. Murphy suffered physical pain and physical injuries, and he relied on his review of those records to testify about Ms. Murphy's somatic and body injuries to describe her pain, physical sickness and physical injuries. J.A., p. 39, Carter Aff., ¶¶ 5-7. Dr. Carter also ruled out causes other than NYANG's illegal acts for the physical components of Ms. Murphy's injuries and sickness. J.A., p. 39, Carter Aff., ¶ 5.

Ms. Murphy's dental records reflecting "bruxism" or teeth grinding were conclusive that Ms. Murphy suffered physical pain and physical injuries as a result of NYANG's illegal action. J.A., pp. 40-41, Carter Aff., ¶¶ 11-13. Dr. Carter reviewed those portions of Ms. Murphy's dental chart that were created prior to the July 1994 hearing and Dr. Carter based his testimony about Ms. Murphy's "somatic" and "body" injuries in part, on the physical problems documented in her dental records. J.A., pp. 39-41, Carter Aff., ¶¶ 7, 9, 11-13, 16.

Ms. Murphy "had no prior history of bruxism," before the acts of retaliation by her employer, NYANG, took place. *Murphy,* 362 F.Supp.2d at 210. Ms. Murphy's dental records specifically show that during the calendar year preceding Ms. Murphy learning about NYANG's negative employment reference that she had no reports of "bruxism" or teeth grinding. J.A., pp. 44-45, Affidavit of Dr. Barry L. Kurzer, ¶¶ 5-6, 14-15. In fact, Ms. Murphy's dental records confirm that she visited her dentist five separate times during calendar year 1993 on the following dates: January 14, 1993, January 20, 1993, August 31, 1993, November 15, 1993, and December 1, 1993. J.A., p. 44, Kurzer Aff., ¶5. At no time prior to December 9, 1993, when Ms. Murphy learned about NYANG's negative employment reference, did she complain about "bruxism" or teeth grinding and she was not treated for that condition in calendar year 1993. J.A., pp. 44-45, Kurzer Aff., ¶¶ 5-6, 14-15. It was not until Ms. Murphy's visit to her dentist on March 11, 1994, that the "bruxism" or teeth grinding was diagnosed. J.A., pp. 43-44, Kurzer

Aff., ¶¶ 4-6. Ms. Murphy's "bruxism" developed between her last visit to dentist on December 1, 1993, just before she learned about NYANG's negative employment reference on December 9, 1993, and the bruxism was not diagnosed until March 11, 1994. J.A., p. 44, Kurzer Aff., ¶12.

Ms. Murphy "continues to experience pain and tooth damage from the bruxism." *Murphy,* 362 F.Supp.2d at 210. Her "bruxism" has needed continued treatment since its first diagnosis in March 1994, and she has suffered permanent damage to her teeth since that time and requires ongoing extensive dental restoration to repair the physical damage to her teeth caused by the bruxing. J.A., pp. 44-45, Kurzer Aff., ¶¶ 7-13. "Bruxism" can be the result of a substantial increase in stress and that stress is the number one cause of bruxism. J.A. 44, Kurzer Aff., ¶ 11.

Ms. Murphy's "bruxism" and permanent damage to her teeth is the result of NYANG's illegal acts. J.A., pp. 39-41, Carter Aff., ¶¶ 6, 9-10, 13, 16. *Also see, Murphy,* 362 F.Supp.2d at 210.

On October 25, 1999, the U.S. Department of Labor Administrative Review Board ("ARB") issued its Final Decision and Order on Damages, adopting the ALJ's recommendation awarding Ms. Murphy $70,000 for compensatory damages and $10,000 in future medical expenses. *Leveille v. New York Air National Guard,* ARB Case No. 98-079, Decision and Order on Damages, 1999 WL 966951 (Oct. 25, 1999). The ARB specifically held that its authority to award compensatory damages was expressly permitted under the federal environmental whistleblower statutes which "***created a 'species of tort liability'*** in favor of persons who are the objects of unlawful discrimination." *Id.*, p. 4, 1999 WL 966951 (Oct. 25, 1999). In addition, the ARB stated that it based its compensatory damages award on a comparison of "damage awards by courts or juries ... ***in analogous tort actions.***" *Id.*, p. 5, 1999 WL 966951 (Oct. 25, 1999).

The ALJ's recommended decision on damages and the ARB's final decision on damages were each based on the original administrative hearing record created on July 18 and 19, 1994, and the Department of Labor's damages determination was expressly based on Dr. Carter's testimony at the July 1994 hearing in which Dr. Carter testified that Ms. Murphy suffered physical injuries related to her stress. *Leveille,* ARB Case No. 98-079, Decision and Order on Damages, 1999 WL 966951 (Oct. 25, 1999); *Leveille,* ALJ Case Nos. 94-TSC-3 and 94-TSC-4, Recommended Decision and Order, at p. 4 (Feb. 9, 1998). None of the compensatory damages awarded to Ms. Murphy were for lost wages, back pay or front pay. *Id.*, p. 5.

By letter dated April 28, 2000, Dr. Carter reiterated his earlier opinions and un-rebutted testimony presented at the July 1994 hearing in Ms. Murphy's case, by stating: "This week I reviewed our records concerning my diagnosis of Marrita. It is my professional opinion that [Ms. Murphy] suffered physical sickness and physical pain as a result of the discrimination and harassment of her employer." *See* J.A., p. 46.

In calendar year 2000 Ms. Murphy received the $70,000 in compensatory damages awarded by the ARB and paid tax on that award when she filed IRS Form 1040 tax return in April of 2001, and they properly requested a refund of that tax. J.A., pp. 2-3, Compl. ¶¶ 6-10; J.A., pp. 15-16, Answer, ¶¶ 6-10. The IRS conducted an office examination of the Plaintiffs' tax year 2000 Form 1040 return and request for tax refund. "Among the additional records" submitted to the IRS by Plaintiffs to support their request for a tax refund "were medical and dental records" of Ms. Murphy "which demonstrated that the amount of damages she was awarded were on account of physical injuries and physical sickness..." J.A., p. 9, Compl., ¶ 13. Ms. Murphy submitted to the IRS copies of her dental records that Dr. Carter had reviewed to

base his 1994 conclusion that Ms. Murphy suffered "somatic" and "body" injuries as a result of NYANG's illegal acts. J.A., p. 3, Carter Aff., at ¶ 9.

The IRS wrongly concluded it was "not verified" that Ms. Murphy's compensatory damages were "attributable to a physical injury or physical sickness." J.A., p. 47. However, the IRS completely disregarded Ms. Murphy's dental records and failed to properly consider the information produced by Ms. Murphy, which expressly showed that Ms. Murphy suffered "bruxism" and permanent damage to her teeth as part of the "somatic" and "body" injuries identified by Dr. Carter at the July 1994 DOL hearing. *Cf., Id.* with J.A., pp. 38-39, Carter Aff., ¶¶ 4-8.

Notably, before the district court the Defendants did not dispute that Ms. Murphy's injuries are physical. Her dentist, Dr. Kurzer, has testified without contradiction that Ms. Murphy suffered permanent physical injury to her teeth. J.A., pp. 43-45, Kurzer Aff.

The physical injury to Ms. Murphy's teeth was the result of "bruxism" (also known as teeth grinding) and it is a permanent condition. J.A., pp. 38-45. Ms. Murphy has undergone continuing treatment and restorative surgery to repair the permanent physical injury to her teeth. J.A., pp. 43-45. Dr. Carter, who testified at the DOL 1994 evidentiary hearing, and who also submitted an affidavit in the district court, testified without contradiction that the permanent injury to Ms. Murphy's teeth is the result of the retaliatory acts of her former employer, NYANG. J.A., pp. 38-42.

Additionally, the following expert conclusions of Dr. Carter were not contested before the district court in this case: "There is a physiological component to all stress and emotional distress, and anxiety, itself, has a physical basis. The brain is an organ of the body, as is the liver or the heart, and emotional distress is always a physical injury or physical sickness just like

physical problems with other parts of the body. Emotional distress can be caused by chemical changes in the brain. In addition, emotional distress is also a physical condition that is characterized by a physical cause." *See*, J.A., p. 41, Carter Aff., ¶ 15.

SUMMARY OF THE ARGUMENT

The personal injury-related damages awarded to Ms. Murphy are not taxable as "income" under 26 U.S.C. §61(a), or the 16th Amendment to the U.S. Constitution, and they are not taxable under any cognizable definition of income in the tax code. In an unbroken line of cases, the Supreme Court and the U.S. Courts of Appeals have drawn a sharp distinction between monetary awards which constitute a taxable "accession to wealth" and monetary awards that make a person "whole" by compensating that person's various losses.

Applying the consistent line of cases interpreting the meaning of "income" under 26 U.S.C. §61(a) and the 16th Amendment as well as the history surrounding its passage, requires a finding that the compensatory damages awarded to Ms. Murphy for an actual loss of reputation and damage to her emotional or physical well being is not subject to income tax.

While Congress amended Section 104(a)(2) of the Internal Revenue Code in 1996 to narrow the exclusion to damages for "personal physical injuries and physical sickness," Congress did not take any action to affirmatively tax such damages. Removing an exemption does not automatically result in a tax if the item is not income to begin with, or, alternatively, if the item does not fall within the scope of the tax levying statute. This change to Section 104 now requires the courts to analyze whether non-physical damages received on account of personal injuries and sickness are included within the tax levying statute, 26 U.S.C. §61(a). By failing to conduct such analyses, the district court improperly classified as taxable income the damages

that were awarded to Ms. Murphy for actual loss or restoration of human capital. Such damages are not included as gross income under the tax levying statute at issue, 26 U.S.C. §61(a).

When a taxpayer challenges whether the levying statute applies to her in the first instance, the tax statute must be construed strictly and all doubts must be resolved in favor of the taxpayer. The district court made a fundamental error by assuming that something not specifically exempted was automatically included in gross income. However, that is not the case, particularly, where, as here, Congress relies on the catchall phrase of 26 U.S.C. §61(a) as the statutory means to levy the tax. Also, by completely ignoring the long line of Supreme Court cases, from *Doyle* through *O'Gilvie*, and including *Glenshaw Glass Co.*, the district court compounded its error in reaching the wrong conclusion.

A long line of administrative rulings articulating that an award of compensatory damages was not income under the code and the 16th Amendment were adopted by the IRS and followed by the courts for over 75 years. Justice Breyer, in his decision in *O'Gilvie,* 519 U.S. at 84-85, carefully reconstructed this history and fully understood that the courts and the framers of the 1918 tax code understood that the specific loss of human capital was non-taxable. In this case, the district court completely ignored the human capital rationale set forth in *O'Gilvie* and other cases. Based on the history behind the 1918 exclusion as well as the 16th Amendment, Ms. Murphy's compensation for actual personal injury losses is not taxable income.

Additionally, in order to determine whether the Ms. Murphy's compensatory damages constitute taxable income this Court must review precisely "in lieu of what were the damages awarded." *Raytheon Production Corp. v. Commissioner of Internal Revenue,* 144 F.2d 110, 113 (1st Cir. 1944). Applying the *Raytheon* test to the facts of this case unquestionably demonstrates that Ms. Murphy's compensatory damages award is nontaxable. The "nature" of the payments

awarded by the DOL were "intended to compensate" Ms. Murphy for her tort-type losses. They were not payments intended to assist her in some form of "accession to wealth." Ms. Murphy's compensation was strictly designed to make her physically and emotionally "whole." Ms. Murphy's compensatory damages award did not "reach beyond those damages that, making up for a loss, seek to make a victim whole, or speaking very loosely, 'return the victim's personal or financial capital.'" *O'Gilvie*, 519 U.S. at 86. In reaching its conclusion, however, the district court ignored the "in lieu of what?" test's central question and failed to determine the "nature" of the payments in question and further determine, "what they were intended to compensate."

As independent grounds for reversing the district court, if the court finds that Ms. Murphy's compensatory damages award are included in gross income, she qualifies for the exclusion from income tax under the statutory exemption. Section 104(a)(2) satisfies the two requirements for damages to be excluded from gross income: (1) the recovery must have been based on a "tort or tort type of rights;" and (2) the damages must be received on account of personal physical injuries or physical sickness. *See Comm'r of Internal Revenue v. Schleier*, 515 U.S. 323, 336-37, 115 S.Ct. 2159, 2167 (1995).

In this case, the district court correctly found that the first requirement of the *Schleier* test is satisfied because the Department of Labor's authority to award compensatory damages was expressly permitted under the six federal environmental whistleblower statutes which "*created a 'species of tort liability'* in favor of persons who are the objects of unlawful discrimination." *Murphy*, 362 F.Supp.2d at 214 (emphasis added). However, at least a portion of Ms. Murphy's injuries were physical in nature and, therefore, she also satisfies the second part of the *Schleier* test. The district court failed to analyze the text of the statute or to consider its plain meaning and the district court incorrectly suggests that the legislative history somehow overrides the plain

meaning of the statute. Notably, the statute's text does not limit physical injuries or physical sickness to those that are caused by a physical stimulus, and the exemption applies where a person receives compensation for physical injuries or physical sickness that results solely from a non-physical stimulus, such as stress.

Finally, the district court erred in granting summary judgment because there was at least a genuine issue of material fact as to whether Ms. Murphy suffered personal physical injuries or physical sickness. There exists a genuine issue of material fact as to whether Ms. Murphy's physical injuries are distinct from the symptoms of emotional distress such as "insomnia, headaches, stomach disorders" as found by the district court. Additionally, the district court failed to draw inferences from the facts in the light most favorably to Ms. Murphy on the nature of her compensatory damages and whether she suffered physical injuries or physical sickness.

ARGUMENT

I. STANDARD OF REVIEW.

The standard of review of an order of the district court granting a motion for summary judgment is *de novo,* and the Court of Appeals applies the same standards as the district court under Fed. R. Civ. P. 56. *Aka v. Wash. Hospital Ctr.*, 156 F.3d 1284, 1288 (D.C. Cir. 1998); *IMS, P.C. v. Alvarez,* 129 F.3d 618, 619 (D.C. Cir. 1997); *Tao v. Freeh*, 27 F.3d 635, 638 (D.C. Cir. 1994).

II. THE IRS CANNOT TAX MS. MURPHY'S COMPENSATORY DAMAGES.

A. Ms. Murphy's Damages Are Not Income Under 26 U.S.C. §61.

Compensatory "make whole" damages for non-physical personal injuries do not fall within the statutory definition of gross income contained in 26 U.S.C. §61(a). The Government contends that the tax at issue here is contained in the catchall phrase, "all income from whatever

source derived." 26 U.S.C. §61(a). Significantly, the definition of "income" in the catchall phrase of §61(a) is expressly based on the 16th Amendment granting Congress the power to tax income "from whatever source derived."[3] *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431-432 and n. 11 (1955), citing H.Rep.No. 1337, 83d Cong., 2d Sess. A 18; S.Rep.No. 1622, 83d Cong., 2d Sess. 168 (The word "income" in 26 U.S.C. §61(a) is based on the 16th Amendment and "is used in its constitutional sense."). Accordingly, the word "incomes" in the 16th Amendment and the definition of "gross income" under 26 U.S.C. §61(a) are coextensive.[4]

Whether the statutory meaning of taxable income under 26 U.S.C. §61(a), or the constitutional meaning of incomes under the 16th Amendment are analyzed, the results are the same: Ms. Murphy's "make whole" damages are not income.

The 1996 amendment to Section 104(a)(2), in which Congress changed the exemption for personal injury damages, did not include the enactment of any tax. A change to a tax exemption does not automatically result in an item previously exempted if it is not already included in gross income. As Congress did not pass a new tax on compensatory damages when it changed the exemption then Ms. Murphy's damages are not subject to tax under the tax code because they are not income under Section 61(a). It is undisputed that a tax on Ms. Murphy's damages is not among the items of taxable income listed in Section 61(a), and such an express tax on damages does not appear in any other section of the Internal Revenue Code.

It is well-established that where the plain meaning of a statute is evident from the face of the statute, "'the sole function of the courts is to enforce it according to its terms.'" *U.S. v. Ron Pair Enters, Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030 (1989). Where the levy of a tax is at

[3] U.S. Const., Amendment XVI, states, "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."

[4] *See also, Helvering v. Clifford*, 309 U.S. 331, 334, 60 S.Ct. 554 (1940).

issue, the rule has been stated as follows:

> In the interpretation of statutes levying taxes it is the established rule *not to extend their provisions*, by implication, *beyond the clear import of the language used*, or to enlarge their operations *so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.*

Gould v. Gould, 245 U.S. 151, 153 (1917) (emphasis added).[5]

This rule has been followed by the Supreme Court and by this Court and other federal courts.[6] As one court recently observed, "the *Gould* rule remains in effect when the taxpayer is arguing that the provision of a statute levying a tax does not apply to him in the first instance." *America Online, Inc. v. United States*, 64 Fed. Cl. 571, 576 (Ct.Cl. 2005).

In this case, it is necessary to construe the meaning of income under the catchall phrase of Section 61(a). The common or plain meaning of income requires something that increases a person's wealth. That was true in 1913,[7] when the 16th Amendment was enacted, and it was also true in the mid-1950's when the Supreme Court reviewed the meaning of income in *Glenshaw*

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[5] In *Gould*, the Supreme Court analyzed the text of predecessor to Section 61 in the 1913 Revenue Act and was unable to determine that alimony fell within any of the terms used in the statute, and concluded that alimony was not a taxable item. *Id.* In subsequent versions of the federal tax code alimony was also not considered to be an item of gross income and were not subject to tax until a separate tax code provision was passed in 1954. *See* 26 U.S.C. §71. *Also see, Taylor v. CIR*, 55 T.C. 1134, 1138 (1971).

[6] *See e.g., White v. Aronson*, 302 U.S. 16, 20, 58 S.Ct. 95 (1937); *Andrus v. Burnet*, 50 F.2d 332, 333 (D.C. Cir. 1931); *Princess Cruises, Inc. v. United States*, 397 F.3d 1358, 1362 (Fed. Cir. 2005); *Ocean Drilling & Exploration Co. v. United States*, 988 F.2d 1135, 1156 (Fed. Cir. 1993); *Estate of Renick v. United States*, 687 F.2d 371, 376 (Ct. Cl. 1982).

[7] Webster's Revised Unabrigdged 1913 Edition defines income as: "That gain which proceeds from labor, business, property, or capital of any kind, as the produce of a farm, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation, or the interest of money or stock in funds, etc.; revenue; receipts; salary; especially, the annual receipts of a private person, or a corporation, from property; as, a large income."

Glass.[8]

Notably, the common definition of what is an "income tax" has remained static. In 1913, the term "income tax" was defined as "a tax upon a person's incomes, emoluments, profits, etc., or upon the excess beyond a certain amount." *Webster's Revised Unabridged Dictionary* (1913).[9]

However, "make whole" compensatory damages for injury to health or emotional well-being, or for lost reputation, do not increase one's wealth and do not fit within the common, ordinary meaning of "income" or "income tax." The Department of Labor ("DOL") fully adjudicated the factual issue as to whether the damages awarded to Ms. Murphy were for lost wages or whether those damages were directly related to compensating Ms. Murphy for an actual loss to her physical and/or mental condition, and no wages or other award was made to increase Ms. Murphy's wealth.

In a long unbroken line of cases, the Supreme Court and the U.S. Courts of Appeals have drawn a sharp distinction between monetary awards which constitute a taxable "gain" or "accession to wealth" and awards that make a person "whole" for restoring a personal loss.[10]

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[8] Merriam-Webster New Collegiate Dictionary (1953) defines income as: "That gain or recurrent benefit (usually measured in money) which proceeds from labor, business or property."

[9] Almost the exact same definition of "income tax" in Webster's 1913 edition was used in the 1953 edition of Merriam-Webster New Collegiate Dictionary.

[10] *See, e.g.*, *Doyle v. Mitchell Bros.*, 235 F. 686, 688 (6th Cir. 1916) (monies paid to compensate for losses in a fire are not income); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918) (return of capital not income under the tax code or 16th Amendment); *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114 (1925) (Brandeis, J.) (neither Congress nor the Courts are permitted to "make a thing income which is not so in fact"); *Glenshaw Glass Co.*, 348 U.S. at 432, n. 8 (personal injury recoveries are "by definition compensatory only" and nontaxable); *U.S. v. Kaiser*. 363 U.S. 299, 311 (1960) (Frankfurter, J., concurring) ("The principle at work here is that payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment"); *O'Gilvie v. United States*, 519 U.S. 79, 84-86

Applying the consistent and unbroken line of cases interpreting the meaning of "income" under the 16th Amendment as well as the history surrounding its passage as well as the understood meaning of "income" under the tax codes that were passed under the 16th Amendment, requires a finding that Murphy's compensatory damages award for an actual loss of reputation and damage to her emotional or physical well being is not income.

In *Glenshaw Glass,* the Supreme Court did not mandate that the IRS could tax all money – regardless of why it was received – unless Congress provided a specific exemption. Rather, the *Glenshaw Glass* Court defined "income" broadly to include any "accession to wealth." *Glenshaw Glass Co.,* 348 U.S. at 431.

What is an "accession to wealth?" Based on the dictionary (and common sense) definition of that phrase, it does not include compensation for a physical or emotional loss – especially if that loss is based on an adjudicated finding of a legally designated government body. For example, "accession" is defined in the following manner:

> *Law.* (a) That mode of acquiring property by which the owner of a corporal substance becomes the owner of *an addition by growth, increase, or labor.* In general, *additions or improvements* made by one person or by the forces of nature to the property of another...

See Webster's New International Dictionary, Second Edition (unabridged), p. 14 (1935) (emphasis added).[11]

(1996) ("a restoration of capital [is] not income; hence it [falls] outside the definition of 'income' upon which the law impose[s] a tax); *Hawkins v. Commissioner,* 6 B.T.A. 1023, 1024-25 (U.S. Bd. Tax. App. 1927) ("compensation for injury to [plaintiff's] personal reputation" was not income because it was "an attempt to make the plaintiff whole as before the injury."); *Dotson v. U.S.*, 87 F.3d 682, 685 (5th Cir. 1996) (personal injuries for physical or emotional well-being nontaxable as a "return of human capital").

[11] Black's Law Dictionary's (8th Edition, 2004) definition of accession consistent with this: "A property owner's right to all that is *added* to the property, naturally or by labor ...." (emphasis added). *Also see,* Bouviers Law Dictionary (Balwin's Edition 1934), p. 30: "The right to all

Here, the compensatory damages award adjudicated by the Secretary of Labor concerning the losses suffered by Ms. Murphy, cannot fit into any coherent or honest definition of "accession." Compensation for such personal harm or a loss is not an "addition" to one's property, either "naturally or by labor." It was not the "addition" of property "by growth, increase, or labor." In short, an "accession to wealth" implies that the property in question has been increased or added to in some manner. If the property is merely restored to its prior condition due to a damage, there is no accession.

The failure or mistake by Congress to include a tax on damages in Section 61(a) or another section of the tax code should not be given effect because it would violate the requirement that statutes levying a tax be clear. *Gould, supra.; America Online, supra., quoting Leavell v. Blades,* 237 Mo. 695, 700-01, 141 S.W. 893, 894 (1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it."). Section 61(a) has specific statutory language that necessarily limits its scope to items of income listed therein or to other income that falls within the scope of the catchall phrase, which is based on and limited by the 16th Amendment.

Accordingly, on the plain meaning of the statute, Ms. Murphy's damages are not included as income under Section 61(a). Moreover, even if there were some ambiguity on this point, the rule of statutory construction applied to statutes levying a tax would require any doubt to be resolved in favor of Ms. Murphy and against the government.

B. Based On the Plain Meaning of the 16TH Amendment Damages Solely Related to Compensating For An Actual Loss Cannot Be Taxed As Income.

The Supreme Court initially defined taxable "income" under the 16th Amendment as a "*gain* derived from capital, from labor, or from both combined." *Eisner v. Macomber,* 252 U.S.

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which one's own property produces."

189, 207 (1920) (emphasis added). That definition was further refined in *Glenshaw Glass*, where the Court recognized that various monetary "gains", "profits", and "income", which resulted in an "accession[] to wealth" constituted taxable income. *Glenshaw Glass Co.*, 348 U.S. at 429-31. Regardless of which definition has been used, the Court consistently interpreted the inclusion of the term "income" in the 16th Amendment as a term of limitation as to the scope of the taxing authority provided by that amendment. Thus, Congress is not permitted "make a thing income which is not so in fact." *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114 (1925).

The early cases decided under the 16th Amendment, none of which have been overruled, consistently examined whether the compensation being taxed was "income" or merely compensation for lost or to restore existing capital. *See*, *Doyle v. Mitchell Brothers Company*, 247 U.S. 179 (1918); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918); *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371, 378-39 (1934), *citing cases*. *Accord.*, *O'Gilvie v. United States*, 519 U.S. 79, 84 (1996) (After passage of the 16th Amendment the Court "decided several cases based on the principle that a restoration of capital was not income; hence it fell outside the definition of 'income'").

In the early cases the Court recognized that the term "income" as used in the 16th Amendment may create some difficulties in interpreting its precise scope. However, the strong distinction between monetary "gain or increase" versus compensation for existing capital was unquestionably established as a bedrock of 16th Amendment law:

> Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports as used here, *something entirely distinct from principal or capital* either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities.

Doyle, 247 U.S. at 185 (emphasis added).

Drawing on the dichotomy articulated in *Doyle,* the courts have consistently held that if the compensation obtained contributed to an "accession to wealth," the money was taxable. However, if the money was purely compensatory in nature, and constituted restitution for a loss, then the compensation was not taxable. These cases, all of which are consistent with the usage of the term "income" in the 16th Amendment, were explained in a concurring opinion by Justice Frankfurter (joined by Justice Clark) concerning the taxability of certain strike benefits:

> The principle at work here is that *payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment.* The principle is clearest when applied to compensation for the loss of what is ordinarily thought of as a capital asset, e.g., insurance when a house is destroyed . . . . The relevant question is whether the Commissioner has, or reasonably could have, applied a principle of reparation to deal with these cases . . . [in *Glenshaw Glass Co.*] we recognized that . . . *personal injury recoveries [are] non-taxable on the theory that they roughly correspond to a return of capital* . . . .

U.S. v. Kaiser, 363 U.S. 299, 311 (1960) (Justice Frankfurter concurring) (emphasis added).

The Supreme Court's reliance upon the plain meaning of "income" contained in the 16th Amendment was further apparent in its decision in *Glenshaw Glass Co.,* 348 U.S. at 432, n. 8, which Justice Frankfurter expressly referred to when he stated in *Kaiser* that "personal injury recoveries" were akin "to a return of capital" and, therefore, "non-taxable." In *Glenshaw Glass,* the Court noted the "long history" of rulings "holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital." The Supreme Court summarized its view on the taxability of compensatory damages in order to make a person whole for an actual injury (as opposed to an award of punitive damages which would result in a windfall to a victim) as follows: "Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes." *Id.*

However, the district court misinterpreted the holding of *Glenshaw Glass* and improperly concluded that compensatory damages no longer "specifically exempted by statute" must "fall[] within the broader definition of taxable income." *Murphy,* 362 F.Supp.2d at 215, citing *Glenshaw Glass Co.*, 348 U.S. at 431. Simply because the Supreme Court noted in *Glenshaw Glass Co.* that the definition of income may include "accessions to wealth" does not mean that compensatory damages awarded to "make whole" a victim of discrimination are subject to tax as income. It is only by completely ignoring the long line of Supreme Court cases, from *Doyle* through *O'Gilvie*, and including *Glenshaw Glass,* that the district court is able to reach that conclusion.[12]

There are simply no grounds for the federal courts to depart from the fundamental principle that compensatory damages awards for personal injuries are the restoration of capital and not income as that term has been consistently understood and applied since the enactment of the 16th Amendment. *O'Gilvie,* 519 U.S. at 86 (The replenishment of human capital, in the form of damages, "aim(s) to substitute for a victims physical or personal well-being – personal assets that the Government does not tax and would not have taxed had the victim not lost them.").

C. The Legislative History and Departmental Rulings Demonstrate That Compensatory Damages Designed to Make A Person Whole Are Excluded From the Definition of "Income" Under 26 U.S.C. §61(a) and/or the 16th Amendment.

The plain language of the 16th Amendment clearly limits the scope of the federal government's income tax powers to the taxation of "income," as opposed to the taxation of

[12] Even where the broad taxing power of Congress was noted the Court has also carefully observed that the "income" in question was in fact a "gain" from the taxpayer's initial basis, or it added to the taxpayer's wealth. *Compare, e.g., Commissioner v. Banks*, 125 S.Ct. 826, 831 (2005) (permitting the taxation of "economic gains") with *U.S. v. Safety Car*, 297 U.S. 88, 99 (1936) ("Income within the meaning of the Sixteenth Amendment is the *fruit that is born of capital*") (emphasis added).

compensation for losses, be they personal injuries or damaged capital.[13] If there was any doubt about this, the legislative history surrounding the enactment of the 16th Amendment and passage of the Revenue Act of 1918 (which exempted personal injuries from taxation), followed by a long line of administrative rulings, provides enormous undisputed support for this interpretation of the Amendment.[14]

In a 1996 decision, the U.S. Court of Appeals for the Fifth Circuit outlined the constitutional limitations on the income tax, as understood at the time the amendment was passed and when the initial statutory exemption for personal injuries was passed. At that time, compensation for personal injuries was "considered" part of a "return of human capital, and thus not constitutionally taxable 'income' under the 16th Amendment." *Dotson v. U.S.*, 87 F.3d 682, 685 (5th Cir. 1996). Because "human capital lost through injury" was understood to be nontaxable, the drafters of the Revenue Act of 1918 incorporated into that tax code a statutory exemption for compensation for personal injury. *Id*. The Fifth Circuit conceptualized this understanding in *Dotson* as follows: "The recipient of personal injury damages is in effect

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[13] In addition to the Supreme Court's explicit requirement that income must involve a gain, the Court has also emphasized that the commonly understood meaning of income is significant. *Glenshaw Glass Co.*, 348 U.S. at 431 (examining the "dictionaries in common use" to inform the proper meaning of income); *Merchants' Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519, 41 S.Ct. 386, 389 (1921) (refusing to consider an economists' definition of income, insisting on following "what it believed to be the commonly understood meaning of the term…."); *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99, 56 S.Ct. 353, 358 (1936) ("Income within the meaning of the Sixteenth Amendment is…[w]ith few exceptions, if any…income as the word is known in the common speech of men."). Both the common meaning and the Court's definition are consistent in their emphasis that income requires an increase in wealth.

14 As noted above, the contemporaneous dictionary meanings in 1913 do not support that "make whole" compensatory damages for personal injury were part of "the commonly understood meaning" of the term income that would "have been in the minds of the people when they adopted the Sixteenth Amendment." *Merchants' Loan & Trust Co.*, 255 U.S. at 519. Additionally, the implementing legislation and the interpretative administrative rulings that followed the 16th Amendment support the construction urged by Ms. Murphy. *Myers v. United States*, 272 U.S. 52, 175, 47 S.Ct. 21 (1926); *Eisner*, 252 U.S. at 202.

forced to sell some part of her physical or emotional well-being in return for money." *Id.* Thus, the statutory exclusion for personal injuries which was contained in the tax code from 1918 until 1996 was based on an understanding by the authors of that code, from its very inception, that such compensatory damages were not constitutionally taxable. This understanding of the Fifth Circuit's decision in *Dotson* is supported by a 1918 U.S. Attorney General Opinion which analyzed the early 16th Amendment Supreme Court cases and applied those holdings to the issue of personal injury compensation. 31 U.S. Op. Atty. Gen. 304, 308, 1918 WL 633 (U.S.A.G.) ("Without affirming that the human body is in a technical sense the 'capital' invested in an accident policy, in a broad, natural sense the proceeds of the policy do but substitute, so far as they go, capital which is the source of future periodical income. They merely take the place of capital in human ability which was destroyed by the accident. They are therefore 'capital' as distinguished from 'income' receipts.").

Justice Breyer, in his decision in *O'Gilvie*, carefully reconstructed this history and fully understood that the courts and the framers of the 1918 tax code understood that the specific loss of human capital was non-taxable:

> That history begins in approximately 1918. At that time, this Court had recently decided several cases based on the principle that a restoration of capital was not income; hence it fell outside the definition of "income" upon which the law imposed a tax. *E.g., Doyle v. Mitchell Brothers Co.*, 247 U.S. 179, 187, 38 S.Ct. 467, 469-470, 62 L.Ed. 1054 (1918); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335, 38 S.Ct. 540, 542, 62 L.Ed. 1142 (1918). The Attorney General then advised the Secretary of the Treasury that proceeds of an accident insurance policy should be treated as nontaxable because they primarily "substitute ... capital which is the source of *future* periodical income ... merely tak[ing] the place of capital in human ability which was destroyed by the accident. They are therefore [nontaxable] 'capital' as distinguished from 'income' receipts." 31 Op. Atty. Gen. 304, 308 (1918). The Treasury Department added that
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> > "upon similar principles ... an amount received by an individual as the result of a suit or compromise for personal injuries

> sustained by him through accident is not income [that is] taxable...." T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).
>
> Soon thereafter, Congress enacted the first predecessor of the provision before us [i.e. the provision of the tax code which exempted personal injuries from taxation and which was subsequently amended in 1996 to eliminate the exemption for non-physical personal injuries]. That provision excluded from income
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> > "[a]mounts received, through accident or health insurance or under workmen's compensation acts, 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." Revenue Act of 1918, ch. 18, § 213(b)(6), 40 Stat. 1066.
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> The provision is similar to the cited materials from the Attorney General and the Secretary of the Treasury in language and structure, all of which suggests that Congress sought, in enacting the statute, to codify the Treasury's basic approach. A contemporaneous House Report, insofar as relevant, confirms this similarity of approach, for it says:
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> > "Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income." H.R.Rep. No. 767, pp. 9-10 (1918).
>
> This history and the approach it reflects suggest there is no strong reason for trying to interpret the statute's language to reach beyond those damages that, making up for a loss, seek to make a victim whole, or, speaking very loosely, "return the victim's personal or financial capital."

See, O'Gilvie, 519 U.S. at 84-87.

The "return of human capital" analogy was expressly adopted by the IRS in 1918, in 1922, and in 1974, and was acknowledged by the Supreme Court in *Glenshaw Glass* and *O'Gilvie*. *See Glenshaw Glass Co.,* 348 U.S. at 433 n. 8; *O'Gilvie,* 519 U.S. at 84-84; 31 Op. Att'y Gen. 304 (1918); T.D. 2747, 20 Treas. Dec. 457 (1918); Sol. Op. 132, 1-1 C.B. 92, 03 (1922). *Also see* Rev. Rul. 77-74, 1974-1 C.B. 33, 1974 WL 34538 (IRS RRU) (adopting Sol.

Op. 132 and agreeing that such non-physical personal injury damages "are not income").[15] In 1922, the Treasury Department expressly stated that money received for alienation for affection or for lost reputation "***does not constitute income within the meaning of the sixteenth amendment and the statutes enacted thereunder.***" Sol. Op. 132, 1-1 C.B. 92, 03 (1922) (emphasis added). Sol. Op. 132, also states:

> ***If an individual is possessed of a personal right*** that is not assignable and ***not susceptible of any appraisal in relation to market values***, and thereafter receives either damages or payment in compromise for an invasion of that right, ***it can not be held that he thereby derives any gain or profit.***

Id. (emphasis added).

This ruling was based on Supreme Court decisions interpreting the definition of income under the 16th Amendment and remained in full force after *Glenshaw Glass* was decided. *Id.*, citing *Stratton's Independence v. Howbert,* 231 U.S. 399; *Eisner*, 252 U.S. at 207. *Also see Hawkins, supra.* This principle was extended long after *Glenshaw Glass* was decided to declare that compensation to victims of Nazi persecution and prisoners of war was not income.[16] Accord., *Starrels v. Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962) ("Damages paid for personal injuries are excluded from gross income because they make the taxpayer whole from a previous loss of personal rights – because, in effect, they restore a loss to capital.").

This binding authority of the IRS, itself, in Sol. Op. 132, and the other related administrative rulings, as well as the long reliance on this rationale by the courts and the taxpayers, completely undermines and contradicts the Government's theory to tax Ms. Murphy's

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[15] *Accord., Dotson,* 87 F.3d at 685 (Because "human capital lost through injury" was understood to be nontaxable, the drafters of the 1918 tax code incorporated into that code a statutory exemption for compensation for personal injury).

[16] Rev. Rul. 56-518, 1956-2 CB 25; Rev. Rul. 57-505, 1957-2 CB 50; Rev. Rul. 58-500, 1955-2 CB 21; Rev. Rul. 58-370, 1958-2 CB 14; Rev. Rul 69-212, 1969-1 CB 34; Rev. Rul. 55-132, 1955-1 CB 213; Rev. Rul. 56-462, 1956-2 CB 20.

damages in this case. Although the IRS concluded in 1922, there is "no gain or profit" realized by an individual who receives non-physical personal injury damages and such compensation is not income at all, and that rule remained in effect for over 75 years, the Government still fails to explain how its unsupported theory that "make whole" damages for personal injury can be turned into a taxable accession to wealth or gain. In light of the binding "long history" of administrative authorities there is not "any gain or profit" derived from an award of such damages.[17]

The Supreme Court has observed that revenue rulings are entitled to "considerable weight where they involve the contemporaneous construction of a statute and where they have been in long use." *Davis v. United States*, 495 U.S. 472, 484, 110 S.Ct. 2014, 109 L.Ed.2d 457 (1990). More recently, *In Del Commercial Properties, Inc. v. Commissioner*, 251 F.3d 210, 214 (D.C. Cir. 2001), this Court observed that revenue rulings are to be accorded "*Skidmore* deference-that is, they are 'entitled to respect' to the extent they 'have the 'power to persuade,' *Christensen v. Harris County*, 529 U.S. 576, 587, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944))." Consequently, the level of deference accorded to a revenue ruling turns on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *United States v. Mead Corp.*, 533 U.S. 218, 228 (2001) (quoting *Skidmore*, 323 U.S. at 140). In this case, the government has not provided any justification for ignoring or departing from the long line of

[17] "Compensation for mental distress is measured by the amount necessary to restore the victim to the status quo ante. This determination is made in an adversarial contest applying traditional tort rules of liability and damages . . . . Because there is no gain to the compensated victim, there is no income under the Sixteenth Amendment." Hubbard, "Making People Whole Again: The Constitutionality of Taxing Compensatory Tort Damages for Mental Distress," 49 *Florida Law Review* 725, 766 (December, 1997). *Also see*, Doti, "Personal Injury Income Tax Exclusion: An Analysis and Update," 75 Denver U. Law Rev. 61 (1997).

administrative and Departmental rulings, including but not limited to the 1918 U.S. Attorney General Opinion, several Treasury Decisions, Sol. Op. 132 and subsequent revenue rulings, applying the human capital analogy to determine that "make whole" personal injury damages are not income. These administrative rulings forcefully support Ms. Murphy's position that her damages are not income as these prior rulings thoroughly considered the matter and were relied upon by the IRS, taxpayers and the courts for more than 75 years.

Additionally, when the 16th Amendment was enacted it was clearly established that damages for emotional distress injuries were compensable under tort law. *Western Union Tel. Co. v. Berdine*, 2 Tex.Civ.App. 517, 522(1893) ("...mental suffering ... may form the basis for compensatory damages, is not now a debatable question in this state."). Accord., *Wells, Fargo & Co.'s Express v. Fuller*, 13 Tex.Civ.App. 610, 614 (1896); *Johnson v. Wells, Fargo & Co.*, 6 Nev. 224 (1870); *Valentine H. Smith v. The Pittsburgh, Fort Wayne and Chicago Railway Company*, 23 Ohio St. 10 (1872); *American Waterworks Co. v. Dougherty*, 55 N.W. 1051, 1053 (1893) (". . . mental suffering and anxiety are, as much as physical, an element for which the plaintiff should be compensated."); *Stuart v. Western Union Tel. Co.*, 66 Tex. 580, 584-88 (1885) ("Physical pain is no more real than is mental anguish.").[18]

[18] Numerous other cases decided before the enactment of the Sixteenth Amendment stand for the same proposition. *See, e.g., Smith et al. v. Overby*, 30 Ga. 241, 1860 WL 2128 (Ga.) (1860) ("Man has a moral as well as a physical nature. Here the injury is to his feelings-his honor-his pride- his social position. Suffer these to go unprotected, unredressed, and life itself is no longer tolerable nor desirable. Hence, the jury in such case should render large damages, not as punishment, but to compensate the actual injury."); *Stewart v. Maddox*, 63 Ind. 51, 1878 WL 6097 (1878); *The Lake Erie and Western Railway Company v. Fix*, 88 Ind. 375, 1882 WL 6625 (1882); *McKinley v. The C. & N. W.R. Co.*, 44 Iowa 314, 1876 WL 259 (1876); *Dirmeyer v. O'Hern*, 3 So. 132 (1887); *Smith v. Holcomb*, 99 Mass. 552 (1868) ("Even where there is no insult or indignity, mental suffering may be a ground of damage, in an action of tort for an injury to the person"); *Shepard v. Chicago, R.I. & P.RY.Co.*, 41 N.W. 564, 565 (1889); *Curtis v. Sioux City & H.P. RY. Co.*, 54 N.W. 339, 340-41 ("Mental suffering, we know, is often poignant, and many times fatal to health or life.").

In this case, the district court completely ignored the human capital rationale set forth in *O'Gilvie* and other cases. In fact, the district court failed to even cite to *O'Gilvie* or determine whether Ms. Murphy's compensatory damages award constituted a return of capital. Rather, the district court simply rested its conclusion on its claim that Congress' taxing authority was broad enough to tax anything not specifically excluded as income by statute. *Murphy,* 362 F.Supp.2d at 217.

By contrast, the legislative materials and Supreme Court case law surrounding the earliest enactment of the personal injury exclusion by Congress in 1918 clearly establishes that the drafters understood that taxing personal injuries raised significant constitutional issues, and that compensation for an actual loss or return of capital could not be classified as "income." *See, e.g., O'Gilvie,* 519 U.S. at 84-87.

Based on the historical record in passing the 16th Amendment, the legislative history, the text of the tax code and the long history of Departmental rulings and court cases, Ms. Murphy's damages are ***not*** income under either Section 61(a) or the 16th Amendment.

D. The Compensatory Damages Awarded to Ms. Murphy By the U.S. Department of Labor Do Not Constitute Income Under the "In Lieu of What?" Test.

In order to determine whether the U.S. Department of Labor compensatory damages awarded to Ms. Murphy constitutes taxable income, either under the 16th Amendment or pursuant to the permissible definition of income under the tax code, this Court must review precisely "in lieu of what were the damages awarded." *Raytheon Production Corp. v. Commissioner of Internal Revenue,* 144 F.2d 110, 113 (1st Cir. 1944). In other words, the court must determine the "nature" of the payments in question and further determine, "what they were intended to compensate." *Gilbertz v. U.S.,* 808 F.2d 1374, 1378 (10th Cir. 1987); *Tribune Publishing Co. v. U.S.,* 836 F.2d 1176, 1179 (9th Cir. 1988) (applying *Raytheon* test); *Franciso v.*

U.S., 267 F.3d 303, 319 (3rd Cir. 2001) (citing *Raytheon* test). Courts are required to maintain "fidelity to the human capital rationale" as originally understood by the Supreme Court in the early 20th Century and determine whether a damage award is in fact an accession to wealth beyond an original capital basis or whether the damage award is "linked to an injury in the same direct way as traditional tort remedies." *Franciso*, 267 F.3d at 313.

In order to determine the "nature" of the payments to Ms. Murphy, this Court must engage in a three part analysis. First, it must determine whether the injury suffered by Ms. Murphy for which she was awarded compensatory damages was for a harm the law prohibits. Second, the Court must determine the basis for the award. Third, the Court must review the "nature" of the payments and determine whether those payments were for compensation for an actual harm or loss, or whether those payments constituted a "gain" as part of an "accession to wealth." Applying the *Raytheon* test to the facts of this case unquestionably demonstrates that Ms. Murphy's compensatory damages award is nontaxable.

First, it is uncontested that the laws upon which Ms. Murphy's entire damages award was based permitted the award of "compensatory damages" and that this award was "a species of tort liability." *Murphy*, 362 F.Supp.2d at 211.

Second, Ms. Murphy's compensatory damage award was *not* "derived from salaries, wages, or compensation for personal service . . . or the transaction of any business carried on for gain or profit . . . ." *Glenshaw Glass Co.*, 348 U.S. at 429. The uncontested record in this case, as set forth by the district court, demonstrates that the compensatory damages award was paid in order to make Ms. Murphy whole for a variety of harms and losses, such as bruxism, permanent tooth damage, "physical manifestations of stress," "anxiety attacks, shortness of breath, and dizziness" as well as damage to reputation. *Murphy*, 362 F.Supp.2d at 210-211. Significantly,

these harms were not based on unsupported allegations, but instead on factual findings of an agency after an evidentiary hearing on the merits.

Third, based on the DOL-determined reasons why the damages in this matter were awarded, it is uncontested as a matter of fact that the "nature" of the award in this case was purely compensatory. *Glenshaw Glass Co.*, 349 U.S. at 433, n. 8. The "nature" of the payments awarded by the DOL were "intended to compensate" Ms. Murphy for her tort-type losses. *See Leveille*, Decision and Order on Damages, pp. 4-5, 1999 WL 966951 (Oct. 25, 1999). They were not payments intended to assist her in some form of "accession to wealth." *Gilbertz.*, 808 F.2d 1374, 1378 (10th Cir. 1987). Ms. Murphy's compensation was strictly designed to make her physically and emotionally "whole." Ms. Murphy's compensatory damages award did not "reach beyond those damages that, making up for a loss, seek to make a victim whole, or speaking very loosely, 'return the victim's personal or financial capital.'" *O'Gilvie*, 519 U.S. at 86.

Although Ms. Murphy satisfied each part of the "in lieu of what?" test, the district court concluded nonetheless that her compensatory damages award could be taxed. In reaching this conclusion the district court ignored the "in lieu of what?" test's central question and failed to determine the "nature" of the payments in question and further determine, "what they were intended to compensate." *Cf., Gilbertz,* 808 F.2d at 1378. Instead, the district court simply concluded that "anything falling outside" the revised language of Section 104(a)(2) was automatically "considered income, and is therefore taxable." *Murphy*, 362 F.Supp.2d at 218. In so doing, the district court failed to conduct the required analysis under the "in lieu of what?" test.

The district court confused its role in interpreting the explicit language contained in a statutory exclusion with its role making a threshold determination as to what sort of damage payment can be "properly regarded as income." *Taft,* 278 U.S. at 481. In order to engage in this required analysis the district court should have relied upon the test set forth in *Raytheon*.

In order to be constitutionally permissible under the 16th Amendment, or within the scope of income under Section 61(a), the IRS must demonstrate that any compensatory damages for non-physical injuries that it seeks to tax are not compensation for actual loss or the restoration of capital or human capital, but are income as defined by the long-standing history of that term both before and since enactment of the 16th Amendment. Simply declaring that the IRS has the power to tax compensatory damages because they are not for physical injuries is a drastic departure from the well-defined historical and constitutional treatment of all make whole compensatory damages as the return of capital.

Accordingly, Ms. Murphy's compensatory damages award, in its entirety, was paid "in lieu of" direct compensation for an actual loss. There was no income involved which is taxable under the Internal Revenue Code or under the 16th Amendment.

E. The Internal Revenue Code Cannot Be Construed to Conflict With Other Laws Providing for "Make Whole" Compensatory Damages.

A court should construe statutes harmoniously, even if an apparent conflict exists. *Anderson v. FDIC,* 918 F.2d 1139, 1143 (4th Cir. 1990), citing 2A N. Singer, *Sutherland Statutory Construction* § 53.01 at 550 (4th ed. 1984). *Also see, Vinar Seguros y Reaseguros, S.A. v. M/V Sky Reefer,* 515 U.S. 528, 533, 115 S.Ct. 2322 (1995). Although Congress did not pass a tax on personal injury damages, if the 1996 amendment to Section 104(a)(2) is interpreted to tax Ms. Murphy's damages that would create considerable tension with the remedial purpose of the six federal environmental statutes under which Ms. Murphy was awarded "make whole"

compensatory damages as well as similar civil rights statutes, such as Title VII of the Civil Rights Act, providing for the same kind of "make whole" relief. Such an interpretation of Sections 61 and 104 of the tax code would also conflict with the long-standing principle under tort law that certain kinds of damages awards are intended to make the victim whole. A tax on these kinds of compensatory damages greatly diminishes the "make whole" nature of the remedial relief to restore personal injury losses. In the absence of clear congressional intent that the 1996 amendment to Section 104(a)(2), which attempts to restrict the personal injury exemption to cases of physical injury or physical sickness, are applicable to "make whole" remedial relief in federal civil rights and whistleblower cases, or in state law tort actions, the taxing of such damages cannot be applied in such circumstances.

In order to avoid such tension or conflict between these laws the amendment to Section 104(a)(2) at issue could be interpreted as applicable only to personal injury awards that are not "make whole" and purely compensatory in nature. The federal anti-discrimination and whistleblower statutes as well as common law tort recoveries must be given their full remedial effect. If a dispute arose as to the nature of the damages awarded this could be accomplished under existing legal principles, such as pursuant to the "In lieu of what?" test. In applying these rules of construction in this case, Ms. Murphy's "make whole" damages must be deemed not taxable.

F. If Ms. Murphy's Damages Are Not Income They Are Not Taxable Under 26 U.S.C. §61(a) Or, Alternatively, They Are A Direct Tax Subject to Apportionment.

If Ms. Murphy's damages are not income under either Section 61(a) or the 16th Amendment, there is no need to determine whether such damages would be taxable under some other taxing power of Congress, because as stated above, they are not income under the catchall

provision of Section 61 or the 16th Amendment, and Congress never enacted a tax on these types of damages. *See Gould, supra.* Unless or until Congress has passed a tax on compensatory damages there is no case or controversy as to whether such a tax would be constitutional under Article I of the Constitution.

Alternatively, for the sake of argument, if the catchall phrase in Section 61(a) is interpreted to be something other than an income tax based on the 16th Amendment, then it would be a direct tax not subject to apportionment and therefore unconstitutional under Article I, §9.[19] A tax on personal injuries is a direct tax because it is a tax on personal property or a tax on the individual. *See* U.S. Const. art. 1, §9, cl. 4, U.S. Const. amend. XVI. *Also see, Pollock v. Farmer's Loan & Trust Co.,* 158 U.S. 601, 15 S.Ct. 912 (1895). A direct tax is assessed directly on the person and cannot be shifted to someone else. On the contrary, an indirect tax, such as tariffs or business taxes, is a tax that is not paid directly but instead indirectly through higher prices. For instance, tariffs do not impose a direct tax on individuals but the tariff raises the price ultimately paid by the consumer. Taxes on personal property are direct taxes. *Id.* A tax on damage awards would tax either the individual directly, or the personal property of the taxpayer and imposes a direct tax. Under the Sixteenth Amendment, the only direct taxes that can be imposed by Congress without apportionment are income taxes. Accordingly, because Ms. Murphy's damages are not income, and they would be subject to a direct tax, Congress cannot tax them without violating the apportionment rule. Once again, if the taxing statute is ambiguous

[19] The catchall phrase of Section 61(a), which is the only method by which Ms. Murphy's damages can be taxed at all, is not based on Article I, §8, cl. 1, which provides only for excise taxes, duties and imposts. Because the catchall phrase of Section 61(a) is the tax at issue and that phrase is expressly based on the 16th Amendment (*see Glenshaw Glass*, 348 U.S. at 431-432 and n. 11), and the word "income" appears only in the 16th Amendment and not elsewhere in the Constitution, then it is not an excise tax, duty or impost pursuant to Article I, §8, cl. 1.

it should be resolved in favor of Ms. Murphy. *America Online, supra.; Gould, supra.*

III. ALTERNATIVELY, MS. MURPHY'S DAMAGES WERE AWARDED ON ACCOUNT OF HER PERSONAL PHYSICAL INJURIES AND PHYSICAL SICKNESS AND SHOULD BE EXCLUDED FROM GROSS INCOME UNDER 26 U.S.C. §104(a)(2).

Summary judgment is appropriate if "there is no genuine issue as to any material fact" and "the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). *See also, Celotex Corp. v. Cartrett*, 477 U.S. 317, 325, 105 S.Ct. 2548, 2554 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48, 106 S.Ct. 2505, 2510 (1986). However, if the non-moving party establishes that there is a dispute of material fact, summary judgment must be denied. Fed. R. Civ. P. 56(c); *Anderson*, 477 U.S. at 242-43, 105 S.Ct. at 2507. Inferences drawn from the facts must be viewed in the light most favorably to the party opposing the motion. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157, 90 S.Ct. 1598 (1970).

The compensatory damages award at issue qualifies for the exclusion from income tax under 26 U.S.C. §104(a)(2) because it satisfies the two requirements for damages to be excluded from gross income: (1) the recovery must have been based on a "tort or tort type of rights;" and (2) the damages must be received on account of personal physical injuries or physical sickness. *See Comm'r of Internal Revenue v. Schleier*, 515 U.S. 323, 336-37, 115 S.Ct. 2159, 2167 (1995); *United States v. Burke*, 504 U.S. 229, 237, 112 S.Ct. 1867, 1872 (1992).[20]

[20] Both *Schleier* and *Burke* were decided before Congress amended section 104(a)(2) to include the word "physical" before the words personal injuries and sickness. Section 104(a)(2) only required that damages be received "on account of personal injuries or sickness" to qualify for the exclusion prior to the 1996 amendments.

In this case, the district court correctly found that the first requirement of the *Schleier* test is satisfied. *Murphy,* 362 F.Supp.2d at 214 (emphasis added).[21]

However, the district court erred in its analysis of the second part of the *Schleier* test because the damages awarded to Ms. Murphy were received on account of personal physical injuries or physical sickness.

As amended in 1996, the personal injury exclusion statute expressly states that "gross income does not include -- the amount of any damages … received … on account of *personal physical injuries or physical sickness*." 26 U.S.C. § 104(a)(2) (emphasis added). The district court erred in analyzing the exclusion as amended by Congress and in determining that Ms. Murphy did not suffer personal physical injuries or physical sickness under the terms of the amended statute.

A. Ms. Murphy Received Damages Within the IRS Exclusion Under the Plain Meaning of Section 104(a)(2), As Amended in 1996.

The plain meaning of the statute allows exemptions for damages received on account of "physical injuries or physical sickness" regardless of what caused the injury or sickness, and the legislative history is irrelevant when the text is unambiguous, as it is in 26 U.S.C. § 104(a)(2). *See BedRoc Ltd., LLC v. United States*, 541 U.S. 176, 124 S.Ct. 1587 (2004); *Lamie v. United*

[21] Ms. Murphy satisfies the first element required to qualify for the exclusion provided in section 104(a)(2) because her recovery was based on a tort type of right. *See Burke*, 504 U.S. at 237, 112 S.Ct. at 1872 (requiring a "tort-like personal injury" to qualify for a section 104(a)(2) exclusion). Each of the six environmental statutes upon which Murphy's complaint was based specifically provide for an award of "compensatory damages." *Murphy*, 362 F.Supp.2d at 214. Furthermore, "[b]y authorizing the award of compensatory damages, the environmental statutes have *created a 'species of tort liability'* in favor of persons who are the objects of unlawful discrimination." *Id.*, citing *Leveille*, ARB Decision and Order on Damages, p. 4, 1999 WL 966951 (Oct. 25, 1999) (emphasis added). The Department of Labor also noted that determining the amount of compensatory damages under the six environmental statutes should be based on a comparison of "damage awards by courts or juries … in *analogous tort actions* …" *Leveille*, ARB Decision and Order at p. 5, 1999 WL 966951 (emphasis added).

States Tr., 540 U.S. 526, 124 S.Ct. 1023, 1030 (2004). *Also see United States ex rel. Totten v. Bombardier Corp.,* 380 F.3d 488, 494 (D.C. Cir. 2004) ("resort to legislative history is not appropriate in construing plain language.").

Nothing in the statute remotely suggests that an injury must be caused by physical stimuli for the exemption to apply. *See* 26 U.S.C. § 104(a)(2). The district court incorrectly suggests that the legislative history somehow overrides the plain meaning of the statute. *See Murphy,* 362 F.Supp.2d at 215 (citing solely the House Report as the grounds for concluding that plaintiff's compensatory damages are not a physical injury or physical sickness within the scope of the exclusion). Specifically, relying on language in the legislative history and not the text of the statute itself, the district court stated as follows: "Here, Murphy's mental anguish manifested itself into a physical problem, bruxism, but this was only a symptom of her emotional distress, not the source of her claim. Plaintiff's emotional distress is not 'attributable to her physical injury'; in fact, it is the other way around." *Murphy,* 362 F.Supp.2d at 215.

It is well-settled that when the statute is unambiguous, legislative history may not be considered. *See BedRoc*, 124 S.Ct. at 1595; *Lamie*, 124 S.Ct. at 1030 ("[W]hen the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms.").

There is no ambiguity about the meaning of "physical injury." *See Ford v. McGinnis*, 198 F.Supp.2d 363, 364-65 (S.D.N.Y. 2001) (holding statute that requires "physical injury" was not ambiguous and resort to legislative history was inappropriate). Because there is no ambiguity about the meaning of "physical injuries" under IRC Section 104(a)(2), the legislative history may not be considered in this case.

In this case, it is clear that the type of injuries or sickness, not the underlying stimulus for the injuries or sickness, determines whether the exclusion applies. *See* 26 U.S.C. §104(a)(2). While the amended statute now states that "emotional distress shall not be treated as a physical injury or physical sickness," 26 U.S.C. §104(a), that requirement is satisfied in this case by the factual record which establishes Ms. Murphy suffered physical injuries, including permanent injury to her teeth, that is a physical injury that is separate and distinct from emotional distress, even though it may have resulted from the emotional distress.

The district court erred by finding that Ms. Murphy did not meet the second part of the *Schleier* test because the court held that her injuries were not "*physical* in nature." *Murphy,* 362 F.Supp.2d at 214-215 (emphasis in original). However, it is not contested that Ms. Murphy suffered physical injuries. Both the DOL ALJ and ARB specifically cited to, and relied upon, the testimony of Dr. Edwin N. Carter, Ms. Murphy's doctor, in awarding Ms. Murphy compensatory damages. Dr. Carter provided unrebutted testimony about the nature of Ms. Murphy's physical injuries and illnesses. *Leveille,* Decision and Order on Damages, 1999 WL 966951 (Oct. 25, 1999); *See Leveille,* Recommended Decision and Order, p. 6 (ALJ Feb. 9, 1998).

Dr. Carter confirms in his affidavit that prior to testifying and in preparation for the hearing in July 1994, he reviewed Ms. Murphy's dental records and medical records. *See* J.A., pp. 39-40, Carter Aff., ¶¶ 5, 7, 9, 11. Indeed, Dr. Carter also confirms that the conclusions he reached at the July 1994 DOL hearing, that Ms. Murphy experienced "somatic" and "body" injuries, were based, in part, on his review of her dental records and her medical records. *Id*.

Moreover, the term "somatic" literally means, "[o]f, relating to, or affecting the body, especially as distinguished from a body part, the mind, or the environment; corporeal or

physical." *See, e.g., The American Heritage® Dictionary of the English Language,* (4th Ed. 2000). *Also see, Webster's New Twentieth Century Dictionary of the English Language* (Unabridged), p. 1729 (Second Ed. 1977) ("Somatic" defined as "corporeal; pertaining to the body as distinct from the soul, mind, or psyche"). Accord., J.A., p. 39, Carter Aff., ¶ 8. The facts of this case, clearly demonstrate that Ms. Murphy suffered "somatic" and "body" injuries, such as her "bruxism" and permanent damage to her teeth, as a result of NYANG's illegal conduct. Ms. Murphy's compensatory damages were received on account of her having suffered physical injuries or physical sickness, as a matter of fact. *Id.* Thus, since Ms. Murphy's symptoms were, in fact, "somatic" they were, by their very definition, physical, and not mental, injuries or sickness. *Id.*, Carter Aff., ¶¶ 7-8.[22]

Dr. Barry L. Kurzer, Ms. Murphy's dentist, authenticated that the dental records submitted to the IRS in December 2002 are his records of Ms. Murphy's dental history and that he has personally treated her since January 1993. *See* J.A. p. 45, Kurzer Aff., ¶14. Consistent with Dr. Carter's uncontested findings, Dr. Kurzer verifies that Ms. Murphy has suffered permanent damage to her teeth requiring continuing treating for years to combat the effects of bruxing. J.A., pp. 44-45, Kurzer Aff., ¶¶ 9-15. Bruxism, a condition more commonly known as teeth grinding, causes physical pain and extensive physical tooth damage. J.A., p. 43, Kurzer Aff., ¶ 4.

In addition, the ALJ found "ample evidence" that Ms. Murphy was entitled to compensation, specifically noting "*physical* manifestations of stress," which included "anxiety

[22] Dr. Carter based his assessment that Ms. Murphy experienced "somatic" and "body" injuries on his review of her dental records and medical reports. *See* J.A., pp. 38-40, Carter Aff., ¶¶ 4-5, 7, 9, 11. Dr. Carter further maintains, without contradiction, "it is [his] professional opinion that [Ms. Murphy] suffered physical sickness and physical pain as a result of the discrimination harassment of her employer." *See* J.A., p. 46, Dr. Carter Letter, p. 1 (April 28, 2000); J.A., pp. 38-40, Carter Aff., ¶¶ 6-7, 9-11.

attacks, shortness of breath, and dizziness." *See Leveille,* Recommended Decision and Order, p. 6 (ALJ Feb. 9, 1998) (emphasis added). The ARB affirmed the ALJ's decision, citing the "medical …problems" that Ms. Murphy suffered. *See Leveille,* ARB Decision and Order on Damages, p. 4, 1999 WL 966951 (Oct. 25, 1999).

Ms. Murphy's injuries, although not caused by a direct physical impact, qualify as physical injuries or physical sickness as a matter of well-established law. There is ample case law that clearly supports that substantial physical problems caused by emotional distress are considered physical injuries or physical sickness. *Walters v. Mintec/International*, 758 F.2d 73, 78 (3rd Cir. 1985) (finding severe physical problems and "bodily harm" resulting from emotional distress are compensable physical harm); *Payne v. General Motors Corp.*, 731 F.Supp. 1465, 1474-1475 (D.Kan. 1990) (constant "exhaustion" and "fatigue" resulting from plaintiff's depression, caused by defendant's discrimination, is considered as "physical injuries").

It is irrelevant that the cause of Ms. Murphy's physical injuries were attributable to emotional trauma rather than a direct physical impact because a physical injury may occur absent any external physical impact and as a result of emotional harm. There is nothing in the statute that limits the physical disability exclusion to a physical stimulus, and the I.R.S. regulations implementing 26 U.S.C. §104(a) contain no such limitation.[23]

Notably, the Restatement (Second) of Torts conflicts with the district court's restrictive interpretation that tort-type damages caused by emotional distress cannot be considered as "physical" injuries. *See, e.g., Walters,* 758 F.2d at 77, citing *Restatement (Second) of Torts* §§ 7

[23] *See,* 26 C.F.R. §1.104-1 (2002). Indeed, nowhere in the code or the accompanying Treasury regulations is the meaning of the term "personal physical injuries or physical sickness" defined. In fact, the Treasury regulations implementing the exclusions contained in 26 U.S.C. §104(a)(2) state: "Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of *personal injuries or sickness*." *See,* 26 C.F.R. §1.104-1 (2002).

and 402A(1) ("To the contrary, our review of the Restatement leads us to conclude that 'physical harm' can encompass bodily injury brought about *solely* by the internal operation of emotional distress.") (Emphasis added). Moreover, there is an entire section of the *Restatement (Section) of Torts* entitled "Physical Harm Resulting from Emotional Disturbance," which evidences "that the drafters of the Restatement believed that emotional distress could cause physical harm." *Id.*, citing *Restatement (Second) of Torts* § 436.

Likewise, under workers compensation statutes, the courts have long held that there are various ways a personal injury can occur. The courts have clearly recognized that where a mental stimulus results in a physical injury, or when a mental stimulus results in a mental injury, that such injuries qualify for compensation as personal injuries. *See, e.g., Donovan v. Workers' Compensation Appeal Bd.*, 739 A.2d 1156, 1158 (Pa.Cmwlth. 1999). Section 104(a)(1) treats as excluded from gross income any amounts received under workmen's compensation acts as compensation for personal injuries or sickness. Notably, even after the 1996 amendments to Section 104, all such recoveries may be excluded from gross income under Section 104, even though there was not a physical stimulus for the resulting injuries. The well-established principle under workers' compensation law that physical injuries may result from a non-physical stimulus should likewise apply in cases arising under Section 104(a)(2)(1996), as amended.

Indeed, the amended statute does not state that physical injuries or physical sickness, like those suffered by Ms. Murphy, would not be eligible for the exclusion of Section 104(a)(2). For example, the permanent injury to Ms. Murphy's teeth is not "emotional distress" and there is no evidence to support such a conclusion, which would defy medical science and common sense. The statute simply states that "emotional distress" is not a physical injury or physical sickness.

However, the statute as written does not bar an exclusion from gross income where, as here, the physical injuries or bodily harm suffered by plaintiff are the result of emotional distress.

B. The Legislative History to the 1996 Amendments Does Not Change the Plain Meaning of the Statute.

When Congress amended Section 104(a)(2) of the Internal Revenue Code in 1996, not only were there no hearings held, but also there was no public debate on an amendment that was included at the eleventh hour in the Small Business Job Protection Act of 1996. *See* 1996 HR 3448 Sec. 1605. Thus, without the benefit of any public hearings or debate, Congress changed the exclusion contained in Section 104(a)(2), which had been in effect since 1918, to require that only compensation from awards or settlements received on account of "physical injuries and physical sickness" would be eligible for the exclusion from gross income, and Congress further stated that "emotional distress" shall not be treated as a "physical injury or physical sickness." 26 U.S.C. §104(a). However, at the same time, Congress did not act to include non-physical compensatory damages as an item of gross income, or enact any taxing statute to collect such a tax.[24]

In this case, as noted above, the district court based its entire interpretation of the 1996 amendment to Section 104(a) on the legislative history without analyzing and applying the actual

[24] Upon signing the bill that amended Section 104(a), President Clinton observed:

> Finally, I have reservations about a provision in the Act which makes civil damages based on nonphysical injury or illness taxable. Such damages are paid to compensate for injury, whether physical or not, and are designed to make victims whole, not to enrich them. These damages should not be considered a source of taxable income.

See Statement of Pres. William J. Clinton on Signing the Small Business Job Protection Act of 1996 (Aug. 20, 1996).

words of the statute itself. *Murphy*, 362 F.Supp.2d at 215. The district court's analysis must fail for several reasons.

1. The district court erred by reading words into the statute.

On its face, the legislative history declares that that certain "symptoms" which may result from emotional distress, such as "insomnia, headaches, stomach disorders" are not physical injuries or physical sickness. *See* H. Conf. Rept. 104-737 at 301 n. 56 (1996). On the basis of this passage, alone, the district court wrongly concluded that all forms of physical problems and physical injuries resulting from emotional distress cannot be considered physical injuries or physical sickness under the 1996 amendment to the statute. *Murphy,* 362 F.Supp.2d at 215.

The district court violated one of the fundamental rules of statutory construction, namely that a court should "resist reading words or elements into a statute that do not appear on its face." *Bates v. United States*, 522 U.S. 23, 29, 118 S.Ct. 285, 289-90 (1997). The district court treated footnote 56 in the House Conference Report as if it was the text of the statute. *See* H. Conf. Rept. 104-737 at 301 n. 56 (1996) ["It is intended that the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress."] *Cf.*, *Murphy,* 362 F.Supp.2d at 215. In so doing, the district court erred as a matter of law because "Congress did not write the statute that way." *United States v. Naftalin,* 441 U.S. 768, 773, 99 S.Ct. 2077, 2081-82 (1979).

As noted above, the amended statute simply says that to be eligible for the exclusion the damages must be received on account of personal physical injuries or physical sickness and it also says that "emotional distress shall not be treated as a physical injury or physical sickness." 26 U.S.C. §104(a). The statute does not state that physical injuries or physical sickness which

may result from emotional distress are not considered a physical injury or physical sickness within the exclusion.

In sum, the district court committed reversible error because the statute simply does not state that physical injuries or physical sickness are excludible if they are derived from emotional distress.

2. Ms. Murphy's damages are excluded from gross income under the terms of the legislative history.

The district court's reliance on the scant legislative history of the 1996 amendment to Section 104(a)(2) is misplaced. The House Conference Report simply states that "the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress." H. Conf. Rep. 104-737, at 301 n. 56 (1996). Notably, the House Conference Report's attempted definition of "emotional distress" does not include permanent physical injuries or physical sickness.

It is clear that the drafters of the 1996 amendment attempted to distinguish between serious and permanent physical injuries or physical sickness, like that suffered by Ms. Murphy, and the comparatively minor and transitory "symptoms" of emotional distress, like headaches, upset stomach and sleeplessness, which are not permanent in nature and which go away after a period of time. Attempting to draw a line between physical injuries and emotional distress, as reflected by the legislative history to the 1996 amendment to Section 104(a), is not the same as stating that any physical injuries or physical sickness resulting from emotional distress is simply a "symptom of emotional distress" that can never be considered as a "physical injury or physical sickness" under Section 104(a)(2). Once again, the legislative history does not go so far as to state that any physical problems caused by emotional distress cannot be considered a "physical injury or physical sickness."

Significantly, the legislative history's language is more comparable to those portions of *Restatement (Second) of Torts* which analyze "the line between mere emotional disturbance and physical harm which results from emotional disturbance." *Walters,* 758 F.2d at 77-78, citing *Restatement (Second) of Torts* §§ 7, 402A, and 436A. As the U.S. Court of Appeals for the Third Circuit found in *Walters,* the Restatement's use of the "term 'physical harm' … does not preclude recovery for physical injuries resulting from emotional disturbance." *Id.* Moreover, the Restatement does make a distinction between "transitory, non-recurring phenomena, harmless in themselves, such as dizziness, vomiting, and the like…" and other "long continued" physical problems that "many amount to physical illness" and "which is bodily harm." *Restatement (Second) of Torts* §436A. Under this definition, the permanent physical damage to Ms. Murphy's teeth and other physical problems that she experienced, which were not merely "transitory, non-recurring" problems would have to be considered a physical injury or physical sickness.

It is common sense that based on the ordinary meaning of the terms used by the drafters of the legislative history to describe "symptoms" such as "insomnia, headaches, stomach disorders" were intended to draw a line between transitory, non-recurring type maladies resulting from emotional distress, which can be readily treated and would likely disappear, from chronic pain or other types of permanent physical damage which can also result from emotional distress. Indeed, the district court's reading of the statute, based solely on its interpretation of the legislative history to the 1996 amendment and not on the text of the statute, could lead to absurd results not intended at all by the drafters. For example, it is not inconceivable that a victim of whistleblower retaliation could suffer a heart attack, stroke or other serious debilitating physical ailment as a result of emotional distress caused by the illegal retaliation. *See Creekmore v. ABB*

Power Systems Energy Services, Inc., 93-ERA-24, Dec. & Order of Remand by SOL, p. 12 (Feb. 14, 1996) (awarding compensatory damages in whistleblower case where the "ALJ found that stress resulting from" an employment action "was the major contributing factor to his heart attack."). However, under the strained definition of "physical injuries or physical sickness" grafted onto the text of the amended statute by district court in this case, damages received for any kind of physical injury or physical sickness would be taxable because it was not the result of physical origin. That, of course, is not what the text of the statute says but that is the result of the district court's interpretation.

Neither the amended statute, nor the legislative history, states that physical injuries and physical sickness resulting from mental stimulus are not eligible for the exclusion. Simply put, under the statute all that Plaintiff needs to show is she received damages on account of physical injuries or physical sickness to qualify for the exclusion in Section 104(a)(2), regardless of the stimulus for said physical injuries or physical sickness.

Accordingly, Ms. Murphy's physical injuries and physical sickness are not "emotional distress," even as defined by the drafters of the legislative history to the 1996 amendment, and her compensatory damages are fully within the exclusion set forth in amended Section 104(a)(2), both on its face, and under the definition of "emotional distress" provided by the drafters of the amendment.

3. The district court's use of the legislative history conflicts with the statute.

Even if it were determined that the legislative history is somehow relevant, the scant legislative history to the 1996 amendment, which suggests that certain "symptoms" which may result from emotional distress, such as "insomnia, headaches, stomach disorders" are not physical injuries or physical sicknesses, must be disregarded because it would contradict the

statute itself. *See* H. Conf. Rept. 104-737 at 301 n. 56 (1996). *Also see, Recording Industry Ass'n of America, Inc. v. Verizon Internet Servs., Inc.*, 351 F.3d 1229, 1237 (D.C.Cir. 2003) ("Legislative history … cannot lead the court to contradict the legislation itself"). Accord., *Lamie*, 124 S.Ct. at 1034.

Moreover, not only are somatic injuries considered physical injuries, emotional distress itself can be considered a physical injury. *See, e.g., Haught v. Maceluch*, 681 F.2d 291, 299 n.9 (5th Cir. 1982) (finding depression, nervousness, weight gain, and nightmares are equivalent to physical injury); *Petition of U.S.*, 418 F.2d 264, 269 (1st Cir., 1969) (finding that a definite nervous disorder is a physical injury); *Corso v. Merrill*, 406 A.2d 300, 307 (N.H. 1979) (depression constitutes a physical injury); *Payne*, 731 F.Supp. at 1474-75 (characterizing constant exhaustion and fatigue resulting from depression as "physical injuries"); *D'Ambra v. United States*, 396 F.Supp. 1180, 1183-1184 (D.R.I. 1973) ("psychoneurosis" or acute depression constitutes physical injury). In light of the case law that characterizes somatic injuries as physical injuries as well as the particular somatic injuries suffered by Ms. Murphy to be physical injury, the interpretation suggested in the legislative history directly contradicts the meaning of "physical injury" and cannot be followed. *Recording Industry*, 351 F.3d at 1237.

C. Ms. Murphy's Damages Were Received "On Account Of" Physical Injuries Or Physical Sickness.

If the personal injury exemption does not require that physical injury or physical sickness result from a physical stimuli, or if the exemption covers permanent or serious physical injury or sickness resulting from emotional distress (as opposed to transient physical symptoms of emotional distress), the Ms. Murphy's damages were received on account of physical injuries. In this case, the district court found, and it was not disputed by defendants, that Ms. Murphy's

"bruxism" and permanent injury to her teeth is the result of her former employer's illegal acts.[25] Specifically, the district found:

> During the trial, Dr. Edwin N. Carter and Dr. Barry L. Kurzer testified that plaintiff's injuries were the result of NYANG's conduct. Dr. Carter testified that Murphy sustained "somatic" and "emotional" injuries, including a condition known as "bruxism," or teeth grinding. (Aff.Dr. Carter.) Murphy had no previous history of bruxism, but was initially treated for the condition in March 1994, when Dr. Kurzer immediately recommended a bite guard. (Aff. of Dr. Kurzer, ¶ 5-6.) Murphy continues to experience pain and tooth damage from the bruxism. (*Id.* at ¶ 13-15.)

Murphy, 362 F.Supp.2d at 210.

It is not a matter of factual dispute that the conduct found to be illegal in Ms. Murphy's DOL whistleblower case caused:

(1) Murphy to sustain ***both*** "somatic" and "emotional" injuries, including the teeth grinding condition;

(2) More than 10 years after the DOL took testimony at the only evidentiary hearing held on Ms. Murphy's claims, she still "continues to experience pain and tooth damage…"; and

(3) Ms. Murphy suffered from other physical manifestations of stress.

See, Murphy v. IRS, 362 F.Supp.2d at 210.

In its decisions supporting the award of damages, the DOL expressly cited to and relied on that portion of Dr. Carter's expert testimony about Ms. Murphy's physical injuries when the DOL justified the amount of Ms. Murphy's compensatory damages for emotional distress. The

[25] As far as the district court's findings and conclusions regarding the second part of the *Schleier* test, the district court simply held, based on its incorrect interpretation of the meaning §104(a)(2), that Ms. Murphy's physical problem "was only a symptom of her emotional distress and not the source of her claim." *Murphy,* 362 F.Supp.2d at 215. That conclusion is addressed above, but it is also contradicted by the factual record on which Judge Lamberth found that Ms. Murphy sustained both "somatic" and "emotional" injuries. *Id.*, 362 F.Supp.2d at 210.

DOL specifically cited the portion of the testimony where Dr. Carter testified unequivocally that Ms. Murphy sustained panic attacks and physical manifestations of stress as well as "somatic references and body references."[26] Defendants cannot be permitted to contradict on appeal the summary judgment record and findings entered by the district court that Ms. Murphy's injuries were both "somatic" and "emotional" injuries. *Murphy v. IRS*, 362 F.Supp.2d at 210. The uncontested summary judgment record, as well as Judge Lamberth's factual findings based on that record, is binding and defendants failed to file any objections or counter-statements of fact to contradict Ms. Murphy's statement of material facts.

Simply because the DOL labeled the award emotional distress damages is not dispositive of the issue, particularly where, as here, the record cited by DOL to support that award expressly cited to Dr. Carter's testimony where he discussed Ms. Murphy's physical problems and where the physical problems were considered to be intertwined with and resulting from the emotional distress. *See, e.g., Church v. CIR*, 80 T.C. 1104, 1106-1108 (1983) (It is appropriate to examine the allegations and evidence in the underlying case to ascertain the nature of the damages); *Bent v. CIR*, 87 T.C. 236, 244-45 (1986) ("proper inquiry being in lieu of what were damages awarded" and looking at the allegations and evidence to make determination). *Also see, Fabry v. CIR*, 223 F.3d 1261, 1269-1271 (11th Cir. 2000) (evaluating claims and evidence and finding $500,000 award for damages to business reputation was on account of personal injuries due to personal problems and adverse health affects resulting from destruction of plaintiffs' business).

[26] The DOL ARB cited generally to Dr. Carter's testimony and the ALJ's decision on damages, adopted by the ARB, specifically cited to and relied on Dr. Carter's testimony about Ms. Murphy's physical or somatic injuries to justify the amount of the award of compensatory damages for emotional distress. *Cf.* Docket #15, PSFOF, ¶¶ 13, 17, citing Transcript, pages 148-149, of Dr. Carter's July 18, 1994 testimony before the DOL *with Leveille v. New York Air National Guard,* ALJ Case Nos. 94-TSC-4 and 94-TSC-4, Recommended Decision and Order, at pp. 4-7 (Feb. 9, 1998), citing Transcript pages, 148-149, 165, of Dr. Carter's testimony. Notably, defendants did not dispute these material facts.

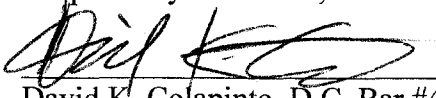
Moreover, Dr. Carter based his expert opinion at the DOL hearing on his review of Ms. Murphy's dental records and medical records. Dr. Carter stated in his affidavit that Ms. Murphy's somatic or physical injuries included the physical damage to Ms. Murphy's teeth as a result of her bruxism, J.A. at 39-41. What's more, Dr. Carter expressly stated that "[b]y using the terms 'somatic references and body references' in [his] testimony before the Department of Labor in July 1994 [he] was referring to Ms. Murphy's physical injuries such as the damage to her teeth that is reflected in her dental records." J.A. 39, Carter Aff., ¶ 7.

As demonstrated by the record and by the supporting affidavits of Ms. Murphy's doctors, part of the basis for the award of Ms. Murphy's damages was that she suffered permanent physical injuries such as "bruxism" which resulted in permanent injury to her teeth. *See, e.g.*, J.A., pp. 39-41, Carter Aff., ¶¶ 7, 11-14; J.A., pp. 43-45, Kurzer Aff., ¶¶ 4-15. Additionally, ongoing treatment and restorative surgery has been required to repair the permanent physical damage to Ms. Murphy's teeth, and she continues to suffer from this permanent physical harm. J.A., pp. 43-45, Kurzer Aff., ¶¶ 4-15.

CONCLUSION

For the foregoing reasons, the district court's order granting Defendants' motion for summary judgment and denying Plaintiff's motion for partial summary judgment must be reversed.

Respectfully submitted,



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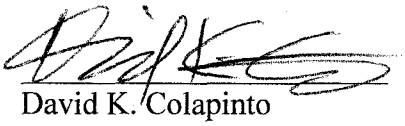
CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation set forth in FRAP 32(a)(7)(B)(i), and that it contains 13,933 words.

By: 

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I HEREBY CERTIFY that on this 29th day of January, 2007, two copies of the foregoing Brief was served by U.S. mail, first-class, postage pre-paid, to counsel for Appellees:

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ADDENDUM

Page(s)

REPRODUCTION OF STATUTES, RULES AND REGULATIONS, ETC.

A. U.S. Constitution.

Amendment XVI: 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. art. 1, §9, cl. 4: No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

B. Statutes.

Section 61(a) of the tax code, entitled, "Gross Income Defined," is applicable:

(a) General definition
Except as otherwise provided in this subtitle, *gross income means all income from whatever source derived*, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property;
(4) Interest;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

(b) Cross references
For items specifically included in gross income, see part II (sec. 71 and following). For items specifically excluded from gross income, see part III (sec. 101 and following).

See 26 U.S.C. §61 (emphasis added).

The following parts of Section 104(a) of the tax code, entitled, "Compensation for injuries or sickness," are applicable:

> … gross income does not include – … (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness.
>
> * * *
>
> For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.

26 U.S.C. § 104(a), as amended in 1996.

C. Regulations.

The following parts of Treasury Regulation, § 1.104-1, are applicable:

> (c) Damages received on account of personal injuries or sickness. *Section 104(a)(2) excludes from gross income the amount of any damages received* (whether by suit or agreement) *on account of personal injuries or sickness*. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

26 C.F.R. § 1.104.1(c) (2005) (emphasis added).

Murphy v. I.R.S.D.D.C.,2005.
United States District Court,District of Columbia.
Marrita MURPHY, et al. Plaintiffs,
v.
INTERNAL REVENUE SERVICE, et al.
Defendants.
No. CIV.A. 03-02414(RCL).

March 22, 2005.

Background: Following denial by Internal Revenue Service (IRS) of her claim for refund of taxes on compensatory damages she was awarded in action against her former employer under whistle blower environmental statutes, taxpayer filed suit against IRS, alleging that her damages award was exempt from taxation under amended statutory provision governing compensation for injuries or sickness, and seeking injunctive and declaratory relief. IRS moved to dismiss for lack of jurisdiction, and moved for summary judgment, and taxpayer moved for partial summary judgment.

Holdings: The District Court, Lamberth, J., held that:

(1) IRS was proper party to suit; but

(2) award for mental pain and anguish was not received on account of physical injury or physical sickness, as required to qualify for tax exception under amended provision; and

(3) amendment of provision was rationally related to legitimate government purpose, and therefore did not violate due process.

Defendant's motion for summary judgment granted.
West Headnotes
[1] United States 393 ⚷125(34)

393 United States
393IX Actions
393k125 Liability and Consent of United States to Be Sued
393k125(28) Particular Departments, Officers, or Agencies, Suits Against
393k125(34) k. Treasury Department and Internal Revenue Bureau. Most Cited Cases
Internal Revenue Service (IRS) was proper party to suit by taxpayer, alleging that federal tax revenue collected from her compensatory damages award violated her Fifth and Sixteenth Amendment rights, and seeking injunctive and declaratory relief. U.S.C.A. Const.Amends. 5, 16; 5 U.S.C.A. § 703.

[2] Federal Courts 170B ⚷978

170B Federal Courts
170BIX District Courts
170BIX(A) In General
170Bk974 Claims Against the United States
170Bk978 k. Recovery of Money Paid or Deposited. Most Cited Cases

Internal Revenue 220 ⚷4915

220 Internal Revenue
220XXVII Remedies for Wrongful Enforcement
220XXVII(A) In General
220k4915 k. In General. Most Cited Cases
District Court had jurisdiction over taxpayer's action against Internal Revenue Service (IRS) because it involved claim of illegally collected federal tax revenue, in that taxpayer alleged collection of federal tax revenue from her compensatory damages award violated her Fifth and Sixteenth Amendment rights. U.S.C.A. Const.Amend. 5, 16; 5 U.S.C.A. § 702; 28 U.S.C.A. § 1346.

[3] Administrative Law and Procedure 15A ⚷229

15A Administrative Law and Procedure
15AIII Judicial Remedies Prior to or Pending Administrative Proceedings
15Ak229 k. Exhaustion of Administrative Remedies. Most Cited Cases
Party aggrieved by administrative agency action must exhaust available administrative remedies before seeking judicial relief.

[4] Internal Revenue 220 ⚷5000

220 Internal Revenue
220XXVIII Refunding Taxes
220XXVIII(B) Actions for Refunds
220XXVIII(B)3 Conditions Precedent
220k5000 k. In General. Most Cited

Cases
In tax dispute case, litigant must pay first and litigate later.

[5] Internal Revenue 220 5003

220 Internal Revenue
220XXVIII Refunding Taxes
220XXVIII(B) Actions for Refunds
220XXVIII(B)3 Conditions Precedent
220k5002 Claim for Refund
220k5003 k. Necessity. Most Cited Cases
Civil actions for tax refund are governed by statutory requirement that any suit involving erroneously or illegally assessed or collected internal revenue tax may not be maintained in any court until claim for refund or credit is filed with Secretary of Treasury. 26 U.S.C.A. § 7422(a).

[6] Internal Revenue 220 5000

220 Internal Revenue
220XXVIII Refunding Taxes
220XXVIII(B) Actions for Refunds
220XXVIII(B)3 Conditions Precedent
220k5000 k. In General. Most Cited Cases

Internal Revenue 220 5002.1

220 Internal Revenue
220XXVIII Refunding Taxes
220XXVIII(B) Actions for Refunds
220XXVIII(B)3 Conditions Precedent
220k5002 Claim for Refund
220k5002.1 k. In General. Most Cited Cases
Taxpayer effectively exhausted all other remedies before bringing her case against Internal Revenue Service (IRS) to district court, in which she alleged that income tax was erroneously assessed on her compensatory damages award; taxpayer paid her taxes before she disputed assessment by IRS of her gross income, and she made multiple claims within IRS prior to filing suit with court. 26 U.S.C.A. § 7422(a).

[7] Internal Revenue 220 3068

220 Internal Revenue
220V Income Taxes
220V(A) In General
220k3068 k. Construction of Income Tax Laws in General. Most Cited Cases
In interpreting definition of income, for purpose of federal income taxation, courts follow default rule of statutory interpretation that exclusions from income must be narrowly construed. U.S.C.A. Const.Amend. 16; 26 U.S.C.A. § 61(a).

[8] Internal Revenue 220 3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Taxpayer, seeking exemption of damages award from federal income tax, under amended statutory provision governing compensation for injuries or sickness, must satisfy two prong test; first prong requires taxpayer to establish that damages were received through tort or tort-like action, and second prong requires taxpayer to establish that damages received were on account of physical injuries or physical sickness. 26 U.S.C.A. § 104(a)(2).

[9] Internal Revenue 220 3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Taxpayer's compensatory damages for mental pain and anguish and damage to reputation, obtained in action against former employer for discrimination in violation of whistle blower environmental statutes, were damages received through tort or tort-like action, as required for income tax exception under amended statutory provision governing compensation for injuries or sickness to apply. 26 U.S.C.A. § 104(a)(2); Toxic Substances Control Act, § 23, 15 U.S.C.A. § 2622; Federal Water Pollution Control Act Amendments of 1972 (Clean Water Act), § 507, as amended, 33 U.S.C.A. § 1367; Public Health Service Act, § 1450, as amended, 42 U.S.C.A. § 300j-9; Solid Waste Disposal Act, § 7001, as amended, 42 U.S.C.A. § 6971; Comprehensive Environmental Response, Compensation, and Liability Act of 1980, § 110, 42 U.S.C.A. § 9610.

[10] Internal Revenue 220 3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Compensatory damage award based on damage to

former employee's professional reputation, obtained in action against former employer for discrimination in violation of whistle blower environmental statutes, did not constitute damages on account of physical injuries or physical sickness, as required for income tax exception under amended statutory provision governing compensation for injuries or sickness to apply. 26 U.S.C.A. § 104(a)(2); Toxic Substances Control Act, § 23, 15 U.S.C.A. § 2622; Federal Water Pollution Control Act Amendments of 1972 (Clean Water Act), § 507, as amended, 33 U.S.C.A. § 1367; Public Health Service Act, § 1450, as amended, 42 U.S.C.A. § 300j-9; Solid Waste Disposal Act, § 7001, as amended, 42 U.S.C.A. § 6971; Comprehensive Environmental Response, Compensation, and Liability Act of 1980, § 110, 42 U.S.C.A. § 9610.

[11] Internal Revenue 220 ⚷3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Damages awarded to taxpayer for mental pain and anguish, obtained in action against former employer for discrimination in violation of whistle blower environmental statutes, did not constitute damages received on account of physical injuries or physical sickness, as required for income tax exception, under amended statutory provision governing compensation for injuries or sickness, to apply; taxpayer's emotional distress was not attributable to her physical injury, but rather, her physical problem, bruxism, or teeth grinding, was symptom of her emotional distress, not source of her claim. 26 U.S.C.A. § 104(a)(2); Toxic Substances Control Act, § 23, 15 U.S.C.A. § 2622; Federal Water Pollution Control Act Amendments of 1972 (Clean Water Act), § 507, as amended, 33 U.S.C.A. § 1367; Public Health Service Act, § 1450, as amended, 42 U.S.C.A. § 300j-9; Solid Waste Disposal Act, § 7001, as amended, 42 U.S.C.A. § 6971; Comprehensive Environmental Response, Compensation, and Liability Act of 1980, § 110, 42 U.S.C.A. § 9610.

[12] Constitutional Law 92 ⚷253(4)

92 Constitutional Law
92XII Due Process of Law
92k253 Nature of Acts Prohibited in General
92k253(4) k. Retrospective Laws and Decisions; Change in Law. Most Cited Cases

Internal Revenue 220 ⚷3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases
Amended version of statutory provision which limited applicability of income tax exemption for compensatory damages, previously applicable to compensation received on account of personal injury or sickness, to compensation received on account of physical injuries or physical sickness, was not applied retroactively, in violation of due process under Fifth Amendment, to deny exemption to taxpayer's award of compensatory damages for mental pain and anguish and damage to reputation, arising from employer's discriminatory conduct; although Secretary of Labor ruled in favor of taxpayer's discrimination complaint prior to effective date of amended provision, taxpayer's damages award was made after its effective date. U.S.C.A. Const.Amend. 5; 26 U.S.C.A. § 104(a)(2).

[13] Constitutional Law 92 ⚷286

92 Constitutional Law
92XII Due Process of Law
92k286 k. Internal Revenue and Customs Duties. Most Cited Cases
Federal tax law is not violative of the due process clause of Fifth Amendment unless statute classifies taxpayers in manner that is arbitrary and capricious. U.S.C.A. Const.Amend. 5.

[14] Constitutional Law 92 ⚷286

92 Constitutional Law
92XII Due Process of Law
92k286 k. Internal Revenue and Customs Duties. Most Cited Cases
Courts may only intervene under due process claim in connection with federal income tax if act complained of is so arbitrary as to constrain to conclusion that it is not exertion of taxation but confiscation of property, that is, taking of same in violation of Fifth Amendment, or what is equivalent thereto, is so wanting in basis for classification as to produce such gross and patent inequality as to inevitably lead to same conclusion. U.S.C.A. Const.Amend. 5.

[15] Constitutional Law 92 ⚷253(4)

92 Constitutional Law
92XII Due Process of Law
92k253 Nature of Acts Prohibited in General
92k253(4) k. Retrospective Laws and Decisions; Change in Law. Most Cited Cases

Internal Revenue 220 3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases
Amendment of statutory provision which limited applicability of income tax exemption for compensatory damages, previously applicable to compensation received on account of personal injury or sickness, to compensation received on account of physical injuries and physical sickness, was rationally related to legitimate government purpose of clarifying state of law, as well as decreasing litigation for cases that did not involve physical injury or physical sickness, and thus, did not violate due process under Fifth Amendment. U.S.C.A. Const.Amend. 5; 26 U.S.C.A. § 104(a)(2).

[16] Internal Revenue 220 3022

220 Internal Revenue
220I Nature and Extent of Taxing Power in General
220I(C) Validity of Statutes in General
220k3022 k. Equality and Uniformity of Taxes. Most Cited Cases
Legislature is not bound to tax every member of class or none; rather, legislature may make distinctions of degree having rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it.

[17] Constitutional Law 92 286

92 Constitutional Law
92XII Due Process of Law
92k286 k. Internal Revenue and Customs Duties. Most Cited Cases

Internal Revenue 220 3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Income tax on taxpayer's damages award for mental pain and anguish and damage to reputation, which was not exempted from taxation under revised statutory provision governing compensation for injuries or sickness, since award was not account of physical injury or physical sickness, did not constitute taking of property without due process of law. U.S.C.A. Const.Amend. 5; 26 U.S.C.A. § 104(a)(2).

[18] Internal Revenue 220 3124

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3124 k. Damages. Most Cited Cases
Taxpayer's compensatory damages award for mental pain and anguish and damage to reputation was "income," within meaning of revised statutory provision governing compensation for injuries or sickness, since award was not exempt from taxation as compensation received on account of physical injury or physical sickness, and as such it was subject to taxation under Sixteenth Amendment, despite taxpayer's contention that it was personal property. U.S.C.A. Const.Amend. 16; 26 U.S.C.A. § 104(a)(2).

[19] Internal Revenue 220 3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases
Congress acted within boundaries of its limits under Sixteenth Amendment in amending provision governing compensation for injuries or sickness, which had previously required only personal injury or sickness to qualify for income tax exemption, by defining "personal injury" and eliminating injuries based on emotional distress from exemption, thereby attempting to clarify law and decrease litigation. U.S.C.A. Const.Amend. 16; 26 U.S.C.A. § 104(a)(2).

***209** David K. Colapinto, Kohn, Kohn & Colapinto, P.C., Washington, DC, for Plaintiffs.
Pat S. Genis, US Department of Justice Tax Division, Washington, DC, for Defendants.

MEMORANDUM OPINION
LAMBERTH, District Judge.

This matter comes before the Court on the defendants' motion to dismiss for lack of jurisdiction over the Internal Revenue Service (IRS) as a proper party to this suit, as well as defendants' motion for summary judgment and plaintiff's cross motion for partial summary judgment. FEd. R. Civ. P. 12(b)(2), FEd. R. Civ. P. 56(c). The ***210** defendants move to dismiss because Congress has not explicitly authorized the IRS as an agency to be sued *eo nomine*. *Blackmar v. Guerre*, 342 U.S. 512, 515, 72 S.Ct. 410, 96 L.Ed. 534 (1952). The issue before the court regarding the summary judgment and partial summary judgment motions dispute is whether or not plaintiff's damages were received "on account of physical injuries or physical sickness" under the 1996 amended definition of Internal Revenue Code § 104(a)(2). Further, the parties dispute whether § 104(a)(2) is constitutional under the Fifth Amendment and Sixteenth Amendment. The defendants submitted a motion and memorandum in support of their position. Plaintiff submitted a memorandum in opposition to the defendants' motion and supporting a cross motion. Defendants subsequently filed a motion in opposition to plaintiff's motion for summary judgment, and plaintiff accordingly provided a reply memorandum. Upon consideration of the parties' filings, the applicable law, the Federal Rules of Civil Procedure and the facts of this case, the Court finds that the defendants' motion to dismiss will be DENIED. Defendant's motion for summary judgment will be GRANTED and plaintiff's cross motion for partial summary judgment will be DENIED.

I. BACKGROUND

Plaintiffs Marrita Murphy and Daniel Leveille filed complaints against the New York National Guard, alleging that their former employer discriminated against them by engaging in conduct that violated six whistle blower environmental statutes. (*Leveille et al. v. New York Air National Guard*, 1995 WL 848112, *3 (DOL Off. Adm.App.)).[FN1] Each of the whistle blower statutes provide for "compensatory damages." *The Toxic Substances Control Act*, 15 U.S.C. § 2622 (1994); *The Safe Drinking Water Act*, 42 U.S.C. § 300j-9(I) (1994); *The Clean Air Act*, 42 U.S.C. § 7622 (1994); *The Solid Waste Disposal Act*, 42 U.S.C. § 6971 (1994); *The Clean Water Act*, 33 U.S.C. § 1367 (1994); *The Comprehensive Environmental Response, Compensation and Liability Act*, 42 U.S.C. § 9610 (1994).

FN1. Marrita Murphy is also known as Marrita Leveille in portions of this litigation.

During the trial, Dr. Edwin N. Carter and Dr. Barry L. Kurzer testified that plaintiff's injuries were the result of NYANG's conduct. Dr. Carter testified that Murphy sustained "somatic" and "emotional" injuries, including a condition known as "bruxism," or teeth grinding. (Aff.Dr. Carter.) Murphy had no previous history of bruxism, but was initially treated for the condition in March 1994, when Dr. Kurzer immediately recommended a bite guard. (Aff. of Dr. Kurzer, ¶ 5-6.) Murphy continues to experience pain and tooth damage from the bruxism. (*Id.* at ¶ 13-15.) Additionally, the Administrative Law Judge noted and the Administrative Review Board confirmed that Murphy suffered from other "physical manifestations of stress" including "anxiety attacks, shortness of breath, and dizziness." (*Leveille v. New York Air National Guard*, Recommended Decision and Order at 6 (ALJ Feb. 9, 1998.))

The Secretary of Labor ruled in favor of Murphy on December 11, 1995, and dismissed Daniel Leveille's complaint due to untimely filing. (*Id.*) Shortly thereafter, in 1996, Congress amended 26 U.S.C. § 104(a)(2), the statute governing plaintiff's potential exclusion from taxation, limiting the exclusion to compensatory damages received on account of "physical injuries and physical sickness." Prior to 1996, § 104(a)(2) required only personal injury or sickness to qualify for the tax ***211** exemption. On October 25, 1999, Murphy was awarded $70,000 in damages-$45,000 for mental pain and anguish, and $25,000 for damage to her professional reputation. (1999 WL 966951, *5 (DOL Adm. Rev.Bd.)) The Department of Labor Decision and Order on Damages stated that "[b]y authorizing the award of compensatory damages, the environmental statutes have created a 'species of tort liability' in favor of persons who are the objects of unlawful discrimination." (Decision and Order on Damages, p. 4 (Oct. 25, 1999).)

Murphy then filed her 2000 tax return on April 11, 2001, reporting the $70,000 she received in compensatory damages. (Compl.¶ 6,7.) Plaintiff later sought a refund of the compensatory damages plus interest on April 15, 2001, December 25, 2001, and October 8, 2002, asserting that such damages were exempted from taxation under 26 U.S.C. § 104(a)(2). (Compl.¶ 8, 9, 10, 20.) The IRS denied plaintiff's claim for a refund, stating that plaintiff did not demonstrate that the compensatory damages were attributable to physical injury or physical sickness.

(*Id.* at ¶ 14.) Plaintiff requested an appeal of this decision on January 16, 2003, and when the Appeals Office did not respond within 180 days, plaintiff filed this action on November 21, 2003. (Compl. at 1, 15-17.)

II. ANALYSIS

A. Motion to Dismiss

1. The IRS is a proper party to this suit under the Administrative Procedure Act.

5 U.S.C. § 702(a) (2000) states that "[a] person suffering a legal wrong because of agency action, or adversely affected or aggrieved by agency action ... is entitled to judicial review," so long as the relief sought is other than monetary damages. More specifically, "[t]he district courts have original jurisdiction of [a]ny civil action against the United States for the recovery of an internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal revenue laws." 28 U.S.C. § 1346 (1997); *United States v. Williams,* 514 U.S. 527, 532, 115 S.Ct. 1611, 131 L.Ed.2d 608 (1995).

Jurisdiction over the United States in federal taxation cases was extended to administrative agencies in 1973. 5 U.S.C. § 703 (1973). The revised statute states that an "action for judicial review may be brought against the United States, *the agency by its official title,* or the appropriate officer" and that such action "is subject to judicial review in civil...proceedings for judicial enforcement." *Id.* (emphasis added). 5 U.S.C. § 703 changed the state of the law under *Blackmar v. Guerre,* 342 U.S. 512, 515, 72 S.Ct. 410, 96 L.Ed. 534 (1952), which held that administrative agencies could not sue or be sued unless Congress authorized the particularly agency as a potential party to the suit. *See Baumohl v. Columbia Jewelry Co.,* 127 F.Supp. 865 (D.Md.1955); *O'Connell v. IRS,* 93 A.F.T.R.2d (RIA) 1841; *M & M Transp. Co. v. U.S. Industries, Inc.,* 416 F.Supp. 865 (1976).

Current case law supports the § 703 change. In *Sarit v. Drug Enforcement Admin.,* 759 F.Supp. 63, 69 (D.R.I.1991) defendants' claimed that the Drug Enforcement Administration could not be sued *eo nomine* because it was a federal agency. The court disagreed, explaining that "[t]his ... is not the case when jurisdiction is viewed in light of the Administrative Procedure Act." The *Sarit* court also referenced the amended language of ***212** § 703, noting that "the previous law under *Blackmar v. Guerre* ... was that suit could not be maintained against an agency. The amendment gets rid of *Blackmar.*" *Id.* (citations omitted). Similarly, in *Blassingame v. Secretary of Navy,* 811 F.2d 65 (2d. Cir.1987), the court clarified that "[t]he rule that a federal agency cannot itself be sued ... no longer holds." *See also B.K. Instrument Inc. v. United States,* 715 F.2d 713, 724-25 (2d. Cir.1983).

[1][2] In this case, the IRS is a proper party to the suit. Under 5 U.S.C. § 702(a), if a party suffers a legal wrong by an agency action, such a party is entitled to bring her case before this Court as long as she seeks relief other than monetary damages. Plaintiff claims violations of her rights Fifth and Sixteenth Amendment rights, and seeks injunctive and declaratory relief, thus satisfying 5 U.S.C. § 702(a). Further, this court has jurisdiction over plaintiff's action because it involves a claim of an illegally collected federal tax revenue. 28 U.S.C. § 1346 (1997). Finally, plaintiff properly named the IRS as party to under 5 U.S.C. § 703 (1973), which codified the principle that such a suit may be brought against a government agency.

2. Plaintiff exhausted all remedies prior to filing suit in District Court.

[3] A party aggrieved by an administrative agency action must exhaust available administrative remedies before seeking judicial relief. *Myers v. Bethlehem Shipbuilding Corp.,* 303 U.S. 41, 50-51, 58 S.Ct. 459, 82 L.Ed. 638 (1938); *McKart v. United States,* 395 U.S. 185, 193, 89 S.Ct. 1657, 23 L.Ed.2d 194 (1969); *Department of Transportation. v. Public Citizen,* 541 U.S. 752, 124 S.Ct. 2204, 159 L.Ed.2d 60 (2004). The rationale behind such a requirement is that "[t]he exhaustion doctrine guarantees administrative autonomy and efficiency, and ensures that administrative agencies are afforded an opportunity to address their own error without judicial intervention." *Sharps v. United States Forest Service.,* 28 F.3d 851, 854 (8th Cir.1994).

[4][5] Several specific requirements exist for a tax dispute case. First, the litigant must "pay first and litigate later." *Flora v. United States,* 362 U.S. 145, 164, 80 S.Ct. 630, 4 L.Ed.2d 623 (1960).

Furthermore, all civil actions for a refund are governed by 26 U.S.C. § 7422(a), which requires that any suit involving an "erroneously or illegally assessed or collected" internal revenue tax may not be "maintained in any court" until a claim for a refund or credit is filed with the Secretary.

[6] In this case, plaintiff complied with all applicable requirements for exhaustion of remedies. First, plaintiff paid her taxes up front, in accordance with the "pay first and litigate later" requirement. *Flora v. United States*, 362 U.S. 145, 164, 80 S.Ct. 630, 4 L.Ed.2d 623. Second, plaintiff filed three amended tax returns on April 15, 2001, December 25, 2001, and October 8, 2002, respectively, and an appeal on December 18, 2002. When plaintiff did not receive a response to her administrative appeal after 180 days, she filed this action on November, 21, 2003. Therefore, plaintiff followed proper procedures in first paying her taxes and then disputing the IRS' assessment of her gross income, and made multiple claims within the IRS prior to filing suit with this Court. Accordingly, plaintiff effectively exhausted all other remedies and her case is properly before this Court.

B. Summary Judgment

1. Standard of Review

Summary judgment is appropriate when "there is no genuine issue as to any material***213** fact." Fed. R. Civ.P. 56(c); *See Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). A fact is material if it will affect the outcome of the case. *Id.* Moreover, a moving party is entitled to summary judgment as a matter of law when the law supports the moving party's position. *See Jeffery v. Sarasota White Sox, Inc.*, 64 F.3d 590, 594 (11th Cir.1995). Inferences drawn from the facts must be viewed in the light most favorable to the party opposing the motion. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970).

Once the moving party files a proper summary judgment motion, the burden shifts to the non-moving party to produce "specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e). The non-moving party cannot establish a genuine issue of material fact exists through "conclusory allegations" or "unsubstantiated assertions." *Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir.1994). Any factual assertions contained in the declaration in support of a motion will be accepted by the Court as true unless plaintiff submits his own declarations or other documentary evidence contradicting the assertions in the attached declarations. *See Neal v. Kelly*, 963 F.2d 453, 456 (D.C.Cir.1992).

2. Plaintiff's damages are income, and are taxable unless exempted by § 104(a)(2) of the Internal Revenue Code.

[7] The Sixteenth Amendment established that "[t]he 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. "Gross income" is broadly defined, for purpose of federal income taxation, as "all income from whatever source derived." 26 U.S.C. § 61(a); *Commissioner v. Banks*, 543 U.S. 426, 125 S.Ct. 826, 160 L.Ed.2d 859 (2005); *C.I.R. v. Glenshaw Glass Co.*, 348 U.S. 426, 429, 75 S.Ct. 473, 99 L.Ed. 483 (1955); *Helvering v. Clifford*, 309 U.S. 331, 334, 60 S.Ct. 554, 84 L.Ed. 788 (1940). The Supreme Court defined income in *Eisner v. Macomber*, 252 U.S. 189, 207, 40 S.Ct. 189, 64 L.Ed. 521 (1920) as "the gain derived from capital, from labor, or from both combined." While this definition is widely quoted, it was not intended to provide a "touchstone to all future gross income questions." *C.I.R. v. Glenshaw Glass*, 348 U.S. 426, 431, 75 S.Ct. 473, 99 L.Ed. 483 (1955); *Roemer v. Commissioner*, 716 F.2d 693, 696 n. 2 (9th Cir.1983); *Prescott v. Commissioner*, 561 F.2d 1287, 1293 (8th Cir.1977). Furthermore, in interpreting the definition of income, courts follow the "default rule of statutory interpretation that exclusions from income must be narrowly construed." *United States v. Burke*, 504 U.S. 229, 248, 112 S.Ct. 1867, 119 L.Ed.2d 34 (1992) (Scalia, J., concurring in judgment, Souter, J., concurring in judgment); see *United States v. Centennial Savings Bank FSB*, 499 U.S. 573, 583-84, 111 S.Ct. 1512, 113 L.Ed.2d 608 (1991); *Commissioner v. Jacobson*, 336 U.S. 28, 49, 69 S.Ct. 358, 93 L.Ed. 477 (1949).

Congress codified one such income tax exception through 26 U.S.C. § 104(a)(2). Prior to 1996, the statute provided that gross income does not include "the amount of any damages (other than punitive damages) received ... on account of *personal* injury or sickness".[FN2] *Id.* (emphasis added.)***214** Therefore, prior to the 1996 amendment, "[t]he reference to personal injury did not include purely economic injuries but did embrace 'nonphysical

injuries to the individual, such as those affecting emotion, reputation, or character.' " *Polone v. Commissioner*, 2003 WL 22953162, T.C.M. (RIA) 2003-339 (T.C.2003) (quoting *Burke*, 504 U.S. at 235 n. 6, 112 S.Ct. 1867.). As amended in 1996, the statute altered the exemption requirements to compensatory damages "on account of *physical injuries or physical sickness.*" (*Id.* (emphasis added).)

> FN2. § 104(a)(2) originates from The Revenue Act of 1918, ch. 18, 40 Stat. 1057, § 213(b)(6). The original rationale for the rule was that damages for personal injuries could not be considered a "gain," and therefore, were not considered income. *See* H.R.Rep. No.767 65th Cong., 2d Sess. 9-10 (1918)(1939-1 C.B. (pt. 2) 86, 92).

The House Report provides further detail regarding the change in language. The report clarifies the meaning of "physical" by explaining that "[i]f an action has its origin in a physical injury or physical sickness, then all damages... that flow therefrom are treated as payments received on account of physical injury or physical sickness ...." 104 H. Rpt. 737. The report further explains that "emotional distress is not considered a physical injury or physical sickness," and furthermore, any damages based on "employment discrimination or injury to reputation accompanied by a claim of emotional distress" do not fall under the § 104(a)(2) exception. *Id.* The report also notes that "the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness." *Id.*

[8] To determine whether § 104(a)(2) applies, a taxpayer must satisfy the two prong test established in *Commissioner v. Schleier*, 515 U.S. 323, 336-37, 115 S.Ct. 2159, 132 L.Ed.2d 294 (1995). The first prong requires a taxpayer to establish that damages were received through a tort or tort-like action. *Id.* at 335, 115 S.Ct. 2159; *Burke*, 504 U.S. at 237, 112 S.Ct. 1867. The second prong requires a taxpayer to establish that the damages received were "on account of" a personal injury. *Schleier*, 515 U.S. at 336, 115 S.Ct. 2159. However, the 1996 revision to § 104(a)(2) adds the additional requirement that such injuries be *physical* in nature.

[9] Plaintiff's compensatory damages satisfy the first prong of the *Schleier* test. A tort-like cause of action includes "the traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, or other consequential damages." *Burke*, 504 U.S. at 239, 112 S.Ct. 1867. Moreover, the six environmental statutes from which plaintiff's claim arose provide for "compensatory damages." *The Toxic Substances Control Act*, 15 U.S.C. § 2622 (1994); *The Safe Drinking Water Act*, 42 U.S.C. § 300j-9(I) (1994); *The Clean Air Act*, 42 U.S.C. § 7622 (1994); *The Solid Waste Disposal Act*, 42 U.S.C. § 6971 (1994); *The Clean Water Act*, 33 U.S.C. § 1367 (1994); *The Comprehensive Environmental Response, Compensation and Liability Act*, 42 U.S.C. § 9610 (1994). Finally, the DOL Decision and Order on Damages stated that "[b]y authorizing the award of compensatory damages, the environmental statutes have created a 'species of tort liability' in favor of persons who are the objects of unlawful discrimination." (Decision and Order on Damages, p. 4 (Oct. 25, 1999).) In this case, plaintiff received compensatory damages for emotional distress and damage to reputation, fitting squarely within the definition of a tort or tort-like action. DOL reaffirmed this finding through specifically stating that the damages awarded were tort-like during the award of plaintiff's damages. Therefore, the first prong of the *Schleier* test is satisfied.

***215** [10] However, the facts of this case do not satisfy the second prong of *Schleier*. First, plaintiff received $25,000 for damage to her professional reputation. (1999 WL 966951, *5 (DOL Adm. Rev.Bd.)) The House Report for the 1996 version of § 104(a)(2) explicitly stated that damages based on "employment discrimination or injury to reputation accompanied by a claim of emotional distress" do not fall within the protection of the tax exemption. 104 H. Rpt. 737. Because plaintiff's $25,000 of compensatory damages was based on damage to Murphy's professional reputation, this award is not specifically exempted by statute, and thus falls within the broader definition of taxable income. *Glenshaw Glass*, 348 U.S. at 431, 75 S.Ct. 473 (noting that the definition of income may include "accessions to wealth.")

[11] Second, plaintiff received $45,000 in damages awarded for mental pain and anguish. Pertaining to emotional distress, the House Report states that "emotional distress is not considered a physical injury or physical sickness," but that "the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness." 104 H. Rpt. 737. (emphasis added). Here, Murphy's

mental anguish manifested into a physical problem, bruxism, but this was only a symptom of her emotional distress, not the source of her claim. Plaintiff's emotional distress is not "attributable to her physical injury"; in fact, it is the other way around. Because the statute clearly provides damages must be received "on account of personal physical injury or physical sickness," and because mental pain and anguish and damage to reputation are not physical injuries, plaintiff's emotional distress damages are not included within the statutory exemption under § 104(a)(2). Therefore plaintiff's entire compensatory damages award of $70,000 is lawfully taxed under § 104(a)(2).

3. The revised version of § 104(a)(2) was not applied retroactively.

[12] Plaintiff asserts that § 104(a)(2) was applied retroactively to the compensatory damages, thus violating plaintiff's due process rights under the Fifth Amendment and conflicting with the presumption that legislation is not retroactive unless Congress expresses clear intent. (P. Cross Motion for Partial Sum. Judgment at 32.) Defendants assert that the statute plainly applies to income received after the effective date and, therefore, § 104(a)(2) is not retroactively applied.

The evidentiary record of plaintiff's case was closed in 1994. In 1995, the Secretary of Labor ruled in favor of plaintiff's discrimination complaint. In 1996, Congress amended § 104(a)(2) requiring physical injury or physical sickness for the exception to apply. The prior version of § 104(a)(2) required only personal injury or sickness. However, the plaintiff was awarded compensatory damages in 1999 after the 1996 version of § 104(a)(2) took effect. Therefore, because the plaintiff's damages award took place after the amendment, the 1996 version of § 104(a)(2) was properly applied in this instance.

While the Fifth Circuit applied § 104(a)(2) retroactively in *Dotson v. United States*, 87 F.3d 682 (5th Cir.1996), the Court did so because the settlement took place prior to the revision in the tax code. Here, the award was not made until 1999, three years after the tax code revision. Therefore, as the facts of this case maintain a different timeline than the facts of *Dotson*, the 1996 version of § 104(a)(2) was properly applied to plaintiff's award that was assessed and received several years after the statute's amendment.

*216 4. § 104(a)(2) remains constitutional after the 1996 amendments.

a. Fifth Amendment due process clause and takings clause

[13][14] "In general, a Federal tax law is not violative of the Due Process Clause of the Fifth Amendment of the U.S. Constitution unless the statute classifies taxpayers in a manner that is arbitrary and capricious." *Berzon v. Commissioner*, 63 T.C. 601, 606, 1975 WL 3068 (1975). Furthermore, courts may only intervene under a due process claim if "the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, or what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion." *Brushaber v. Union Pac. RR*, 240 U.S. 1, 24-25, 36 S.Ct. 236, 60 L.Ed. 493 (1916). Historically, the courts "never used the [substantive] due process clause to regulate federal income tax," and have showed similar restraint under procedural due process claims except for cases involving "specific classifications" or inadequate administrative processes. Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, Volume 1, Third Edition (1999) (citing *Black v. United States*, 534 F.2d 524 (2d Cir.1976); *McGlotten v. Connally*, 338 F.Supp. 448 (D.D.C.1972)).

[15][16] The facts of this case do not provide a strong basis for a due process challenge under the Fifth Amendment. Members of Congress did not arbitrarily nor capriciously alter the applicability of § 104(a)(2) through the 1996 amendment. Moreover, in a similar challenge of the constitutionality of § 104(a)(2), The Court of Appeals for the Sixth Circuit found the revised statute constitutional. The Court noted that because the statute does not preserve a fundamental right, "the distinction that it creates is constitutional as long as it bears a rational relationship to a legitimate government purpose." *Young v. United States*, 332 F.3d 893, 895-96 (6th Cir.2003) (citing *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547, 103 S.Ct. 1997, 76 L.Ed.2d 129 (1983)). Further, the legislature "is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to

judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509, 57 S.Ct. 868, 81 L.Ed. 1245 (1937).

In this case, as in *Young*, the legislative history of § 104(a)(2) provides that Congress intended to clarify the state of the law, as well as decrease litigation for cases that do not involve physical injury or physical sickness. H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R.Rep. No. 104-586, at 142-43. Clarifying the tax code and decreasing litigation satisfy the minimal requirement of a "rational basis," and therefore § 104(a)(2) does not violate the due process clause under the Fifth Amendment.

[17] Plaintiff's argument that the disputed taxation violates the Takings Clause is also without merit. Courts generally reject the argument that taxing provisions can be classified as "taking of property without due process of law." *See Freeman*, 2001 WL 1140022, T.C.M. (RIA) 2001-254 (Tax Ct.2001); *see also Coleman v. Commissioner*, 791 F.2d 68, 70 (7th Cir.1986); *Van Sant*, 98 A.F.T.R.2d 2002-302, *7 (D.D.C.2001). The Seventh Circuit clarifies the meaning of taking in *Coleman*, ***217** stating that taxation does indeed "take" income, "but this is not the sense in which the constitution uses 'takings.' " *Id.* The Second Circuit further explained that because Article I, section 8, clause 1 of the U.S. Constitution granted Congress the power to tax before the passage of the Sixteenth Amendment, its passage "did no more than remove the apportionment requirement of Article I, § 2, cl. 3, from taxes on 'incomes, from whatever source derived.' " Therefore, although taxation on damages that are not exempted under the revised version of § 104(a)(2) may appear to be a "taking" by the government, the constitutional provision was not intended, nor should it be extended, to cover plaintiff's situation in this case.

b. Sixteenth Amendment

Article I, § 8 of the U.S. Constitution delegates to Congress the power "to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform through the United States." Article I, § 9 implements a proportionality requirement, stating that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. Const. art. I, § 9. This apportionment requirement led the Supreme Court to hold the 1894 income tax law unconstitutional in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 15 S.Ct. 912, 39 L.Ed. 1108 (1895), which later prompted the passage of the Sixteenth Amendment. Under the Sixteenth Amendment "[t]he 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. The Sixteenth amendment therefore effectively eliminated the apportionment requirement for income tax.

Plaintiff asserts that the 1996 amendments to § 104(a)(2) are unconstitutional because the statute (a) imposes a direct tax on personal injuries which cannot be classified as income, (b) taxes compensation despite the "in lieu of what?" test, and (c) conflicts with the constrained definition of income established under the Sixteenth amendment.

[18] As previously discussed, "gross income" is broadly defined by statute as "all income from whatever source derived." 26 U.S.C. § 61(a). The Supreme Court has broadened its interpretation from "the gain derived from capital, from labor, or from both combined," as established in 1920 in *Eisner*, to a more all-encompassing standard, including "all economic gains not otherwise exempted." *Eisner*, 252 U.S. at 207, 40 S.Ct. 189; *Commissioner v. Banks*, 543 U.S. 426, 125 S.Ct. 826, 160 L.Ed.2d 859 (2005). In this case, plaintiff argues that § 104(a)(2) assesses a direct tax on personal property rather than a constitutional tax of income. (P. Cross Motion for Partial Summary Judgment at 31.) Further, plaintiff asserts that these compensatory damages are not income and therefore they cannot be taxed under the Sixteenth amendment. While confusion remains within in the law regarding the exact definition of a "direct tax," because of the broad definition of "income" purported by the tax code and the courts' subsequent interpretation thereof, plaintiff's argument fails.

Plaintiff also argues that the disputed damages are not taxable under the "in lieu of what" test established in *Raytheon Production Corp. v. Commissioner*, 144 F.2d 110 (1st Cir.1944), *cert. denied* 323 U.S. 779, 65 S.Ct. 192, 89 L.Ed. 622 (1944). *Raytheon* directs the inquiry, "in ***218** lieu of what were the damages awarded?" *Id.* at 113. If

what is being taxed can be considered "income," it may be taxed; if it cannot, then it is exempted. While defendants do not directly respond to this theory, courts have applied the *Raytheon* test in cases involving settlement, not in cases where damages are awarded by an administrative body. *See Lindsey v. C.I.R.*, 2004 WL 1052772 (U.S. Tax Ct. 2004). Moreover, the revised language of § 104(a)(2) indicates that only physical injuries and physical sickness are exempted from the definition of "income." Therefore, anything falling outside this definition is considered income, and is therefore taxable. *Burke*, 504 U.S. at 248, 112 S.Ct. 1867 (noting that it is the "default rule of statutory interpretation that exclusions from income must be narrowly construed").

[19] Finally, plaintiff asserts that Congress cannot act unilaterally to determine its taxing power, but is restrained by the Supreme Court and the constitutional limitations established under the Sixteenth Amendment. While this is true, the Supreme Court has continually affirmed the broad interpretation of the taxing power and the definition of income. *Banks*, 543 U.S. at ----, 125 S.Ct. 826; *Glenshaw Glass Co.*, 348 U.S. at 429, 75 S.Ct. 473; *Helvering*, 309 U.S. at 334, 60 S.Ct. 554. In clarifying the definition of "personal injury" and eliminating injuries based on emotional distress from the exemption, Congress has limited the scope of its taxation power to damages which are not the result of physical injury or sickness. Congress' attempt to clarify the law and decrease litigation is within the boundaries of its limits under the Sixteenth Amendment. See H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R.Rep. No. 104-586, at 142-43. Therefore, § 104(a)(2) does not pose a constitutional problem under the Sixteenth Amendment.

III. CONCLUSION

For the foregoing reasons, the defendants' motion to dismiss will be DENIED. Defendants' motion for summary judgment will be GRANTED. Plaintiff's cross-motion for partial summary judgment will be DENIED.

A corresponding Order will issue this date.

ORDER

In accordance with the Memorandum Opinion issued this date; and upon consideration of the defendants' Motion [9] to Dismiss for lack of jurisdiction, the opposition thereto, the reply brief, the applicable law, and the entire record herein, it is hereby

ORDERED that the defendants' Motion [9] to Dismiss is DENIED.

Furthermore, in accordance with the Memorandum Opinion issued this date; and upon consideration of the plaintiffs' Motion [19] for Partial Summary Judgment, the opposition thereto, the reply brief, the applicable law, and the entire record herein, it is hereby

ORDERED that the plaintiffs' Motion [19] for Partial Summary Judgment is DENIED.

Finally, in accordance with the Memorandum Opinion issued this date; and upon consideration of the defendants' Motion [10] for Summary Judgment, the opposition thereto, the applicable law, and the entire record herein, it is hereby

ORDERED that the defendants' Motion [10] for Summary Judgment is GRANTED; and it is further

***219** ORDERED that the plaintiffs' Complaint is hereby DISMISSED WITH PREJUDICE.

SO ORDERED.

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