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 ORDER OF THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE APPELLEES

EILEEN J. O'CONNOR
Assistant Attorney General

RICHARD T. MORRISON
Deputy Assistant Attorney General

GILBERT S. ROTHENBERG (202)514-3361
KENNETH L. GREENE (202)514-3573
FRANCESCA U. TAMAMI (202)514-1882
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

Of Counsel:
JEFFREY A. TAYLOR
United States Attorney

CERTIFICATE OF PARTIES, RULINGS AND RELATED CASES

A. *Parties and Amici.* The parties in the District Court and in this Court are Marrita Murphy, Daniel J. Leveille, the Internal Revenue Service, and the United States of America. The No FEAR Coalition, National Employment Lawyers Association, Andrew Jackson Society, National Taxpayers Union, Liberty Coalition, and Innocence Project appear on appeal as *amici curiae.*

B. *Rulings under Review.* The rulings under review are the memorandum opinion of the District Court (Judge Royce C. Lamberth) dated March 22, 2005 (reported at 362 F. Supp. 2d 206) (JA 19-35), and the court's accompanying order entered that same day (JA 36-37).

C. *Related Cases.* This case previously was argued before this Court on February 24, 2006, and the judgment that followed was vacated on December 22, 2006. The following pending cases involve substantially the same issues as the present case: *Jesse Goode v. Commissioner*, D.C. Cir. No. 06-1219; and *Mary E. Hubbard v. Commissioner*, Tax Ct. No. 019649-06 (petitioner is a resident of the District of Columbia and, thus, venue for an appeal of that case lies in this Court, 26 U.S.C. § 7482(b)(1)(A)).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: **Page(s)**

* Authorities chiefly relied upon are marked with an asterisk.

Cases (cont'd): **Page(s)**

* Authorities chiefly relied upon are marked with an asterisk.

Cases (cont'd): **Page(s)**

U.S. Constitution and Statutes:

* Authorities chiefly relied upon are marked with an asterisk.

U.S. Constitution and Statutes (cont'd): **Page(s)**

Rules and Regulations:

* Authorities chiefly relied upon are marked with an asterisk.

Rule and Regulations (cont'd): **Page(s)**

Miscellaneous:

Administrative Rulings:

Legislative History:

* Authorities chiefly relied upon are marked with an asterisk.

Miscellaneous (cont'd): **Page(s)**

* Authorities chiefly relied upon are marked with an asterisk.

Miscellaneous (cont'd): **Page(s)**

Periodicals and Treatises (cont'd):

*Authorities chiefly relied upon are marked with an asterisk.

Miscellaneous (cont'd): **Page(s)**

*Authorities chiefly relied upon are marked with an asterisk.

GLOSSARY

ALJ	Administrative Law Judge
DOL	Department of Labor
IRS	Internal Revenue Service
SBJPA	Small Business Job Protection Act

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JURISDICTIONAL STATEMENT

Marrita Murphy and Daniel Leveille[1] timely filed refund claims with the Internal Revenue Service ("IRS"), seeking a refund of tax paid for their 2000 tax year. (JA 8.) I.R.C. § 6511(a) (26 U.S.C.). The IRS denied the claims, and taxpayer timely filed suit seeking a refund. (JA

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[1] Daniel Leveille is a party solely because he filed a joint return with Marrita Murphy ("taxpayer") for the tax year at issue. (JA 7.)

6-13.) I.R.C. § 6532(a)(1). The District Court had jurisdiction under I.R.C. § 7422 and 28 U.S.C. § 1346(a)(1).[2]

On March 22, 2005, the District Court entered an order granting summary judgment to the Government. (JA 36-37.) The order is final and appealable. On April 6, 2005, taxpayer filed a timely notice of appeal. (JA 4.) Fed. R. App. P. 4(a)(1). This Court has jurisdiction under 28 U.S.C. § 1291.

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[2] In the District Court, the Government moved to dismiss the IRS as a party. (Dist. Ct. Docket Entry ("Doc.") 9.) The Government argued that the IRS is not a separately suable entity in this tax refund action, and that the United States is the only properly named defendant. The court denied the motion, holding that the Administrative Procedures Act, 5 U.S.C. § 702(a), allows a suit against an administrative federal agency where the complainant seeks relief other than monetary damages. (JA 22-23.) We submit that the court erred. Though taxpayer's complaint requested non-monetary relief, *viz.*, declaratory and injunctive relief, respecting her liability for the taxes in issue, the Government's sovereign immunity was not waived for declaratory and injunctive relief respecting taxpayer's liability, and was waived only for a suit for a tax refund. *See* 28 U.S.C. § 2201; I.R.C. § 7421(a); *Bob Jones Univ. v. Simon*, 416 U.S. 725 (1974); *Flora v. United States*, 357 U.S. 63, 75 (1958). The statutes waiving sovereign immunity for a tax refund suit allow it to be brought against the United States only. I.R.C. § 7422(f)(1); 28 U.S.C. § 1346(a)(1); *see Gomez v. United States*, 2003-1, USTC (CCH) ¶ 50,519 (9th Cir. 2003). Thus, taxpayer's request for non-monetary relief here was specifically barred, and the Administrative Procedures Act does not allow taxpayer's suit to be brought against the IRS.

STATEMENT OF THE ISSUES

1. Whether the District Court correctly held that monetary damages taxpayer received for emotional distress and injury to professional reputation are constitutionally subject to tax as income under I.R.C. § 61(a) and are not excluded from income under I.R.C. § 104(a)(2) because they were not received on account of a personal physical injury or physical sickness.

2. Whether, in any event, taxation of the damages award is not unconstitutional because the tax at issue is not a "direct tax" subject to apportionment and is imposed uniformly.

STATUTES

The relevant Constitutional provisions and statutes are set forth in an Addendum to this brief, *infra.*

STATEMENT OF FACTS

A. Taxpayer's receipt of damages

In 1994, taxpayer filed an administrative complaint with the U.S. Department of Labor ("DOL") against her former employer, the New York Air National Guard, alleging that it discriminated against her by engaging in conduct prohibited under the whistle-blower

protection provisions of six federal environmental statutes. *See Leveille v. New York Air National Guard*, Nos. 94-TSC-3 & 94-TSC-4 (DOL Off. Adm. App. 1995), *available in*, 1995 WL 848112, *3 (copy attached in Addendum, *infra*). DOL ruled in favor of taxpayer on her discrimination complaint and remanded the case to an administrative law judge ("ALJ") to make recommendations on damages and attorney's fees and costs. *Id.* at *9.

DOL subsequently issued a Decision and Order on Damages in which it adopted as reasonable the damages recommendation of the ALJ. *See Leveille v. New York Air National Guard*, ARB No. 98-079 (DOL Adm. Rev. Bd. 1999), *available in*, 1999 WL 966951, *5 (copy attached in Addendum, *infra.*) DOL observed that the ALJ had "compared this case to other whistle-blower cases in which damages had been awarded for mental anguish and recommended an award of $45,000 for mental distress." *Id.* at *1. It also noted that the ALJ "recommended an award of $25,000 for damage to Complainant's professional reputation." *Id.*

In the section of its decision entitled "Compensatory damage for emotional distress or mental anguish," DOL reviewed the ALJ's

recommendations in detail. *Id.* at *2-4. It stated that "the environmental statutes have created a 'species of tort liability'" that "compensate discriminatees not only for direct pecuniary loss, but also for such harms as impairment of reputation, personal humiliation, and mental anguish and suffering." *Id.* at *2. DOL noted that taxpayer "testified that she experienced a variety of medical and personal problems after learning that she had been blacklisted by the Air National Guard, including severe anxiety attacks, inability to concentrate, a feeling that she no longer enjoyed 'anything in life,' and marital conflict." *Id.* at *3. DOL noted that taxpayer's "description of her mental anguish was supported by a psychologist, Dr. Carter, who testified about the substantial effect the negative references had on Complainant." *Id.* Acknowledging that "[a]ny attempt to set a monetary value on intangible damages such as mental pain and anguish involves a subjective judgment," DOL concluded that the "ALJ's recommendation of an award of $45,000 for emotional distress is reasonable, and we adopt it." *Id.* at *4. It also agreed with the ALJ's recommendation of a $25,000 award to taxpayer for "damage to [her] professional reputation." *Id.* Thus, DOL awarded taxpayer damages of

"$45,000 for mental pain and anguish" and "$25,000 for injury to professional reputation." *Id.* at *5.[3]

B. Taxpayer's 2000 tax return and refund claim

Taxpayer received the damages award in 2000 and reported $70,000, representing the awards for mental pain and anguish and injury to reputation, as income on her 2000 federal income tax return. (JA 8.) Taxpayer later filed amended returns for 2000, seeking a refund of $20,865. (JA 8.) She asserted that the damages award was excludable from income under I.R.C. § 104(a)(2), which provides an exclusion for tort or tort-type damages received "on account of personal physical injuries or physical sickness." (JA 9.) The IRS denied the claim, and taxpayer filed the instant suit. (JA 6-13.)

C. The District Court proceedings

The Government moved for summary judgment, arguing that the damages were awarded to taxpayer on account of nonphysical injuries, *i.e.*, mental pain and anguish and injury to professional reputation, and

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[3] DOL also awarded taxpayer $529.28 for past medical expenses, $10,000 for future medical expenses, and $126,845.94 for attorney's fees and costs. 1999 WL 966951, *5. Only the award of damages for mental pain and anguish and injury to professional reputation is at issue here.

thus were not excludable from income under I.R.C. § 104(a)(2) as a matter of law. (Doc. 10.) Taxpayer opposed the Government's motion and filed a cross-motion for partial summary judgment, arguing that the damages award was not income; that if the award was income, it fell within I.R.C. § 104(a)(2); and that, in any event, § 104(a)(2), as amended in 1996, was unconstitutional. (Docs. 19-21.) Taxpayer alleged that the damages award was received on account of a physical injury because she developed bruxism, or teeth-grinding, as "the result of a substantial increase in stress" that occurred after learning of her employer's retaliatory conduct. (JA 44.)

The District Court ruled in favor of the Government. First, it held that the damages award constituted gross income unless subject to exclusion under I.R.C. § 104(a)(2). (JA 26-27.) The court observed that longstanding Supreme Court precedent establishes a broad definition of income, including "all income from whatever source derived" and "all economic gains not otherwise exempted." (JA 26, 34.) It held that the damages award falls within "the broad definition of 'income' purported by the tax code and the courts' subsequent interpretation thereof." (JA 34.) The court also rejected taxpayer's argument that the damages

award is not income under the "in lieu of" test used in *Raytheon Prod. Corp. v. Commissioner*, 144 F.2d 110 (1st Cir. 1944), stating that "courts have applied the *Raytheon* test in cases involving settlement, not in cases where damages are awarded by an administrative body." (JA 34.)

The District Court next held that the damages award was not excluded from income under I.R.C. § 104(a)(2). It observed that "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 (1995)," which "requires a taxpayer to establish that damages were received through a tort or tort-like action" and "that the damages were received 'on account of' a personal injury" that is "physical in nature." (JA 27-28, emphasis in original.) It found that taxpayer met the first prong but not the second. (JA 28.) Noting that taxpayer's award was for "damage to her professional reputation" (JA 28) and "mental pain and anguish" (JA 29), the court observed that the House Report accompanying the 1996 amendment to § 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." (JA 29.) It further observed that "the House Report states that 'emotional distress is not considered a physical injury or physical sickness.'" (JA 29.) The court held that "[h]ere, 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." (JA 29.)

The District Court also rejected taxpayer's constitutional challenges. In response to taxpayer's contention that "these compensatory damages are not income and therefore they cannot be taxed under the Sixteenth Amendment" (JA 34), the court observed that Congress has the power "to lay and collect Taxes, Duties, Imposts and Excises" under Article I, sec. 8 of the Constitution, and that the only limitations on that power are that "all Duties, Imposts and Excises shall be uniform throughout the United States," and that "no Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." (JA 33, citing U.S. Const. Art. I, sec. 8, cl. 1 & sec. 9, cl. 4.) It observed that

"[t]his 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 . . . (1895), which later prompted the passage of the Sixteenth Amendment." (JA 33.) Under the Sixteenth Amendment, the court stated, "[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." (JA 33.) The court explained that "[t]he Sixteenth Amendment therefore effectively eliminated the apportionment requirement for income tax." (JA 33.) Recalling that "the Supreme Court has continually affirmed the broad interpretation of the taxing power and the definition of income," the court concluded that Congress's 1996 amendment of § 104(a)(2) "is within the boundaries of its limits under the Sixteenth Amendment" and "does not pose a constitutional problem under the Sixteenth Amendment." (JA 35.)

The District Court also rejected taxpayer's arguments that I.R.C. § 104(a)(2), as amended, resulted in an unconstitutional retroactive

application of law and that it violated the due process and takings clauses of the Fifth Amendment.[4] (JA 30-33.)

The District Court entered an order granting the Government's motion for summary judgment. (JA 36-37.) Taxpayer now appeals.

SUMMARY OF ARGUMENT

The District Court correctly held that the damages award taxpayer received for emotional distress and injury to professional reputation is income under I.R.C. § 61(a), and that it is not excluded under I.R.C. § 104(a)(2). Its order of summary judgment should be affirmed.

1. Gross income includes "all income from whatever source derived." I.R.C. § 61(a). Congress purposely modeled this definition upon the language of the Sixteenth Amendment to establish the all-inclusive nature of statutory gross income and exert the "full measure of its taxing power." *Helvering v. Clifford*, 309 U.S. 331, 334 (1940). As the District Court correctly observed, the Supreme Court has repeatedly reaffirmed the broad, unrestricted scope of the term

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[4] Taxpayer does not raise these arguments in her opening brief on appeal and, thus, they are waived. *See World Wide Minerals, Ltd. v. Republic of Kazakhstan*, 296 F.3d 1154, 1160 (D.C. Cir. 2002).

"income," stating that it includes all accessions to wealth and all economic gains not otherwise exempted by the Internal Revenue Code. The District Court correctly held that taxpayer's award of $70,000 cash was income within the meaning of § 61(a) and the Sixteenth Amendment.

Taxpayer argues that because the damages were awarded to make her "whole," they do not represent an accession to wealth or a gain but merely a return of human capital. The human capital rationale, however, merely supports the notion that an individual might be entitled to damages for nonphysical injuries in the first instance, but it does not dictate the tax treatment of such damages. In this case, Congress did not provide an exclusion for the type of damages taxpayer received and, in amending § 104(a)(2) in 1996 to cover only damages received on account of personal physical injuries or physical sickness, it evidenced a clear intent to tax the type of award taxpayer received. Contrary to taxpayer's assertions, neither the Constitution nor the case law requires that returns of human capital be excluded from income, and any decision to exclude damages for nonphysical personal injuries is a policy decision left solely to Congress. In any

event, a return of capital is excludable from income only to the extent of the taxpayer's basis, and because taxpayer here has no basis in her human capital, the damages award is taxable in full.

2. The District Court also correctly held that taxpayer's award is not excluded from income under § 104(a)(2) because it was not received "on account of personal physical injuries or physical sickness," as required by the statute. The phrase "on account of" requires a direct causal link between the damages award and the physical injury. The District Court correctly held that there was no such link in this case, as DOL clearly awarded damages for emotional distress and injury to professional reputation, which are not physical injuries. Indeed, § 104(a) plainly states that "emotional distress shall not be treated as a physical injury or physical sickness." That taxpayer may have also suffered a physical injury stemming from the emotional distress is beside the point because the damages were not received on account of that injury.

3. Even if taxpayer's damages award is not income within the meaning of § 61(a) and the Sixteenth Amendment, there is no constitutional impediment to taxing the award. The Constitution

grants Congress plenary taxing power, and requires only that indirect taxes be uniform throughout the United States and that direct taxes be apportioned by population. Contrary to taxpayer's assertions, the tax at issue is not a direct tax. The Framers understood direct taxes to include only capitation taxes and taxes on land, and the Supreme Court has accorded a similarly narrow definition to the term. Moreover, the historical events surrounding the inclusion of the direct-tax clause in the Constitution indicate that it was intended as a resolution on the treatment of slaves, not as a serious restriction on Congress's taxing power. This case involves a tax on the receipt of money damages, which is not a direct tax requiring apportionment. And it is unquestionably uniform throughout the United States. Accordingly, the tax at issue is not unconstitutional.

ARGUMENT

I

The District Court correctly held that taxpayer's damages award is income, and that it is not excluded from income under I.R.C. § 104(a)(2)

Standard of review

This Court reviews the District Court's grant of summary judgment *de novo*.

A. Constitutional and statutory framework

The Constitution grants Congress plenary taxing power. Article I, sec. 8, cl. 1, provides: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts, and Excises." The only limitations on that power are that "Duties, Imposts and Excises shall be uniform throughout the United States" (Art. I, sec. 8, cl. 1); "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken" (Art. I, sec. 9, cl. 4); and "No Tax or Duty shall be laid on Articles exported from any State" (Art. I, sec. 9, cl. 5). In addition, the Sixteenth Amendment to the Constitution relieves income taxes from the apportionment requirement of Art. I, sec. 9, cl. 4. It states: "The Congress shall have

power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const., Am. XVI. As discussed in more detail *infra*, pp. 55-65, the Sixteenth Amendment was added in 1913 to reverse the Supreme Court's holding in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), that a tax on income from real and personal property was a direct tax requiring apportionment. *Pollock* did not hold that all income taxes are direct taxes, however—only those on income derived from real and personal property. *Id.* at 635-37. A tax on income from other sources is not a direct tax subject to the apportionment requirement, even apart from the Sixteenth Amendment.

Thus, taxpayer is incorrect in asserting throughout her brief that the Sixteenth Amendment operates as a limitation upon Congress's power to tax income. (*See, e.g.*, Br. 17, 18, 20, 30.)[5] As the Supreme Court explained, "[i]t is clear on the face of [the Amendment] that it does not purport to confer power to levy income taxes in a generic

[5] "Br." refers to Appellants' opening brief. "ABr." refers to the brief of Amici Curiae.

sense—an authority already possessed and never questioned—or to limit and distinguish between one kind of income taxes and another, but that the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment [and] from a consideration of the source whence the income was derived." *Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1, 17-18 (1916); *see Eisner v. Macomber*, 252 U.S. 189, 205-06 (1920); *Stanton v. Baltic Mining Co.*, 240 U.S. 103, 112-13 (1916). Indeed, "[t]he amendment does not attempt to define income." *Taft v. Bowers*, 278 U.S. 470, 481 (1929). The Court has emphasized repeatedly that Congress's taxing power is "exhaustive and embraces every conceivable power of taxation," *Brushaber*, 240 U.S. at 12-13; *see Steward Mach. Co. v. Davis*, 301 U.S. 548, 581-83 (1937), and that the constitutional limitations are "not so much a limitation upon the complete and all-embracing authority to tax, but in their essence . . . simply regulations concerning the mode in which the plenary power was to be exerted." *Brushaber*, 240 U.S. at 13.

Thus, the Sixteenth Amendment does not in any way affect Congress's power to tax the damages award at issue. It is only potentially relevant in determining *how* Congress can tax the award:

only if the tax at issue is both a "direct" tax, requiring apportionment in the first instance, and not an "income" tax, relieved from apportionment by the Sixteenth Amendment, would the tax be problematic. In such case, the Constitution would require that the tax be apportioned according to population. As we will show, however, the tax at issue is indeed an income tax within the meaning of the Sixteenth Amendment. And, in any event, it is not a direct tax, and thus, contrary to taxpayer's argument, need not be apportioned.

Against this constitutional backdrop, Congress enacted in 1913 an income tax that defined gross income as "income derived from any source whatever." Revenue Act of 1913, § II(B), 38 Stat. 167. That definition has remained substantively unchanged except that, after being brought into the 1954 Internal Revenue Code at I.R.C. § 61(a), its language was altered slightly to mirror precisely that of the Sixteenth Amendment, such that gross income means all income "from whatever source derived." *See* 1 Boris I. Bittker & Lawrence Lokken, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS, ¶ 5.1 (3d ed. 1999). Thus, the House Report accompanying the 1954 Code noted that the definition of gross income in § 61(a) "is based upon the 16th

Amendment and the word 'income' is used in its constitutional sense," and further affirmed the "all-inclusive nature of statutory gross income." H.R. Rep. No. 83-1337, at A18 (1954); *see* S. Rep. No. 83-1622, at 168 (1954); *see also Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 433 n.11 (1955). The present version of the Code[6] continues to provide that "gross income means all income from whatever source derived, including (but not limited to) the following items," and enumerates fifteen items not relevant here. I.R.C. § 61(a).

The Code also provides numerous exclusions from income. One such exclusion is contained in § 104, which, as relevant here, states:

> (a) In General.— Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, 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;
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> * * *

[6] Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended (the "Code").

> . . . For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress.

Prior to 1996, § 104(a)(2) excluded from gross income "the amount of any damages received . . . on account of personal injuries or sickness." As then in effect, § 104(a)(2) was held to encompass damages compensating all personal injuries, including nonphysical injuries, *e.g.*, "those affecting emotions, reputation, or character." *United States v. Burke*, 504 U.S. 229, 236 n.6 (1992); *see Schleier*, 515 U.S. at 329-30. Section 104(a) was amended on August 20, 1996, by the Small Business Job Protection Act, Pub. Law No. 104-188, § 1605(a), 110 Stat. 1755, 1838 ("SBJPA"), *reprinted in*, 1996-3 C.B. 155, 238, and as amended, it expressly limits the type of damages excludable from income to those received "on account of personal physical injuries or physical sickness," and expressly states that emotional distress does not constitute a physical injury or sickness.[7]

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[7] The amendment was made effective to any "amounts received after the date of the enactment of this Act, in taxable years ending after such date." SBJPA § 1605(d), *reprinted in*, 1996-3 C.B. at 239. Taxpayer

(continued...)

The legislative history of the amendment explains that the change was made because "confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation, including two Supreme Court cases within the last four years. The taxation of damages received in cases not involving a physical injury or physical sickness should not depend on the type of claim made." H.R. Rep. No. 104-586, at 143, *reprinted in* 1996-3 C.B. at 481. In explaining the change, the House Report states that "the exclusion from gross income does not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress." *Id.* It further states that "[t]he Committee intends that the term emotional distress includes physical symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress." *Id.*

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[7](...continued)
was awarded damages in 1999 and received them in 2000, well after the effective date of the amendment. Thus, as the District Court correctly held (JA 30), the amended version of § 104(a)(2) applies here.

at 144; *see* H.R. Conf. Rep. No. 104-737, at 301, *reprinted in* 1996-3 C.B. at 1041.

B. Taxpayer's damages award is income within the meaning of § 61 and the Sixteenth Amendment

The District Court correctly held that taxpayer's damages award is income, as it is within the scope of "all income from whatever source derived." I.R.C. § 61(a). (JA 34.) As the court correctly observed, "the Supreme Court has continually affirmed the broad interpretation of the taxing power and the definition of income." (JA 35.)

In the seminal case addressing the meaning of "income," *Glenshaw Glass*, 348 U.S. 426, the Supreme Court resoundingly rejected attempts to confine the definition. *See* Joseph M. Dodge, *The Story of Glenshaw Glass: Towards a Modern Concept of Income*, TAX STORIES 30-44 (2003). In that case, the taxpayers argued that punitive damages were not income under a definition previously used by the Court in *Macomber*, 252 U.S. 189. In *Macomber*, the Court had held that a tax on unrealized stock dividends was unconstitutional. *Id.* at 189. It defined income as "the gain derived from capital, from labor, or from both combined." *Id.* at 207. In *Glenshaw Glass*, the Court reviewed the "sweeping scope" of the predecessor to § 61(a) and

observed that it had "given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted." 348 U.S. at 430. The Court explained that the definition contained in *Macomber* had, in the context of that case, "served a useful purpose," but cautioned that the definition "was not meant to provide a touchstone to all future gross income questions." *Id.* at 430-31. The Court held that income includes "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.* at 431.

Since then, the Supreme Court repeatedly has reaffirmed the broad, unrestricted scope of the term "income," most notably in the context of two cases construing § 104(a)(2): *Schleier*, 515 U.S. at 327 ("We have repeatedly emphasized the 'sweeping scope' of [§ 61] and its statutory predecessors."), and *Burke*, 504 U.S. at 233 ("The definition of gross income under the Internal Revenue Code sweeps broadly," including all income "subject only to the exclusions specifically enumerated elsewhere in the Code."). And in *Commissioner v. Banks*, 543 U.S. 426, 433 (2005), the Court made clear that income "extends broadly to all economic gains not otherwise exempted."

Consistent therewith, the Court has "emphasized the corollary to § 61(a)'s broad construction, namely, the 'default rule of statutory interpretation that exclusions from income must be narrowly construed.'" *Schleier*, 515 U.S. at 328; *see Commissioner v. Jacobson*, 336 U.S. 28, 49 (1949).

Under the standard enunciated in *Glenshaw Glass*, the $70,000 cash award that taxpayer received was an accession to wealth, clearly realized, over which she had complete dominion. Taxpayer here undeniably had economic gain because she was better off financially after receiving the damages award than she was prior to receiving it. That the damages were received in an effort to make taxpayer "whole" for the personal injuries she suffered does not change the indisputable fact that the method chosen to make her "whole" increased her wealth by $70,000. *Cf. Crane v. Commissioner*, 331 U.S. 1, 15 (1947), where the Supreme Court appeared to recognize that "the direct receipt of cash is thought to be income" within the meaning of the Sixteenth Amendment. In short, the award is income under the catch-all provision of § 61(a) and within the meaning of the Sixteenth Amendment.

Despite the broad construction of income established by the Supreme Court, taxpayer argues that the catch-all provision of § 61(a) should be narrowly construed "*most strongly against the government, and in favor of the citizen*," citing *Gould v. Gould*, 245 U.S. 151, 153 (1917). (Br. 13-14 (emphasis in original), 17, 32-33.) In *Gould*, the Supreme Court determined that alimony payments were not income under the Revenue Act of 1913. Alimony payments were not among the income items specifically enumerated in the statute, and, at the time, there was no deduction available to the payor. *Id.* at 154.[8] That case was decided in the fledgling years of the income tax—one year after the constitutionality of the income tax was finally established in *Brushaber*, and at a time when there were numerous economic theories of income and uncertainties regarding the extent to which those theories affected the definition of income for tax purposes. *See* Dodge, TAX STORIES 31-37. The Supreme Court has not cited *Gould* since 1940, *see Helvering v. Fuller*, 310 U.S. 69 (1940), some fifteen years

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[8] Congress later added alimony to the list of items expressly included in gross income and provided a deduction for the payor. I.R.C. §§ 71, 215; *see Mahana v. United States*, 88 F. Supp. 285 (Ct. Cl. 1950) (rejecting Sixteenth Amendment challenge to the inclusion of alimony in income).

before *Glenshaw Glass* was decided. In light of *Glenshaw Glass* and its progeny, the proposition that income is to be construed narrowly against the Government is insupportable.[9]

C. That the damages may have been intended to make taxpayer "whole" does not render them non-taxable

Taxpayer asserts that the damages she received for emotional distress and injury to her professional reputation are not income within the meaning of § 61(a) and the Sixteenth Amendment because they were designed to make her "whole." (Br. 12, 17-18.) Thus, taxpayer argues, her award represents a non-taxable return of capital rather than a gain. (Br. 17, 28-29.) As noted above, and as discussed in detail below, that taxpayer may have received the damages in an effort to make her "whole" for the personal injuries she suffered does not change the indisputable fact that the method chosen to make her "whole" increased her wealth by $70,000, and therefore was an accession to wealth subject to income tax.[10]

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[9] Taxpayer's reliance on *America Online, Inc. v. United States*, 64 Fed. Cl. 571, 576 (2005), (Br. 14, 17, 33) is misplaced for the same reason.

[10] If damages received on account of personal injury are not income (continued...)

1. Payments representing a return of human capital are not *per se* non-taxable

Under the Code, a return of financial capital to the extent of the taxpayer's basis is not subject to tax. I.R.C. § 1001. Some payments that can be characterized as representing a return of "human capital" also are not taxed, but that is a result of Congress's provision of an exclusion or deduction. *E.g.*, I.R.C. § 101 (certain death benefits), § 104(a)(1) (workers' compensation benefits), § 105 (accident and health plan benefits), § 139 (disaster relief payments), § 140(a)(3) (veterans'

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[10](...continued)
in the first instance, there would be no need for § 104(a)(2). But Congress, beginning at least in 1918 when the exclusion was first enacted, quite plainly did not believe that the exclusion is unnecessary. Moreover, the Supreme Court has considered the scope of § 104(a)(2) on three separate occasions, and in none of those cases was the possibility even raised that personal injury damages were not income in the first instance. *See Burke, supra; Schleier, supra; O'Gilvie v. United States,* 519 U.S. 79 (1996). In this regard, it is noteworthy that in *O'Gilvie,* 519 U.S. at 84-85, the Court discussed both the Attorney General's opinion and the Treasury Decision relied upon by taxpayer here (Br. 22-23), viewing them as the "history of the statutory provision," *i.e.*, the predecessor of § 104(a)(2). Similarly, the validity of the 1996 amendment to § 104(a)(2) has been considered and upheld on three previous occasions, and, again, no argument was made that nonphysical personal injury damages are not income in the first instance. *See Polone v. Commissioner*, 449 F.3d 1041 (9th Cir. 2006); *Lindsey v. Commissioner*, 422 F.3d 684 (8th Cir. 2005); *Young v. United States*, 332 F.3d 893 (6th Cir. 2003).

benefits), § 151 (personal exemptions), § 165 (losses). There is no authority for taxpayer's position (Br. 12) that recoveries of human capital are *per se* not income. Indeed, if that were the case, the numerous exclusions and deductions provided by Congress would be superfluous because the recoveries would not be included in gross income in the first instance.

a. The case law cited by taxpayer does not establish that payments representing a return of human capital are not income

Taxpayer refers to "a long unbroken line of cases" that purportedly establishes that "awards that make a person 'whole' for restoring a personal loss" are not income. (Br. 15, n.10.) Two of the cases cited by taxpayer, however, have nothing at all to do with a loss or return of capital (*i.e., Burk-Waggoner Oil Ass'n v. Hopkins*, 269 U.S. 110 (1925), and *United States v. Kaiser*, 363 U.S. 299 (1960)). Indeed, only three of the cases actually involve a personal loss (*i.e., O'Gilvie v. United States*, 519 U.S. 79 (1996) (wrongful death), *Dotson v. United States*, 87 F.3d 682 (5th Cir. 1996) (ERISA claim), and *Hawkins v. Commissioner*, 6 B.T.A. 1023 (1927) (slander and libel)). Moreover, all of the relevant cases turned on the courts' determination of whether

Congress intended to include the recovery in income. *See O'Gilvie,* 519 U.S. at 86-87; *Glenshaw Glass,* 348 U.S. at 429-30; *Doyle v. Mitchell Bros.*, 247 U.S. 179, 184-85 (1918); *Southern Pac. Co. v. Lowe*, 247 U.S. 330, 335, 337 (1918); *Hawkins,* 6 B.T.A. at 1025. None suggest that Congress may not tax such recoveries, if it so chooses. *See Hawkins*, 6 B.T.A. at 1025 (suggesting the result would be different if there were an express provision including damages in income); *see also Lukhard v. Reed,* 481 U.S. 368 (1987) (upholding treatment of personal injury awards as "income" for purposes of Aid to Families with Dependent Children program).[11] Indeed, taxpayer implicitly acknowledges that

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[11] In this regard, taxpayer quotes *Burk-Waggoner* ("Congress cannot make a thing income which is not so in fact") out of context. (Br. 15 & 18.) In that case, the taxpayer argued that it could not be taxed as a corporation because, under state law, its form was more akin to a partnership. It argued that it had no income or property as an entity and that "ownership, receipt and segregation are essential elements of income which Congress cannot affect." 269 U.S. at 112. In rejecting the argument as "unsound," the Court stated that "[i]t is true that Congress cannot make a thing income which is not so in fact. But the thing to which the tax was here applied is confessedly income earned in the name of the association. Congress cannot convert into a corporation an organization which by the law of its State is deemed to be a partnership. But nothing in the Constitution precludes Congress from taxing as a corporation an association which, although unincorporated, transacts its business as if it were incorporated." *Id.* at 114. Rather than supporting taxpayer's arguments here, *Burk-*

(continued...)

Congress can expressly tax such recoveries in stating that because "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." (Br. 13; *see* Br. 15 (referring to "[t]he failure or mistake by Congress to include a tax on damages in Section 61(a) or another section of the tax code."))[12]

Taxpayer's reliance on *Glenshaw Glass* and *O'Gilvie*, in particular, is misplaced. (Br. 19-20, 22-23.) First, taxpayer alleges that, in footnote 8 of *Glenshaw Glass*, the "Supreme Court summarized its view on the taxability of compensatory damages in order to make a person whole." (Br. 19.) The Court was not, however, expressing *its* view on the taxability of compensatory damages. Rather, in explaining why punitive damages do not fall within *Congress's* rationale for excluding compensatory damages, it stated that the "long history of

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[11](...continued)
Waggoner reaffirms Congress's broad taxing power. In any event, the Government does not suggest that Congress can make a thing income which is not so in fact. Damages received for personal injury are a clear accession to wealth and, thus, are income.

[12] There is also no support for Amici's contention that damages awarded for wrongful imprisonment are *per se* not income and, indeed, they cite to none. (ABr. 13.)

departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages." 348 U.S. at 433, n.8. The Court did not thereby lay down an exception to its broad definition of income for personal injury damages. Indeed, such an interpretation is wholly at odds with the ultimate holding of *Glenshaw Glass*.

Similarly, in *O'Gilvie*, the Court provided a detailed history of the pre-1996 version of § 104(a)(2) in explaining why punitive damages awarded in a wrongful death suit do not come within Congress's rationale for excluding compensatory damages. 519 U.S. at 84-86. The Court concluded that the "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.'" *Id.* at 86. The Court's discussion makes clear that it was opining on Congress's intent—not announcing its own rule regarding the taxability of compensatory damages. *Id.* at 86-87 (referring to the "statute's rationale," "tax-policy-related 'human

capital' rationale," "tax-equality objective," and "congressional generosity or concern").[13]

Any determination to exclude damages for personal injuries from income is thus not required by the Constitution or the case law, but is one of policy based upon value judgments.[14] Such determinations are the sole province of Congress, and in amending § 104(a)(2) in 1996 to cover only damages received on account of a physical injury or physical sickness, Congress established its clear intent to tax precisely the type of award taxpayer here received.

In this regard, it is irrelevant whether taxation of the damages at issue "would create considerable tension with the remedial purpose of

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[13] Nowhere did the Court suggest that § 104(a)(2) was unnecessary or superfluous because compensatory damages are not income in the first instance, an argument taxpayer here advances (Br. 12). Thus, the Court implicitly recognized that compensatory damages are income. *See Lukhard*, 481 U.S. at 376 (the fact that § 104(a) expressly excludes personal injury awards from income supports the proposition that, absent express exclusion, such awards are included in income).

[14] Taxpayer's reliance (Br. 40) on President Clinton's signing statement with respect to the 1996 amendment is misplaced. Although as a policy matter President Clinton may have indicated that he believed all personal injury damages should be excluded from income, the fact of the matter is that he signed into law the Congressional enactment that limited the exclusion to personal *physical* injury or *physical* sickness.

the six federal environmental statutes under which Ms. Murphy was awarded 'make whole' compensatory damages," as taxpayer asserts. (Br. 30-31.) At the outset, there simply is no conflict between the relevant Code provisions and the environmental statutes under which taxpayer sued her employer. And to the extent that taxing such damages may have a chilling effect on employment discrimination claims, as taxpayer and Amici predict, this, too, is a policy matter for Congress to decide, not the courts.[15] (Br. 31; ABr. 11.) In amending § 104(a)(2) in 1996, Congress presumably weighed such policy considerations and nevertheless elected to confine the exclusion

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[15] Amici argue at length that taxation of the damages at issue "is directly at odds with, and undermines the purpose of, Title VII." (ABr. 8-11.) But taxpayer did not sue her employer under Title VII, so that statute is not implicated in this case. Amici also suggest that § 104(a)(2) conflicts with the ADA and discriminates against the mentally ill. (ABr. 15-17.) Amici fail to grasp the appreciable difference between mental illness and nonphysical personal injuries actionable in tort, which are the subject of § 104(a)(2). Finally, Amici argue that, because § 104(a)(2) was amended to "decrease litigation," it conflicts with Title VII. (ABr. 11.) The House Report makes clear that the amendment was intended to decrease litigation regarding the tax treatment of damages, not to decrease civil rights litigation, as Amici suggest. *See* H. Rep. No. 104-586, at 142-43. In any event, as noted above, taxpayer's and Amici's concerns in these regards involve policy determinations and are not relevant to the legal question whether personal injury damages are income under § 61(a).

available under § 104(a)(2) to damages received on account of physical injuries. Taxpayer's quarrel is properly with Congress, not with the IRS.

b. Administrative rulings cited by taxpayer do not establish that payments representing a return of human capital are not income

Taxpayer asserts (Br. 23-27) that numerous administrative rulings establish that recoveries of human capital are not income. But the definition of income is not constrained by such rulings, and Congress's 1996 amendment of § 104(a)(2) trumps any administrative interpretations that are to the contrary anyway. In any event, taxpayer's contentions in this regard are mistaken.

Taxpayer first asserts that, when the exclusion for personal injury awards was enacted in 1918, "compensation for personal injuries was 'considered' part of a 'return of human capital, and thus not constitutionally taxable 'income' under the 16th Amendment.'" (Br. 21, quoting *Dotson*, 87 F.3d at 685.) This erroneous view is belied by the historical materials, however. The initial view of the Treasury was that damages received on account of personal injury *were* income. *See* T.D. 2135, 17 Treas. Dec. 39, 42 (1915) (concluding that money paid to

an insured with respect to an accident insurance policy and amounts received as the result of a suit or compromise for "pain and suffering" were income); T.D. 2570, 19 Treas. Dec. 321, 323 (1917) (concluding that payments made to an injured employee by a corporation under state accident compensation laws were income). Consistent with this view, Treasury Regulations promulgated in 1918 stated that an "[a]mount received as the result of a suit or compromise for personal injury, being similar to the proceeds of accident insurance, is to be accounted for as income." Reg. No. 33 (Rev.), Art. 4(25), 20 Treas. Dec. 126, 130 (1918). It was against this backdrop that the Attorney General thereafter opined that such damages were not income, 31 Op. Att'y Gen. 304 (1918), and, following that opinion, the Treasury changed its position in T.D. 2747, 20 Treas. Dec. 457 (1918).[16] The House subsequently proposed codifying an exclusion for personal injury damages because "under the present law *it is doubtful* whether [such]

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[16] These sources came five years after the ratification of the Sixteenth Amendment and are not necessarily indicative of what was thought to be income at that time. Indeed, the intervening years saw World War I and a rise in the top tax rate from 6% (Revenue Act of 1913, Sec. II) to 65% (Revenue Act of 1918, Sec. 211). These factors may well have influenced attitudes regarding the taxation of damages received for personal injuries.

amounts . . . are required to be included in gross income." H.R. Rep. No. 65-767, at 9-10 (1918) (emphasis added), *reprinted in* 1939-1 C.B. (pt. 2) 92. This, in itself, demonstrates that there was no firm understanding that personal injury damages were not income. Indeed, if there had been, there would have been no need for the statutory exclusion Congress eventually enacted.[17]

Moreover, the view that personal injury damages were not subject to income tax extended only to damages received for physical injuries. Thus, Sol. Mem. 957, 1919-1 C.B. 65 (1919), ruled that "[m]oney received as damages in libel proceedings is subject to income tax." And Sol. Mem. 1384, 1920-2 C.B. 71 (1920), ruled that damages for alienation of affections did not fall within the exclusion provided by the newly enacted predecessor to § 104(a)(2), stating that "the term 'personal injuries,' as used therein means physical injuries only." Only after the Supreme Court decided *Macomber*, which has subsequently been limited, *see* pp. 22-23, *supra*, did the Treasury change its stance

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[17] Thus, the statement in *Dotson* (quoted by taxpayer at Br. 21-22), made in reliance on the 1918 House report, that personal injury damages were not considered income under the Sixteenth Amendment, is inconsistent with the historical record and entitled to no weight.

and rule that damages for nonphysical personal injuries were not income in Sol. Op. 132, I-1 C.B. 92 (1922).

Taxpayer places great weight on Sol. Op. 132, calling it "binding authority" (Br. 24), and argues that this Court should defer to it and subsequent revenue rulings that reiterate its reasoning (Br. 24-26). However, Sol. Op. 132 was issued after an exclusion for personal injury damages had been enacted and should properly be seen in that light. Moreover, Sol. Op. 132 was withdrawn by the Treasury long ago. It was superseded by Rev. Rul. 74-77, 1974-1 C.B. 33, which stated that "the position stated [in Sol. Op. 132] is set forth under the current statute and regulations," referring to § 104 and 26 C.F.R. § 1.104-1. Rev. Rul. 74-77 was then, in turn, declared obsolete in Rev. Rul. 98-37, 1998-2 C.B. 133, because "the applicable statutory provisions or regulations [*i.e.*, § 104(a)(2)] have been changed or repealed."

Taxpayer is thus mistaken in asserting that "the common definition of what is an 'income tax' has remained static" since 1913 and that this definition did not include personal injury damages. (Br. 15.) Moreover, in ratifying the Sixteenth Amendment, Congress did not intend to implement a static definition of income. Indeed, income

now includes many items that likely were not thought of as income when the Sixteenth Amendment was ratified in 1913. *E.g.*, *Commissioner v. Tufts*, 461 U.S. 300 (1983) (income from discharge of nonrecourse debt); *Diedrich v. Commissioner*, 457 U.S. 191 (1982) (income to donor when gift tax exceeding donor's basis was paid by donee); *Helvering v. Bruun*, 309 U.S. 461 (1940) (income to lessor when lessee improved leased property; since overruled by enactment of I.R.C. § 109); *Mahana*, 88 F. Supp. 285 (income from alimony); I.R.C. § 7872 (income from foregone interest on interest-free loans); I.R.C. §§ 1271-1278 (income from original issue discount).

The revenue rulings regarding compensation to prisoners of war and victims of Nazi persecution, upon which taxpayer also relies (Br. 24), have been obsoleted by the Treasury. *See* Rev. Rul. 2007-14, I.R.B. 2007-12; Notice 95-31, 1995-1 C.B. 307. In any event, those obsolete rulings do not establish that recoveries of human capital are *per se* not income. In Rev. Rul. 55-132, 1955-1 C.B. 213, the Treasury summarily concluded that payments received by a POW from the U.S. Government under the War Claims Act of 1948 "are in the nature of reimbursement for the loss of personal rights and are not includible in the gross income

of such individual for Federal income tax purposes." The ruling does not state whether its holding is based on earlier *Macomber*-era rulings that limited the definition of income to "the gain derived from capital, from labor, or from both combined," *e.g.*, Sol. Op. 132, I-1 C.B. at 93, or on the fact that such payments were not treated as income by Congress under I.R.C. § 104(a)(2) (1954). The holding of Rev. Rul. 55-132 was extended to cover payments to Korean War POWs in Rev. Rul. 56-462, 1956-2 C.B. 20, and payments by Germany to victims of Nazi persecution in Rev. Rul. 56-518, 1956-2 C.B. 25, with no further explanation or reasoning. The holding of Rev. Rul. 56-518 was then extended to cover two types of payments by Austria to victims of Nazi persecution, again with no further explanation or reasoning. Rev. Rul. 58-370, 1958-2 C.B. 14; Rev. Rul. 69-212, 1969-1 C.B. 34. (Two other rulings cited by taxpayer (Br. 24, n.16) merely clarified the type of German payments covered by Rev. Rul. 56-518. *See* Rev. Rul. 57-505, 1957-2 C.B. 50; Rev. Rul. 58-500, 1958-2 C.B. 21.) At the time, those rulings were consistent with Congress's policy determination reflected in § 104(a)(2) to exclude all compensatory personal injury damages from income.

Amici argue that "the Treasury Regulations support the understanding that Section 61 is not intended to tax 'make whole' payments" because they expressly state that punitive damages are income but are silent regarding compensatory damages. (ABr. 19.) *See* Treas. Reg. § 1.61-14(a) (26 C.F.R.). But the regulation's silence does not establish that compensatory damages are not income, particularly where the regulation states that "there are many other kinds of gross income." *Id.* Moreover, Treas. Reg. § 1.61-14, entitled "Miscellaneous items of gross income," at least impliedly provides that damages received on account of personal injury are income. Treas. Reg. § 1.61-14(a) provides that items not specifically enumerated in § 61 also constitute gross income, such as punitive damages and treasure trove. As relevant here, Treas. Reg. § 1.61-14(b)(2) provides a cross-reference to § 104(a)(2) for damages received on account of personal injury, thus implying that such damages are gross income but for the exclusion.

Because damages awarded to make a taxpayer "whole" are not *per se* excludable from income, taxpayer's reliance (Br. 27-30) on the "in lieu of" test of *Raytheon*, 144 F.2d 110, is misplaced. Indeed, that case did not create a test for income distinct from the standard described

above, *supra* pp. 22-24. In *Raytheon*, the court considered "whether an amount received by the taxpayer in compromise settlement of a suit for damages under the Federal Anti-Trust Laws . . . is a non-taxable return of capital or income." *Id.* at 111. The court determined that in order to properly characterize the settlement payments for tax purposes, it had to ask: "In lieu of what were the damages awarded?" *Id.* at 113. The court did not purport to establish a talismanic test for determining whether something is income in the first instance. Rather, the "in lieu of" question merely was instructive in classifying, for tax purposes, unspecified settlement proceeds. The "in lieu of" question is not instructive here because DOL made clear that it was awarding damages to taxpayer for emotional distress and injury to professional reputation. Cash payments on account of such intangible personal attributes are income under the standard described above.

2. In any event, recoveries representing a return of capital are excludable only to the extent of basis, and taxpayer here has no basis in her human capital

Even if taxpayer's damages award is considered a replacement of human capital (and we do not think it is), the award is nevertheless includable in income because taxpayer has no tax "basis" in her human

capital. Basis refers to the Code's system of tracking previously taxed dollars so that those amounts are not taxed to the same taxpayer more than once. 1 MERTENS LAW OF FED. INCOME TAX § 5:12 (2005); Deborah A. Geier, *Murphy and the Evolution of "Basis,"* 113 Tax Notes 576, 578-79 (Nov. 6, 2006). To illustrate, a taxpayer who purchases property has a basis in the property equal to its cost under § 1012. The taxpayer's basis reflects the after-tax dollars exchanged for the property. When the taxpayer sells the property, she is taxed only on that portion of the sales proceeds that exceeds her basis. I.R.C. § 1001. Thus, the after-tax dollars used to acquire the property are not taxed a second time upon the property's sale. The Code provides for numerous additions to, and subtractions from, basis to properly maintain this tracking system. I.R.C. §§ 1011, 1016. For example, if the taxpayer claims depreciation deductions for the property, she must decrease her basis accordingly to reflect the tax benefit she received from the deductions. I.R.C. § 1016(a)(2). If the taxpayer improves the property, she may increase her basis to reflect the after-tax dollars invested in the property that should not be taxed again. I.R.C. § 1016(a)(1).

The basis rules are fundamental to the Code and apply even where a taxpayer suffers a loss and is made whole. Thus, absent an exclusion, the taxpayer recognizes gain to the extent her recovery exceeds her basis. *See Woodall v. Commissioner*, 964 F.2d 361 (5th Cir. 1992); *Barry v. United States*, 501 F.2d 578 (6th Cir. 1974); *see also United States v. Ludey*, 274 U.S. 295 (1927). The human capital rationale urged by taxpayer merely supports the notion that, as a policy matter, an individual might be entitled to damages for nonphysical injuries in the first instance. At issue here, however, are the *tax* consequences of the receipt of those damages, and, in that context, tax concepts must be considered. That taxpayer may have only been returned to the status *quo ante* does not answer the far different question whether, for tax purposes, she received income subject to tax. As the court in *Raytheon* explained, "to say that the recovery represents a return of capital in that it takes the place of [what was damaged] is not to conclude that it may not contain a taxable benefit. Although the injured party may not be deriving a profit as a result of the damage suit itself, the conversion thereby of his property into cash is a

realization of any gain made over the cost or other basis of the [thing damaged] prior to the illegal interference." 144 F.2d at 114.

The Code does not allow individuals to claim a basis in their human capital, and numerous courts have acknowledged that an individual has no tax basis in her person or well-being. *Roemer v. Commissioner*, 716 F.2d 693, 696 n.2 (9th Cir. 1983) ("Since there is no tax basis in a person's health and other personal interests, money received as compensation for an injury to those interests might be considered a realized accession to wealth."); *see Lary v. United States*, 787 F.2d 1538, 1540-41 (11th Cir. 1986) (proceeds from sale of blood are income under § 61); *Green v. Commissioner*, 74 T.C. 1229, 1233-34 (1980) (same); *see also* Paul B. Stephan III, *Federal Income Taxation and Human Capital*, 70 VA. L. REV. 1357, 1388-1405 (1984); Note, *Tax Consequences of Transfers of Bodily Parts*, 73 COLUM. L. REV. 842, 853-55 (1973).[18]

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[18] Commentators have been nearly unanimous in concluding that personal injury damages constitute income because a taxpayer has no basis in his or her human capital. *See* Dodge, TAX STORIES 45-46; Geier, 113 Tax Notes 576; Jeffrey H. Kahn, *The Mirage of Equivalence and the Ethereal Principles of Parallelism and Horizontal Equity*, 57 HASTINGS L.J. 645 (2006); Douglas Kahn, *The Constitutionality of*

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There is also no support for Amici's contention (ABr. 15) that taxpayer had a basis in her cause of action against the Air National Guard equal to the amount of damages she was awarded and, indeed, Amici cite to none. *See Polone v. Commissioner*, 449 F.3d 1041, 1045 (9th Cir. 2006) (taxpayer has no basis in defamation claim). As a leading treatise has explained:

> Taxing a recovery for personal injury or deprivation may be a harsh response to the taxpayer's misfortune, but it is not significantly different from taxing wages and salaries without allowing an offsetting deduction for the exhaustion of the taxpayer's physical prowess and mental agility during his working life. Taxpayers claiming deductions for "human depreciation" have been summarily told by the courts that Congress has not granted such an allowance. Thus, if the courts were writing on a clean slate, the personal injury issue could be analogized to the human depreciation issue. Since defamation or alienation of affections does not entail the loss of something for which the taxpayer paid cold cash, this analogy implies that compensation for such a wrong is

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[18](...continued)
Taxing Compensatory Damages for Mental Distress When There Was No Accompanying Physical Injury, 4 FLA. TAX REV. 128 (1999); J. Martin Burke & Michael Friel, *Tax Treatment of Employment-Related Personal Injury Awards: The Need for Limits*, 50 MONT. L. REV. 13 (1989); Mark Cochran, *Should Personal Injury Damage Awards be Taxed?*, 38 CASE W. RES. L. REV. 43 (1987); Lawrence Frolik, *Personal Injury Compensation as a Tax Preference*, 37 ME. L. REV. 1 (1985); *but see* F. Patrick Hubbard, *Making People Whole Again: The Constitutionality of Taxing Compensatory Damages for Mental Distress*, 49 FLA. L. REV. 725 (1997).

> an accession to the taxpayer's wealth that must be included in gross income unless Congress chooses to grant an explicit exemption. [Footnotes omitted.]

1 Bittker & Lokken, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 5.6.[19] Since taxpayer here had no basis in her human capital, the damages she received are thus fully taxable, even if the damages are viewed as a replacement of that capital.

D. The damages award is not excluded from income under § 104(a)(2) because it was not received on account of a personal physical injury or physical sickness

The District Court correctly held that taxpayer's damages award is not excluded from income under § 104(a)(2) because it was not received "on account of a personal physical injury or physical sickness." (JA 28-29.) As the court correctly observed (JA 27-28), damages are excluded under § 104(a)(2) only if (1) "the underlying cause of action giving rise to the recovery is based upon tort or tort type rights," and

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[19] The human capital concept has also been advanced to support the contention, frequently made by adherents of the tax protest movement, that wages are not income within the meaning of the Sixteenth Amendment, on the ground that wages constitute nothing more than the return of personal capital exhausted by one's labor. That argument has been uniformly rejected as frivolous. *E.g., United States v. Connor*, 898 F.2d 942, 943-44 (3d Cir. 1990); *Coleman v. Commissioner*, 791 F.2d 68, 70 (7th Cir. 1986).

(2) the damages were received on account of personal physical injuries or physical sickness. *Schleier*, 515 U.S. at 337. These requirements are independent and must both be satisfied for the exclusion to apply. *Id.*[20]

The Supreme Court has construed the "on account of" phrase in § 104(a)(2) as requiring a *direct* causal link between the physical injury and the damages recovery in order to qualify for the income exclusion. *See Schleier*, 515 U.S. at 329-31; *Rivera v. Baker West, Inc.*, 430 F.3d 1253, 1257-58 (9th Cir. 2005); *Lindsey v. Commissioner,* 422 F.3d 684, 688-89 (8th Cir. 2005). The Court has clarified that the phrase "on account of" requires more than a "but for" connection between the personal injury and the damages award. *O'Gilvie*, 519 U.S. at 82-83, The Court observed that a "but for" analysis would "bring virtually all personal injury lawsuit damages within the scope of the provision, since: 'but for the personal injury, there would be no lawsuit, and but for the lawsuit, there would be no damages.'" *Id.* at 82. The "on

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[20] The District Court held that the first prong was satisfied because DOL stated that "by 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." (JA 28.) The Government does not challenge that determination in this appeal.

account of' phrase imposes a stronger causal connection such that § 104(a)(2) only applies to those damages that were awarded by reason of, or because of, a personal physical injury. *See id.* at 83.

In this case, the District Court correctly held that there was no direct causal link between taxpayer's alleged physical injury (bruxism) and the damages award.[21] (JA 29.) This is clear from DOL's decision awarding damages, which does not even mention taxpayer's bruxism.[22] DOL repeatedly referred to the damages as "compensatory damage for emotional distress or mental anguish" and "injury to professional reputation." 1999 WL 966951, *2-5. DOL observed that the ALJ had

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[21] Taxpayer incorrectly states (Br. 36) that the District Court held she did not meet the second prong of the *Schleier* test because her injuries were not physical in nature. Instead, the court held that taxpayer did not receive any damages "on account of" any physical injury she may have sustained.

[22] Taxpayer refers vaguely to other "somatic" and "body" injuries, but the only alleged physical injury she has actually specified throughout these proceedings is bruxism. (Br. 36-37; JA 39.) In addition, taxpayer incorrectly asserts that "before the district court the Defendants did not dispute that Ms. Murphy's injuries are physical." (Br. 8, 45-46.) The Government's position throughout these proceedings has been that taxpayer was awarded damages on account of emotional distress and injury to reputation, which are not physical injuries. (Doc. 10 at 17; *see* Doc. 21 at 7-10.) The Government has further maintained that, to the extent taxpayer suffers from bruxism, that is a symptom of her emotional distress. (Doc. 21 at 7-10.)

"compared this case to other whistleblower cases in which damages had been awarded for mental anguish and recommended an award of $45,000 for mental distress." *Id.* at *1. It also noted that the ALJ "recommended an award of $25,000 for damage to Complainant's professional reputation." *Id.* In the section of its decision entitled "Compensatory damage for emotional distress or mental anguish," DOL reviewed the ALJ's recommendations in detail. It stated that "the environmental statutes have created a 'species of tort liability'" that "compensate discriminatees not only for direct pecuniary loss, but also for such harms as impairment of reputation, personal humiliation, and mental anguish and suffering." *Id.* at *2.

Although DOL stated that taxpayer "experienced a variety of medical and personal problems after learning that she had been blacklisted," it only referred to "severe anxiety attacks, inability to concentrate, a feeling that she no longer enjoyed 'anything in life,' and marital conflict," and made no mention of bruxism. *Id.* at *3. DOL noted that taxpayer's "description of her mental anguish was supported by a psychologist," but it made no mention of taxpayer's dentist, who

apparently did not testify.[23] *Id.* Acknowledging that "[a]ny attempt to set a monetary value on intangible damages such as mental pain and anguish involves a subjective judgment," DOL concluded that the "ALJ's recommendation of an award of $45,000 for emotional distress is reasonable, and we adopt it." *Id.* at *4. It also agreed with the ALJ's recommendation of a $25,000 award to taxpayer for "damage to [her] professional reputation." *Id.* In addition, DOL's award of past medical expenses was for "expenses related to such emotional distress," and DOL contemplated that its award of future medical expenses would be for continued psychotherapy, stating that "[i]t is difficult to determine in advance how many hours of counseling Complainant will require, but based on the amount she has already incurred, $10,000 for future medical expenses is a reasonable approximation." *Id.* at *3-4. In short,

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[23] The District Court stated that "[d]uring the trial, Dr. Edwin N. Carter [the psychologist] and Dr. Barry L. Kurzer [the dentist] testified that plaintiff's injuries were the result of [the Air National Guard's] conduct." (JA 20.) There is no evidence in the record, however, that Dr. Kurzer testified before the DOL, and taxpayer has not asserted that he testified. (Br. 4-5, 7, 46-48; JA 43-45; Doc. 20, Plaintiffs' Statement of Material Facts.) Taxpayer asserts that Dr. Carter based his expert opinion on a review of her medical and dental records (Br. 48), but it is not clear whether Dr. Carter actually conveyed the nature of taxpayer's dental problems to DOL (*see* JA 39-40).

DOL awarded taxpayer damages of "$45,000 for mental pain and anguish" and "$25,000 for injury to professional reputation," *id.* at *5, and there was no direct causal link between the damages award at issue and taxpayer's bruxism.

Thus, the fact that taxpayer may have suffered a physical injury is of no moment because the damages she received were not received "on account of" that injury. After concluding that the damages were not received on account of physical injury, the District Court, in further response to taxpayer's assertion that she suffered a physical injury, noted that H. Rep. No. 104-586, which explained the 1996 amendment, indicated that a physical manifestation of emotional distress was not to be considered a physical injury, and stated that "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." (JA 29.) Taxpayer assails the District Court for relying on the legislative history in this regard. But, given the court's holding that the damages were not received on account of physical injury, this is a red herring. In any event, the meaning of emotional distress, as used in the amended version of the § 104(a), is not so unambiguous as to prohibit consulting

the legislative history. It is clear from the House Report that physical manifestations of emotional distress are to be considered emotional distress within the meaning of § 104(a)(2).[24]

Taxpayer also argues that the District Court misread the legislative history as evidencing an intent to exclude the type of damages she received from the ambit of § 104(a)(2). (Br. 41-45.) To the contrary, the legislative history could not be more clear that Congress sought to remove from § 104(a)(2)'s reach precisely the type of damages at issue. The House Report plainly states that "the exclusion from gross income does not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress." H.R. Rep. No. 104-586, at 144. It further states that "the term emotional distress includes physical symptoms (e.g.,

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[24] Taxpayer's strained arguments (Br. 37-40) attempting to characterize emotional distress or physical manifestations of emotional distress as a physical injury are unavailing because, regardless of the views of the medical community or tort law, Congress has declared that "emotional distress shall not be treated as a physical injury or physical sickness." I.R.C. § 104(a) (flush language). In any event, taxpayer did not receive the damages at issue on account of any physical manifestations of her emotional distress.

insomnia, headaches, stomach disorders) which may result from such emotional distress." *Id.* Here, taxpayer's damages were based on a claim of employment discrimination and injury to reputation accompanied by a claim of emotional distress. She concedes that her only alleged physical injury, bruxism, was caused by emotional distress and, indeed, that is the opinion of both her psychologist and her dentist. (Br. 36-38; JA 41, 44.) Any attempt to characterize the House Report as not covering taxpayer's circumstances is patently wrong.

There is also no support for taxpayer's contention 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," and, indeed, taxpayer cites to none. (Br. 42.) The plain language of the statute does not draw any such temporal distinction in stating that "emotional distress shall not be treated as a physical injury or physical sickness." I.R.C. § 104(a) (flush language). Nor does the legislative history suggest any such distinction. Rather, the legislative history shows an intent to draw a bright line between damages arising from physical injuries and

damages arising from nonphysical injuries. The House expressed concern that courts had interpreted § 104(a)(2) "broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness," citing employment discrimination and injury to reputation as specific examples. H. Rep. No. 104-586, at 144. It stated that:

> The bill provides that the exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. . . . The bill also specifically provides that emotional distress is not considered a physical injury or physical sickness. Thus, the exclusion from gross income does not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income applies to any damages based on a claim of emotional distress that is attributable to a physical injury or physical sickness.

Id. at 143-44. Congress drew no distinction between short-term and long-term symptoms of emotional distress, though it did carve out

emotional distress that is attributable to a physical injury or physical sickness.

In sum, the District Court correctly held that taxpayer's damages award is income within the meaning of § 61(a) and the Sixteenth Amendment, and that the award is not excluded from income under § 104(a)(2) because it was not received on account of a physical injury or physical sickness.

II

Even if the damages award is not income, there is no constitutional impediment to taxing it because a tax on the award is not a direct tax and is imposed uniformly

Standard of review

This Court reviews the District Court's rulings of law *de novo*.

In the proceedings below, taxpayer argued that a tax on her damages award is unconstitutional because it is a "direct tax" that must be apportioned.[25] (JA 33.) The District Court properly rejected

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[25] Taxpayer now asserts that "Congress never enacted a tax on these types of damages," so if this Court finds that the damages are not income under § 61(a), "there is no case or controversy as to whether (continued...)

the argument. (JA 34.) On appeal, taxpayer repeats the argument, alleging that "[a] tax on personal injuries is a direct tax because it is a tax on personal property or a tax on the individual." (Br. 32.) Taxpayer is wrong.

"The elementary rule is that every reasonable construction must be resorted to, in order to save a statute from unconstitutionality." *Rust v. Sullivan*, 500 U.S. 173, 190 (1991). As discussed on pp. 15-18 *supra*, the Constitution grants Congress the power "To lay and collect Taxes, Duties, Imposts, and Excises."[26] U.S. Const. Art. I, sec. 8, cl. 1. It also provides that "No 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, sec. 9, cl. 4; *see* Art. I, sec. 2, cl. 3 ("Representatives and direct taxes shall be apportioned among the

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[25](...continued)
such a tax would be constitutional." (Br. 32.) In amending § 104(a)(2) to cover only damages for personal physical injuries, Congress clearly established its intent to tax the type of damages at issue here.

[26] Thus, taxpayer's assertion that "Article I, § 8, cl. 1 . . . provides only for excise taxes, duties and imposts" is plainly incorrect. (Br. 32, n.19.) Article I, sec. 8, cl. 1 is the source of Congress's plenary taxing power, including the power to tax income. *Brushaber*, 240 U.S. at 12-13.

several states which may be included within this Union, according to their respective Numbers . . . .") These limitations address only *how* Congress may tax, not *what* it may tax. Thus, only if the tax at issue were both a "direct" tax requiring apportionment, and not an income tax relieved from apportionment by the Sixteenth Amendment, would the tax be problematic under the Constitution. *See supra*, pp. 17-18. The tax at issue is not, however, a direct tax. The precise meaning of "direct tax" is not entirely clear, but the historical context of its inclusion in the Constitution and early Supreme Court case law indicate that it covers only capitation taxes (also called head or poll taxes) and taxes on land.

The need for plenary taxing power was a driving force in developing the Constitution. *See* Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 CONST. COMMENT. 295, 297 (2004); Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1, 6 (1999). Under the Articles of Confederation, the Continental Congress could raise revenue only through requisitions. Edwin R.A. Seligman, THE INCOME TAX 542-44 (1911). Under the requisition system, Congress determined how much

money was needed, apportioned each state its quota, and relied on the states' voluntary remittance of funds. Each state's quota generally was based on the value of land and improvements within the state. *Id.* The system quickly disintegrated as states accused one another of cheating in their appraisals, and Congress had no means of appraising land itself or forcing states to comply. *Id.* at 544. Numerous proposals were made to give Congress power to impose specific types of taxes, in particular a tax on imports, but these measures were not approved by the states. Seligman at 544. The nation's bankrupt status was a strong contributing factor to the call for a convention to revise the Articles of Confederation, which evolved into the Constitutional Convention. Calvin H. Johnson, *The Constitutional Meaning of "Apportionment of Direct Taxes,"* 80 Tax Notes 591, 593-94 (Aug. 3, 1998).

As the Constitutional Convention got underway, the focus quickly turned to how states would be represented in the new Congress. Seligman at 545-46. The decision was made to link representation in the House of Representatives to population, but this led to fierce disagreement regarding the treatment of slaves. *Id.* at 549. The

Southern states wanted slaves to be counted in full for purposes of representation, but the Northern states objected that that would further encourage the slave trade—Southern landowners would acquire more slaves to gain more seats. *Id.* at 550. A compromise was reached on July 12, 1787: taxation would also be in proportion to population, and for purposes of both representation and taxation, slaves would be counted as three-fifths of a person. *Id.* at 550-51.[27] The idea was that if the South wanted to treat slaves as persons for purposes of representation, when it had insisted on treating them as property for all other purposes, then it would have to pay. George Mason expressed concern that linking taxation to population would devolve into the failed requisition system, so Gouverneur Morris suggested limiting apportionment to direct taxes. *Id.* at 551. This final resolution is reflected in Art. I, sec. 2, cl. 3, and is echoed in Art. I, sec. 9, cl. 4.

The historical accounts of the Constitutional Convention do not reveal a definition of "direct tax," and James Madison's notes of August 20, 1787, reflect that Rufus King asked for "the precise meaning

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[27] James Madison's notes from the debates are available online at www.teachingamericanhistory.org/convention/debates.

of direct taxation," and no one answered. Seligman at 568. Scholars have opined that direct tax refers only to taxes that are capable of apportionment in the first instance, specifically, capitation taxes and taxes on land. Johnson, 21 CONST. COMMENT. at 298; Alan O. Dixler, *Direct Taxes Under the Constitution: A Review of the Precedents*, 113 Tax Notes 1177, 1189 (Dec. 25, 2006); *cf.* Ackerman at 58; *but see* Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334 (1997). There are several reasons for this conclusion. First, the Constitution specifically contemplates that a capitation tax is a direct tax. Art. I, sec. 9, cl. 4. Second, the Framers understood direct taxes to be synonymous with requisitions and the state taxes used to satisfy them. Johnson, 21 CONST. COMMENT. at 313; *see also* Seligman at 564-66. Those taxes necessarily were apportioned and were largely based on the value of land. Third, apportionment is virtually impossible in the context of other types of taxes,[28] and the Framers could not have intended to give Congress plenary taxing power, on the one hand, and then so limit that

[28] For an in-depth explanation of how apportionment yields absurd results in such instances, *see* Johnson, 21 CONST. COMMENT. at 323-30.

power by requiring apportionment for a broad category of taxes, on the other. Johnson, 21 CONST. COMMENT. at 310-13; *see also* Seligman at 546-48. Indeed, the direct-tax clause was the result of a compromise and was more symbolic than anything else: it appeased the anti-slavery sentiment of the North and offered a practical advantage to the South as long as the scope of direct taxes was limited. Seligman at 555; Ackerman at 10-11. At the time, there was a general belief that Congress would not resort to direct taxes as long as states paid their requisitions. It was also expected that Congress would raise revenue primarily through tariffs and excise taxes. Johnson, 80 Tax Notes at 594. The direct-tax compromise was not a thoughtful consensus on the proper mode of taxation, but rather was a hastily conceived measure to save the Convention from dissolving over the issue of slavery.[29] Seligman at 553.

The Supreme Court's decision in *Hylton v. United States*, 3 U.S. 171 (1796), the first case to address the meaning of direct tax, confirms this view. In *Hylton*, the plaintiff argued that a federal carriage tax

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[29] Thus, Amici's characterization of the apportionment requirement as serving to regulate federal taxing power and prevent overreaching by the political majority is inaccurate. (ABr. 21-24.)

was unconstitutional because it was a direct tax that had to be apportioned. The Government, represented by Alexander Hamilton, defended the tax, and the Court unanimously ruled that the tax was not a direct tax.[30] The justices opined that direct tax includes only those taxes that are susceptible of apportionment in the first instance, for otherwise absurd results would attain. 3 U.S. at 174, 179, 181-82. Justice Paterson recalled that the requirement of apportionment for direct taxes was intended as a resolution on the treatment of slaves, not as restriction on Congress's taxing authority, and concluded that "[t]he rule, therefore, ought not to be extended by construction." *Id.* at 178. The justices also opined, in dicta, that the Framers understood direct taxes to include only capitation taxes and taxes on land. *Id.* at 175-77, 183.

This narrow view of direct tax prevailed for 100 years and was applied by a unanimous Supreme Court in subsequent cases upholding

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[30] The Court was composed of six justices at the time. Four justices (Chase, Paterson, Iredell, and Wilson) heard the argument and issued *in seriatim* opinions. These four had participated in the Constitutional Convention and, thus, their interpretations are entitled to particular weight in terms of discerning original intent. *See* Ackerman at 21; Seligman at 546.

various federal taxes. *E.g., Pacific Ins. Co. v. Soule*, 74 U.S. 433 (1868) (tax on income of insurance companies); *Veazie Bank v. Fenno*, 75 U.S. 533 (1869) (tax on the issuance of circulating bank notes); *Springer v. United States*, 102 U.S. 586 (1880) (individual income tax); *see* Seligman at 576; Dixler at 1178-80. It was not until *Pollock*, decided in 1895, that the Court expanded its view of direct tax to include a tax on income from real and personal property on the theory that such a tax was, in substance, a tax on the property itself. 158 U.S. at 637. Justice Harlan, writing in dissent, took issue with what he deemed to be the majority's re-write of history, noting that the direct-tax clause was borne out of a compromise regarding the treatment of slaves, and with slavery abolished, there was no continuing purpose for the direct-tax clause. 158 U.S. at 684.

Public reaction to *Pollock* was universally negative. Seligman at 586. The Court quickly retreated from *Pollock*'s reasoning and limited it in subsequent cases. Dixler at 1182-84. Notably, five years after *Pollock*, the Court unanimously held that the estate tax is not a direct tax, quoting liberally from *Hylton*. *Knowlton v. Moore,* 178 U.S. 41, 85 (1900). In the meantime, momentum was building in Congress to enact

another income tax to provoke a judicial challenge in hopes that the Court would overrule *Pollock*. Ackerman at 33-34. Political considerations and respect for the Court prevailed, and President Taft proposed a constitutional amendment in 1909. *Id.* at 34-35. The Sixteenth Amendment was overwhelmingly approved by Congress, endorsed by 42 state legislatures, and ratified in 1913. *Id.* at 38.

The Sixteenth Amendment effectively reversed *Pollock*'s holding that a tax on income from real and personal property is a direct tax that must be apportioned. Though *Pollock* has never been explicitly overruled by the Court, every aspect of its reasoning has been eroded.[31] *Stanton*, 240 U.S. at 112-13; *Graves v. People of New York*, 306 U.S.466 (1939); *South Carolina v. Baker*, 485 U.S. 505 (1988); *see* Dixler at

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[31] Amici appear to stand alone in arguing that *Pollock* "was correct." (ABr. 24.) Amici also assert that the Federal Circuit "agreed with the reasoning in *Pollock*" in *Union Elec. Co. v. United States*, 363 F.3d 1292 (Fed. Cir. 2004). (ABr. 25.) In that case, however, the court rejected Union Electric's claim that a special assessment under the Energy Policy Act of 1992 was unconstitutional as a direct tax requiring apportionment. *Id.* at 1293. The court noted that "the appellant places its primary reliance" on *Pollock*, *id.* at 1298, but stated (immediately after the quote reproduced on p. 25 of Amici's brief to the effect that *Pollock* has not been overruled): "However, we do not think *Pollock* stands for the proposition that appellant urges or that the EPACT special assessments fall within *Pollock*'s definition of direct taxes," *id.* at 1300.

1184-88. The subsequent case law regarding direct tax restored the narrow interpretation accorded the term in *Hylton*. Dixler at 1184-88. Thus, there is no principled basis for a broad interpretation of direct tax. Moreover, even under *Pollock*, not all income taxes were direct taxes: the Court's decision did not extend to "gains or profits from business, privileges, or employments." 158 U.S. at 635. Thus, a tax on the conversion of human capital into money has never been problematic, even under *Pollock*.

Indeed, a tax on damages received on account of nonphysical personal injury is not a tax on property. Rather, it is a tax on the *receipt* of the damages. As such, it need not be apportioned. *Cf. United States v. Mfrs. Nat'l Bank of Detroit*, 363 U.S. 194, 197-198 (1960) (estate tax not an impermissible direct tax on property, but a permissible tax on the transfer of property); *Penn Mutual Indem. Co. v. Commissioner*, 277 F.2d 16, 20 (3d Cir. 1960) (income tax on interest, rents, dividends, and net premiums of an insurance company valid even though company had overall loss during year as tax could be considered an excise tax). In this regard, it is irrelevant that the tax is imposed by § 61 because, as observed in *Penn Mutual*, 277 F.2d at 20, "[i]t is not

necessary to uphold the validity of the tax imposed by the United States that the tax itself bear an accurate label." *See also Simmons v. United States*, 308 F.2d 160, 166 n.21 (4th Cir. 1962) ("if Congress has the power to impose the tax in question, it is not material that it call the tax one on income, for it has been clearly established that the labels used do not determine the extent of the taxing power").

Furthermore, the tax clearly is uniform throughout the United States (assuming it is an "excise" subject to the uniformity requirement of Art. I, sec. 8, cl. 1). Thus, there is no constitutional impediment to taxing taxpayer's award.

CONCLUSION

The District Court's order of summary judgment should be affirmed. Its order denying the Government's motion to dismiss the IRS as a party should be reversed.

Respectfully submitted,

EILEEN J. O'CONNOR
Assistant Attorney General

RICHARD T. MORRISON
Deputy Assistant Attorney General

Francesca U. Tamami

GILBERT S. ROTHENBERG (202)514-3361
KENNETH L. GREENE (202)514-3573
FRANCESCA U. TAMAMI (202)514-1882
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

Of Counsel:

JEFFREY A. TAYLOR
United States Attorney

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Francesca U. Tamami
FRANCESCA U. TAMAMI
Attorney for the Appellees

Dated: February 28, 2007

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It is hereby certified that this brief was hand-delivered to the Clerk on this 28th day of February, 2007. It is also certified that service of this brief has been made on counsel for the appellants and on counsel for *amici curiae* on this 28th day of February, 2007, by sending, via FedEx, two copies thereof in envelopes properly addressed as follows:

David K. Colapinto, Esq.
Kohn, Kohn & Colapinto, LLP
3233 P Street, NW
Washington, DC 20007-2756

Richard R. Renner, Esq.
Tate & Renner
505 North Wooster Ave.
P.O. Box 8
Dover, OH 44622

Francesca U. Tamami

FRANCESCA U. TAMAMI
Attorney