REFERENCE TO ORAL ARGUMENT

Plaintiffs-Appellants request that oral argument be scheduled.

JURISDICTIONAL STATEMENT

The basis for the district court's subject-matter jurisdiction is 28 U.S.C. § 1346, which provides for district court jurisdiction over Plaintiffs-Appellants' tax refund claim. Ms. Murphy received an award of compensatory damages after prevailing on her claims of whistleblower retaliation against her former employer, the New York Air National Guard ("NYANG") and the Secretary of the Air Force, pursuant to six federal environmental whistleblower statutes. Plaintiffs paid taxes on the compensatory damages and requested a tax refund because the damages were on account of personal injuries. Following denial by the IRS of the Plaintiffs' tax refund request, and after exhausting all available remedies before the IRS, the Plaintiffs filed an action in U.S. District Court for the District of Columbia seeking a tax refund pursuant to 28 U.S.C. § 1346, and pursuant to the Administrative Procedure Act, 5 U.S.C. § 702(a), 703, and 706.

The basis for this court's appellate jurisdiction is 28 U.S.C. §1291. On March 22, 2005, the district court entered a final decision dismissing Plaintiffs' claims with prejudice. *See* J.A., pp. 19-37.

The Notice of Appeal from the district court's March 22, 2005 Memorandum Opinion and Order was timely filed on April 6, 2005. *See* J.A., p. 4.

STATEMENT OF THE ISSUES

(1) Whether the district court either erred when it granted the Defendants' motion for summary judgment on Plaintiffs' tax refund claim?

(2) Whether Congress has the authority under the U.S. Constitution, Sixteenth Amendment,

or any cognizable definition of gain or income under the tax code, to tax "make whole" emotional distress personal injury or sickness compensatory damage awards when such a tax would be on compensation for a loss (or restoration of human capital) as opposed to income or any accession to wealth?

(3) Whether compensatory damages awarded to Plaintiff Murphy based on evidence, including, among other physical injuries, teeth grinding and permanent damage to her teeth and physical manifestations of stress, resulting from the violation of her legally cognizable federal statutory rights should be excluded from gross income based on Internal Revenue Code ("IRC") section 104(a)(2), which excludes from gross income "damages received…on account of personal physical injuries or physical sickness"?

(4) Whether the plain meaning of the statute, 26 U.S.C. § 104(a)(2), allows exemptions for damages received "on account of physical injuries or physical sickness" regardless of what caused the injury or sickness?

STATUTES AND REGULATIONS

Pursuant to D.C. Circuit Rule 28(a)(5), Appellants set forth the pertinent portions of statutes and regulations that are applicable to determination of this appeal in the addendum.

STATEMENT OF THE CASE

Plaintiffs Marrita Murphy and Daniel J. Leveille filed a refund action in the district court seeking a tax refund from the United States for the improper and erroneous assessment of a tax on compensatory damages awarded to Plaintiff Murphy for physical injuries and physical sickness that she sustained as a result of illegal retaliation by her former employer. Plaintiffs also seek declaratory relief and to enjoin the Internal Revenue Service ("IRS") and the United

States from enforcing the assessment of the tax based on Plaintiffs' constitutional challenges set forth in Counts II and III of the Complaint. J.A., pp. 6-13.

Plaintiffs filed this action on November 21, 2003, seeking to recover $20,865.00, plus interest, in Federal income taxes paid on April 11, 2001, for the year 2000. After paying the tax, Plaintiffs filed three separate amended tax returns requesting a tax refund with the Internal Revenue Service ("IRS"). J.A., pp. 6, 8, Complaint, ¶¶ 8-10; J.A., pp. 14-16, Answer, ¶¶ 8-10. On December 18, 2002, the IRS disallowed the claim for a tax refund. J.A., p. 47, Plaintiffs' Summary Judgment Exhibit 5, Exceprt from IRS Form 886-A, Explanation of Items Disallowed on Request for Refund. After exhausting administrative remedies, Plaintiffs filed a claim for refund in this Court. J.A., p. 9, Compl., ¶ 17; J.A., p. 16, Answer, ¶ 17.

Shortly after filing an Answer the Defendants moved for summary judgment on the grounds that the compensatory damages awarded to Ms. Murphy were taxable. Plaintiffs opposed Defendants' motion for summary judgment and filed a cross-motion for partial summary judgment on the grounds that the taxing of Ms. Murphy's compensatory damages to make her whole for personal injuries and, alternatively, that Ms. Murphy's compensatory damages award fell within the scope of the statutory exemption as amended in 1996. In support of Plaintiffs' opposition and cross-motion on summary judgment, Plaintiffs submitted the affidavits of two doctors who testified that Plaintiffs' injuries for which she was awarded compensatory damages included bruxism, permanent damage to her teeth, and other physical injuries. These affidavits were not controverted by Defendants.

The district court granted Defendants' motion for summary judgment and dismissed the Complaint, with prejudice. *Murphy v. IRS,* 362 F.Supp.2d 206 (D.D.C. 2005). Despite finding that Ms. Murphy sustained permanent physical injuries in the form of bruxism and permanent

teeth damage, and that she "suffered from other 'physical manifestations of stress,'" the district court concluded that Ms. Murphy's damages fell outside the scope of the IRS personal injury exclusion, as amended in 1996, because they were "not considered a physical injury or physical sickness." *Murphy,* 362 F.Supp.2d at 215. Additionally, the district court concluded that the taxation of Ms. Murphy's damages was constitutional under the 16th Amendment because, according to the district court, anything falling outside a specific statutory exclusion is taxable as income regardless of whether it should be considered as compensation for a loss or a return of capital. *Murphy,* 362 F.Supp.2d at 217-218.

STATEMENT OF FACTS

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

On December 11, 1995, the Secretary of Labor issued a Decision and Order finding that Plaintiffs "proved that [NYANG] retaliated against" Ms. Murphy. *Leveille,* Decision and Order of Remand, p. 22, 1995 WL 848112 (Dec. 11, 1995). Accordingly, the Secretary ordered affirmative relief in favor of Plaintiff and remanded the case to the ALJ for findings on compensatory damages..."[2] *Id.*

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

[2] Each of the federal environmental whistleblower statutes under which Plaintiffs filed their claims with the DOL provide for "compensatory damages." *See* Toxic Substances Control Act, 15 U.S.C. §2622; Safe Drinking Water Act, 42 U.S.C. §300j-0(1); Clean Air Act, 42 U.S.C.

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

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

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

After reviewing Plaintiff's medical and dental records during this relevant period, Dr. Carter concluded that Plaintiff Murphy suffered physical pain and physical injuries, and he relied on his review of those records to testify about Plaintiff's somatic and body injuries to describe her pain, physical sickness and physical injuries at the July 1994 hearing. J.A., p. 39, Aff. of Dr.

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§7622; Solid Waste Disposal Act, 42 U.S.C. §6971; Clean Water Act, 33 U.S.C. §1367; Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §9610.

Carter at ¶¶ 5-7. Dr. Carter also ruled out causes other than NYANG's illegal acts for the physical components of Plaintiff's injuries and sickness. J.A., p. 39, Aff. of Dr. Carter at ¶ 5.

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

Ms. Murphy "had no prior history of bruxism," before the acts of retaliation by her employer, NYANG, took place. *Murphy,* 362 F.Supp.2d at 210. Ms. Murphy's dental records specifically show that during the calendar year preceding Ms. Murphy learning about NYANG's negative employment reference that she had no reports of "bruxism" or teeth grinding. J.A., pp. 44-45, Affidavit of Dr. Barry L. Kurzer, ¶¶ 5-6, 14-15. In fact, Ms. Murphy's dental records confirm that she visited her dentist five separate times during calendar year 1993 on the following dates: January 14, 1993, January 20, 1993, August 31, 1993, November 15, 1993, and December 1, 1993. J.A., p. 44, Aff. of Dr. Kurzer, ¶5. At no time prior to December 9, 1993, when Ms. Murphy learned about NYANG's negative employment reference, did she complain about "bruxism" or teeth grinding and she was not treated for that condition in calendar year 1993. J.A., pp. 44-45, ¶¶ 5-6, 14-15. It was not until Plaintiff's visit to her dentist on March 11, 1994, that the "bruxism" or teeth grinding was diagnosed. J.A., pp. 43-44, Aff. of Dr. Kurzer, ¶¶ 4-6. Plaintiff's "bruxism" developed between her last visit to dentist on December 1, 1993,

just before she learned about NYANG's negative employment reference on December 9, 1993, and the bruxism was not diagnosed until March 11, 1994. J.A., p. 44, Aff. of Dr. Kurzer, ¶12.

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

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

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

The ALJ's recommended decision on damages and the ARB's final decision on damages were each based on the original administrative hearing record created on July 18 and 19, 1994, and the Department of Labor's damages determination was based on Dr. Carter's testimony at the July 1994 hearing. *Leveille,* ARB Case No. 98-079, Decision and Order on Damages, 1999 WL 966951 (Oct. 25, 1999); *Leveille,* ALJ Case Nos. 94-TSC-3 and 94-TSC-4, Recommended Decision and Order, at p. 4 (Feb. 9, 1998). None of the compensatory damages awarded to Ms. Murphy were for lost wages, back pay or front pay. *See Id.,* Recommended Decision and Order, p. 5. As the district court found, "the [ALJ] noted and the Administrative Review Board confirmed that Murphy suffered from other 'physical manifestations of stress' including, 'anxiety attacks, shortness of breath, and dizziness.'" *Murphy,* 362 F.Supp.2d at 210.

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

It is undisputed that in calendar year 2000 Plaintiff received the $70,000 in compensatory damages awarded by the ARB and that Plaintiffs paid tax on that award when they filed their IRS Form 1040 tax return in April of 2001, and that they properly requested a refund of that tax. J.A., pp. 2-3, Compl. ¶¶ 6-10; J.A., pp. 15-16, Answer, ¶¶ 6-10. It is also undisputed that the IRS examined Plaintiffs' original and amended tax returns for calendar year 2000, as well as additional information provided by Plaintiffs in response to the IRS' request for documents, to determine whether Plaintiffs' request for a tax refund should be granted. J.A., pp. 3-4, Compl. ¶¶ 11-13; [Docket # 11] Defendants' Statement of Material Facts, ¶ 10.

The IRS conducted an office examination of the Plaintiffs' 2000 Form 1040 return and request for tax refund, and Plaintiffs submitted written documentation to support their request for a tax refund. "Among the additional records" submitted to the IRS by Plaintiffs to support their request for a tax refund "were medical and dental records of Plaintiff Murphy which demonstrated that the amount of damages she was awarded were on account of physical injuries and physical sickness..." J.A., p. 9, Compl., ¶ 13. Plaintiffs submitted copies of Ms. Murphy's dental records that Dr. Carter had reviewed to base his conclusion that Ms. Murphy suffered "somatic" and "body" injuries as a result of NYANG's illegal acts. J.A., p. 3, Aff. of Dr. Carter, at ¶ 9.

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

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

The physical damage to Ms. Murphy's teeth was the result of "bruxism" (also known as teeth grinding) and it is a permanent condition. J.A., pp. 38-45. Ms. Murphy has undergone

continuing treatment and restorative surgery to repair the permanent physical damage to her teeth. J.A., p.. 43-45. Moreover, Dr. Carter, who testified as an expert at the evidentiary hearing in the whistleblower case before the DOL, and who also submitted an affidavit in this case, testified without contradiction that the permanent damage to Ms. Murphy's teeth is the result of the retaliatory acts of her former employer, NYANG. J.A., pp. 38-42.

Additionally, the following expert conclusions of Dr. Carter were not contested before the district court in this case: "There is a physiological component to all stress and emotional distress, and anxiety, itself, has a physical basis. The brain is an organ of the body, as is the liver or the heart, and emotional distress is always a physical injury or physical sickness just like physical problems with other parts of the body. Emotional distress can be caused by chemical changes in the brain. In addition, emotional distress is also a physical condition that is characterized by a physical cause." *See,* J.A., p. 41, Aff. of Dr. Carter at ¶ 15.

SUMMARY OF THE ARGUMENT

The personal injury-related damages awarded to Ms. Murphy are not taxable as "income" under the 16th Amendment to the U.S. Constitution, *O'Gilvie v. United States*, 519 U.S. 79, 84-86 (1996), or under any cognizable definition of income or gain in the tax code. *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114 (1925). In an unbroken line of cases, the Supreme Court and the U.S. Courts of Appeals have drawn a sharp distinction between monetary awards which constitute a taxable "accession to wealth" and monetary awards that make a person "whole" by compensating that person's various losses. *See, e.g., Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432, n. 8 (1955) (personal injury recoveries are "by definition compensatory only" and are thus nontaxable); *Doyle v. Mitchell Bros.*, 235 F. 686, 688 (6th Cir. 1916) (monies paid to compensate for losses in a fire are not income); *U.S. v. Kaiser.* 363 U.S. 299, 311 (1960) (Justice

Frankfurter concurring) ("The principle at work here is that payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment"); *Gilbertz v. U.S.,* 808 F.2d 1374, 1378 (10th Cir. 1987) (the nature of the harm being compensated determines the taxability of payments); *Dotson v. U.S.,* 87 F.3d 682, 685 (5th Cir. 1996) (personal injuries for physical or emotional well-being nontaxable as a "return of human capital").

Applying the consistent line of cases interpreting the meaning of "income" under the 16th Amendment as well as the history surrounding its passage, requires a finding that the compensatory damages awarded to Ms. Murphy for an actual loss of reputation and damage to her emotional or physical well being is not subject to income tax. *See, e.g., O'Gilvie*, 519 U.S. at 84 (After passage of the 16th Amendment the Court "decided several cases based on the principle that a restoration of capital was not income; hence it fell outside the definition of 'income'").

Congress amended Section 104(a)(2) of the Internal Revenue Code in 1996 to narrow the exclusion to "personal physical injuries and physical sickness," as opposed to "personal injuries and sickness" which was the scope of the exclusion prior to 1996. This change now requires the courts to analyze the taxing of any non-physical damages received on account of personal injuries and sickness pursuant to the constitutional limits imposed by the 16th Amendment. By failing to conduct such analyses, the district court improperly classified as taxable income the damages that were awarded to Ms. Murphy for actual loss or restoration of human capital.

However, the district court misinterpreted the holding of *Glenshaw Glass Co.* and improperly concluded that compensatory damages no longer "specifically exempted by statute" must "fall[] within the broader definition of taxable income." *Murphy,* 362 F.Supp.2d at 215, citing *Glenshaw Glass Co.,* 348 U.S. at 431. By completely ignoring the long line of Supreme

Court cases, from *Doyle* through *O'Gilvie*, and including *Glenshaw Glass Co.,* the district court reached the wrong conclusion.

The statutory exclusion for personal injuries, which was contained in the tax code from 1918 until 1996, was based on an understanding, from its very inception, that such compensatory damages were not constitutionally taxable. Justice Breyer, in his decision in *O'Gilvie*, 519 U.S. at 84-85, carefully reconstructed this history and fully understood that the courts and the framers of the 1918 tax code understood that the specific loss of human capital was non-taxable. *Accord., Dotson,* 87 F.3d at 685 (Because "human capital lost through injury" was understood to be nontaxable, the drafters of the 1918 tax code incorporated into that code a statutory exemption for compensation for personal injury).

In this case, the district court completely ignored the human capital rationale set forth in *O'Gilvie* and other cases. Based on the history behind the 1918 exclusion as well as the 16th Amendment, Ms. Murphy's compensation for actual losses is not taxable income.

Additionally, in order to determine whether the Ms. Murphy's compensatory damages constitute taxable income this Court must review precisely "in lieu of what were the damages awarded." *Raytheon Production Corp. v. Commissioner of Internal Revenue,* 144 F.2d 110, 113 (1st Cir. 1944). *Also see, Gilbertz v. U.S.,* 808 F.2d 1374, 1378 (10th Cir. 1987) (the court must determine the "nature" of the payments in question and further determine, "what they were intended to compensate."). Applying the *Raytheon* test to the facts of this case unquestionably demonstrates that Ms. Murphy's compensatory damages award is nontaxable. The "nature" of the payments awarded by the DOL were "intended to compensate" Ms. Murphy for her tort-type losses. They were not payments intended to assist her in some form of "accession to wealth." *Gilbertz.,* 808 F.2d at 1378 (10th Cir. 1987). Ms. Murphy's compensation was strictly designed

to make her physically and emotionally "whole." Ms. Murphy's compensatory damages award did not "reach beyond those damages that, making up for a loss, seek to make a victim whole, or speaking very loosely, 'return the victim's personal or financial capital.'" *O'Gilvie*, 519 U.S. at 86.

In reaching its conclusion, however, the district court ignored the "in lieu of what?" test's central question and failed to determine the "nature" of the payments in question and further determine, "what they were intended to compensate." *Cf., Gilbertz,* 808 F.2d at 1378.

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

In this case, the district court correctly found that the first requirement of the *Schleier* test is satisfied because the Department of Labor's authority to award compensatory damages was expressly permitted under the six federal environmental whistleblower statutes which "***created a 'species of tort liability'*** in favor of persons who are the objects of unlawful discrimination." *Murphy,* 362 F.Supp.2d at 214 (emphasis added).

Additionally, Ms. Murphy's injuries were physical in nature and, therefore, she also satisfies the second part of the *Schleier* test. Ms. Murphy received damages for personal physical injuries or physical sickness under the plain meaning of the terms of the 1996 amendments to the personal injury exclusion. However, the district court failed to analyze the

text of the statute or to consider its plain meaning. Nothing in the statute remotely suggests that the cause of the injury is relevant to deciding whether the exclusion applies. *See* 26 U.S.C. § 104(a)(2). The district court incorrectly suggests that the legislative history somehow overrides the plain meaning of the statute. *See Murphy,* 362 F.Supp.2d at 215 (citing solely the House Report). Notably, the statute's text does not limit physical injuries or physical sickness to those that are caused by a physical stimulus. The text of the statute does not prevent an exclusion from gross income where a person receives compensation for physical injuries or physical sickness that results solely from a non-physical stimulus, such as stress.

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

ARGUMENT

I. STANDARD OF REVIEW.

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

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

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

The principal issue raised in this appeal is very straight forward. Are the personal injury-related damages awarded to Ms. Murphy by the U.S. Department of Labor taxable as "income" under the 16th Amendment, or any other cognizable definition of income under the tax code?

The 16th Amendment only authorizes Congress to tax "income." On the one hand, if Ms. Murphy's compensatory damages award was "income" as understood by that amendment, it could be subject to an income tax. However, if Ms. Murphy's compensatory damages award was not "income" as defined under the 16th Amendment, this Court must overturn the IRS's taxation ruling.

From the outset -- and in an unbroken line of cases -- the Supreme Court and the U.S. Courts of Appeals have drawn a sharp distinction between monetary awards which constitute an "accession to wealth," and thus are taxable income, and monetary awards which merely make a

person "whole" as a result of compensating that person's various losses. *See, Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432, n. 8, 75 S.Ct. 473 (1955). In other words, every court that has reviewed this issue has clearly distinguished the authority of Congress to tax income versus the inability under the 16th amendment for Congress to tax compensation to restore a loss. *See, Doyle v. Mitchell Bros.*, 235 F. 686, 688 (6th Cir. 1916) (monies paid to compensate for losses in a fire are not income); *Farmers' & Merchants' Bank v. Commissioner,* 59 F.2d 912 (6th Cir. 1932) (compensation for injury to business reputation nontaxable); *Raytheon Production Corp. v. Commissioner of Internal Revenue,* 144 F.2d 110 (1st Cir. 1944) (injury to "good will" not taxable income); *U.S. v. Kaiser.* 363 U.S. 299, 311, 80 S.Ct. 1204 (1960) (Justice Frankfurter concurring) ("The principle at work here is that payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment"); *Gilbertz v. U.S.,* 808 F.2d 1374, 1378 (10th Cir. 1987) (the nature of the harm being compensated determines the taxability of payments); *Dotson v. U.S.,* 87 F.3d 682, 685 (5th Cir. 1996) (personal injuries for physical or emotional well-being nontaxable as a "return of human capital").

As explained by Justice Brandeis in his dissent and major opinion in two early tax cases, Congress had very broad power to constitutionally define and tax "income," but Congress "cannot make a thing income which is not so in fact." *Eisner v. Macomber*, 252 U.S. 189, 226, 40 S.Ct. 189 (1920) (J. Brandeis dissenting) and *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114, 46 S.Ct. 48 (1925) (J. Brandeis writing for unanimous Court). Thus, under the 16th Amendment, the value of capital or the value associated with the restoration of capital is not taxable. *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371, 378-79 (1934) (collecting cases). *Accord.*, *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432, n. 8 (1955); *O'Gilvie v. United States*, 519 U.S. 79, 84-85, 117 S.Ct. 452 (1996). Congress' broad power to define what

is income is limited by the 16th Amendment. *Taft v. Bowers,* 278 U.S. 470, 481 (1929) (taxation permitted for monies or profits "*properly* regarded as income"); *Helvering v. Clifford*, 309 U.S. 331, 334 (1940) ("broad sweep" of Congresses taxing power still confined to "definable categories" of "gains, profits and income").

The case analysis referenced above is further supported by the plain language of the 16th Amendment and the legislative and regulatory history which followed that Amendment's enactment. *See, e.g., O'Gilvie*, 519 U.S. at 84-85; U.S. Attorney General Opinion 304 (June 26, 1918), 1918 WL 633 (U.S.A.G.). The history demonstrates that personal injury related awards were "roughly" considered a "return of capital" based on compensating a person for a loss. *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432, n. 8 (1955). Based on the "return of capital" theory understood at the time the 16th Amendment was passed, damages directly tied to compensating a person for losses caused by an injury were "by definition compensatory only" and not understood to be subject to the income tax. *Id.*

Based on the plain meaning of the 16th Amendment, the consistent line of cases interpreting the meaning of "income" under that Amendment and the legislative history surrounding the passage of that Amendment, any compensation awarded by the U.S. Department of Labor to Ms. Murphy to compensate her for an actual loss of reputation or an actual damage to her emotional or physical well being is not subject to income tax. *Glenshaw Glass Co.,* 348 U.S.at 432, n. 8 (1955) (personal injury recoveries are "by definition compensatory only" and are thus nontaxable).

Because Section 104(a)(2) of the Internal Revenue Code was amended in 1996 in an effort to narrow the statutory exclusion for "personal injuries,"[3] this Court must now analyze the taxing of any non-physical damages received on account of personal injuries and sickness in light of the constitutional limits imposed by the 16th Amendment.[4]

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

The Supreme Court initially defined taxable "income" under the 16th Amendment as a "*gain* derived from capital, from labor, or from both combined." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920) (emphasis added). That definition was further refined in *Glenshaw Glass Co.,* where the Court recognized that various monetary "gains", "profits", and "income", which resulted in an "accession[] to wealth" constituted taxable income. *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 429-31 (1955). Regardless of which definition has been used, the Court consistently interpreted the inclusion of the term "income" in the 16th Amendment as a term of limitation as to the scope of the taxing authority provided by that amendment. Thus,

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[3] Prior to 1996, 26 U.S.C. § 104(a)(2) allowed an exemption from gross income for the "amount of any damages received … on account of personal injuries or sickness." *See* 26 U.S.C. § 104(a)(2) (1995). However, section 104(a)(2) was later amended to limit the exclusion to "personal *physical* injuries and *physical* sickness." 26 U.S.C. § 104(a)(2) (1996) (emphasis added).

[4] Congress has the "power to lay and collect taxes"; however, this power is not plenary. U.S. Const. art. I, §8, cl. 1. Among other limitations on Congress' taxing power, the original Constitution forbade Congress from taxing any and all direct taxes without apportionment. U.S. Const. art. I, §9, cl. 4. While originally Congress only had the power to tax indirect taxes without apportionment, the 16th Amendment expanded the taxing power to allow Congress to tax a distinct subset of direct taxes, direct taxes on incomes. *See* U.S. Const. amend. XVI. All direct taxes that are not income taxes must still be apportioned. The taxation of damages received on account of personal injuries or personal sickness is a direct tax. Congress only has the authority to tax direct taxes, without apportionment, if it is an income tax. Compensation for damages awarded on account of personal injuries and sickness are not income, but simply a return of capital, which cannot be taxed.

neither Congress nor the Courts are permitted "make a thing income which is not so in fact." *Burk-Waggoner Oil*, 269 U.S. at 114.

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

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

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

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

Drawing on the dichotomy articulated in *Doyle,* the courts have consistently held that if the compensation obtained contributed to an "accession to wealth," the money was taxable. However, if the money was purely compensatory in nature, and constituted restitution for a loss, then the compensation was not taxable. These cases, all of which are consistent with the usage

of the term "income" in the 16th Amendment, were explained in a concurring opinion by Justice Frankfurter (joined by Justice Clark) concerning the taxability of certain strike benefits:

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

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

The Supreme Court's reliance upon the plain meaning of "income" contained in the 16th Amendment was further apparent in its decision in *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 432, n. 8 (1955), which Justice Frankfurter expressly referred to when he stated in *Kaiser* that "personal injury recoveries" were akin "to a return of capital" and, therefore, "non-taxable." In *Glenshaw Glass Co.,* the Court noted the "long history" of rulings "holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital." The Supreme Court summarized its view on the taxability of compensatory damages in order to make a person whole for an actual injury (as opposed to an award of punitive damages which would result in a windfall to a victim) as follows: "Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes." *Id.*

However, the district court misinterpreted the holding of *Glenshaw Glass Co.* and improperly concluded that compensatory damages no longer "specifically exempted by statute" must "fall[] within the broader definition of taxable income." *Murphy,* 362 F.Supp.2d at 215, citing *Glenshaw Glass Co.,* 348 U.S. at 431. Simply because the Supreme Court noted in

Glenshaw Glass Co. that the definition of income may include "accessions to wealth" does not mean that compensatory damages awarded to "make whole" a victim of discrimination are subject to tax as income. It is only by completely ignoring the long line of Supreme Court cases, from *Doyle* through *O'Gilvie*, and including *Glenshaw Glass Co.,* that the district court is able to reach that conclusion.

Regardless of the broad powers Congress has to define and tax income, every case which has upheld that power has carefully noted that the "income" in question was in fact a "gain" from the taxpayer's initial basis. *Compare, e.g.*, *Commissioner v. Banks*, 125 S.Ct. 826, 831 (2005) (permitting the taxation of "economic gains") with *U.S. v. Safety Car*, 297 U.S. 88, 99 (1936) ("Income within the meaning of the Sixteenth Amendment is the *fruit that is born of capital*") (emphasis added).

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

B. The Legislative History Surrounding Passage of the 16TH Amendment Demonstrates That Compensatory Damages Designed to Make A Person Whole Are Excluded From the Definition of "Income".

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

compensation for losses, be they personal injuries or damaged capital.[5] If there was any doubt about this, the legislative history surrounding the enactment of the 16th Amendment and passage of the Revenue Act of 1918 (which exempted personal injuries from taxation), provides enormous undisputed support for this interpretation of the Amendment.

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

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[5] In addition to the Supreme Court's explicit requirement that income must involve a gain, the Court has also emphasized that the commonly understood meaning of income is significant. *Glenshaw Glass Co.,* 348 U.S. at 431 (examining the "dictionaries in common use" to inform the proper meaning of income); *Merchants' Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519, 41 S.Ct. 386, 389 (1921) (refusing to consider an economists' definition of income, insisting on following "what it believed to be the commonly understood meaning of the term…."); *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99, 56 S.Ct. 353, 358 (1936) ("Income within the meaning of the Sixteenth Amendment is…[w]ith few exceptions, if any…income as the word is known in the common speech of men."). The dictionary definition and common understanding of income is "a gain or recurrent benefit usu[ally] measured in money that derives from capital or labor." *Merriam-Webster's Collegiate Dictionary* 588 (10th ed. 1997). Both the common meaning and the Court's definition are consistent in their emphasis that income requires a gain.

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

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

> That history begins in approximately 1918. At that time, this Court had recently decided several cases based on the principle that a restoration of capital was not income; hence it fell outside the definition of "income" upon which the law imposed a tax. *E.g., Doyle v. Mitchell Brothers Co.,* 247 U.S. 179, 187, 38 S.Ct. 467, 469-470, 62 L.Ed. 1054 (1918); *Southern Pacific Co. v. Lowe,* 247 U.S. 330, 335, 38 S.Ct. 540, 542, 62 L.Ed. 1142 (1918). The Attorney General then advised the Secretary of the Treasury that proceeds of an accident insurance policy should be treated as nontaxable because they primarily "substitute ... capital which is the source of *future* periodical income ... merely tak[ing] the place of capital in human ability which was destroyed by the accident. They are therefore [nontaxable] 'capital' as distinguished from 'income' receipts." 31 Op. Atty. Gen. 304, 308 (1918). The Treasury Department added that
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>> "upon similar principles ... an amount received by an individual as the result of a suit or compromise for personal injuries sustained by him through accident is not income [that is] taxable...." T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).

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

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

Since 1996, after Congress re-wrote its statutory 1918 personal injury exemption exclusion by amending Section 104(a)(2) of the Internal Revenue Code, commentators have examined the post-1996 tax code in light of the 16th Amendment and the original drafting of the 1918 exclusion. One commentator, after conducting an exhaustive review of the case law and history behind the personal injury exclusion, concluded that compensation for actual losses to person, including compensation for mental distress, could not be classified as income under the

16th Amendment: "Compensation for mental distress is measured by the amount necessary to restore the victim to the status quo ante. This determination is made in an adversarial contest applying traditional tort rules of liability and damages . . . . Because there is no gain to the compensated victim, there is no income under the Sixteenth Amendment." Hubbard, "Making People Whole Again: The Constitutionality of Taxing Compensatory Tort Damages for Mental Distress," 49 *Florida Law Review* 725, 766 (December, 1997).

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

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

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

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

Consequently, this Court must look to the 16th Amendment, and the understanding of that amendment at the time it was enacted, in order to adjudicate whether Ms. Murphy's compensatory damages award for "tort-like" injuries by the U.S. Department of Labor constitute taxable income. *See Leveille,* Decision and Order on Damages, pp. 4-5, 1999 WL 966951 (Oct. 25, 1999). Based on the history behind the 1918 exclusion as well as the 16th Amendment, Ms. Murphy's compensation for actual losses is ***not*** income.

C. The Compensatory Damages Awarded to Ms. Murphy By the U.S. Department of Labor Do Not Constitute Income.

In order to determine whether the U.S. Department of Labor compensatory damages awarded to Ms. Murphy constitutes taxable income, either under the 16th Amendment or pursuant to the permissible definition of income under the tax code, this Court must review

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many times fatal to health or life.").

precisely "in lieu of what were the damages awarded." *Raytheon Production Corp. v. Commissioner of Internal Revenue,* 144 F.2d 110, 113 (1st Cir. 1944). In other words, the court must determine the "nature" of the payments in question and further determine, "what they were intended to compensate." *Gilbertz v. U.S.,* 808 F.2d 1374, 1378 (10th Cir. 1987); *Tribune Publishing Co. v. U.S.,* 836 F.2d 1176, 1179 (9th Cir. 1988) (applying *Raytheon* test); *Franciso v. U.S.*, 267 F.3d 303, 319 (3rd Cir. 2001) (citing *Raytheon* test). Courts are required to maintain "fidelity to the human capital rationale" as originally understood by the Supreme Court in the early 20th Century and determine whether a damage award is in fact an accession to wealth beyond an original capital basis or whether the damage award is "linked to an injury in the same direct way as traditional tort remedies." *Franciso*, 267 F.3d at 313.

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

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

Second, Ms. Murphy's compensatory damage award was *not* "derived from salaries, wages, or compensation for personal service . . . or the transaction of any business carried on for gain or profit . . . ." *Glenshaw Glass Co.,* 348 U.S. at 429. The uncontested record in this case, as set forth by the district court, demonstrates that the compensatory damages award was paid in order to make Ms. Murphy whole for a variety of harms and losses, such as bruxism, permanent tooth damage, "physical manifestations of stress," "anxiety attacks, shortness of breath, and dizziness" as well as damage to reputation. *Murphy*, 362 F.Supp.2d at 210-211. Significantly, these harms were not based on unsupported allegations, but were based strictly on the factual findings of an agency of the United States, after a hearing on the merits in which both Ms. Murphy testified and expert witness testimony was received into evidence by the Department of Labor.

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

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

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

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

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

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

The compensatory damages award at issue qualifies for the exclusion from income tax under 26 U.S.C. §104(a)(2) because it satisfies the two requirements for damages to be excluded from gross income: (1) the recovery must have been based on a "tort or tort type of rights;" and (2) the damages must be received on account of personal physical injuries or physical sickness. *See Comm'r of Internal Revenue v. Schleier*, 515 U.S. 323, 336-37, 115 S.Ct. 2159, 2167 (1995); *United States v. Burke*, 504 U.S. 229, 237, 112 S.Ct. 1867, 1872 (1992).[7]

In this case, the district court correctly found that the first requirement of the *Schleier* test is satisfied. *Murphy,* 362 F.Supp.2d at 214 (emphasis added). Ms. Murphy satisfies the first element required to qualify for the exclusion provided in section 104(a)(2) because her recovery was based on a tort type of right. *See Burke*, 504 U.S. at 237, 112 S.Ct. at 1872 (requiring a "tort-like personal injury" to qualify for a section 104(a)(2) exclusion). Each of the six environmental statutes upon which Murphy's complaint was based specifically provide for an award of "compensatory damages." *Murphy,* 362 F.Supp.2d at 214. Furthermore, "[b]y

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

authorizing the award of compensatory damages, the environmental statutes have *created a 'species of tort liability'* in favor of persons who are the objects of unlawful discrimination." *Id.,* citing *Leveille,* ARB Decision and Order on Damages, p. 4, 1999 WL 966951 (Oct. 25, 1999) (emphasis added). The Department of Labor also noted that determining the amount of compensatory damages under the six environmental statutes should be based on a comparison of "damage awards by courts or juries … in *analogous tort actions* …" *Leveille,* ARB Decision and Order at p. 5, 1999 WL 966951 (emphasis added).

Accordingly, the district court correctly found that Ms. Murphy's compensatory damages award meets the first part of the two-part test in *Schleier* because the cause of action in Ms. Murphy's case is expressly based on "tort or tort type rights." As demonstrated in the next section, Ms. Murphy's injuries were physical in nature and, therefore, she also satisfies the second part of the *Schleier* test.

IV. MS. MURPHY'S PHYSICAL INJURIES AND PHYSICAL SICKNESS QUALIFY FOR EXCLUSION FROM GROSS INCOME UNDER THE STATUTE AS AMENDED.

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

Ms. Murphy more than satisfies the second part of the *Schleier* test because her physical injuries and physical sickness (referred to by Dr. Carter in his July 1994 testimony as her

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exclusion prior to the 1996 amendments.

“somatic” and “body” injuries) were part and parcel of the Ms. Murphy’s compensatory damages. Significantly, among other physical problems, Ms. Murphy incurred permanent physical damage to her teeth as a result of “bruxism” which, according to the un-rebutted sworn affidavits submitted by Ms. Murhpy’s expert psychologist and her treating dentist, she developed following the illegal acts of retaliation by her former employer NYANG. Accordingly, Ms. Murphy’s damages were received on account of personal physical injuries and physical sickness.

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

The plain meaning of the statute allows exemptions for damages received on account of “physical injuries or physical sickness” regardless of what caused the injury or sickness, and the legislative history is irrelevant when the text is unambiguous, as it is in 26 U.S.C. § 104(a)(2). *See BedRoc Ltd., LLC v. United States*, __U.S. __, 124 S.Ct. 1587 (2004); *Lamie v. United States Tr.,* 540 U.S. 526, 124 S.Ct. 1023, 1030 (2004). *Also see United States ex rel. Totten v. Bombardier Corp.,* 380 F.3d 488, __ (D.C. Cir. 2004) (“resort to legislative history is not appropriate in construing plain language.”).

Nothing in the statute remotely suggests that the cause of the injury is relevant to deciding whether the exclusion applies. *See* 26 U.S.C. § 104(a)(2). The district court incorrectly suggests that the legislative history somehow overrides the plain meaning of the statute. *See Murphy,* 362 F.Supp.2d at 215 (citing solely the House Report as the grounds for concluding that plaintiff’s compensatory damages are not a physical injury or physical sickness within the scope of the exclusion). Specifically, relying on language in the legislative history and not the text of the statute itself, the district court stated as follows: “Here, Murphy’s mental anguish manifested itself into a physical problem, bruxism, but this was only a symptom of her emotional distress,

not the source of her claim. Plaintiff's emotional distress is not 'attributable to her physical injury'; in fact, it is the other way around." *Murphy,* 362 F.Supp.2d at 215.

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

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

In this case, it is clear that the type of injury, not the underlying cause of the injury, determines whether the exclusion applies. *See* 26 U.S.C. §104(a)(2). While the amended statute now states that "emotional distress shall not be treated as a physical injury or physical sickness," 26 U.S.C. §104(a), that requirement is satisfied in this case by the factual record which establishes without contradiction that Ms. Murphy suffered physical injuries or physical sickness, including but not limited to permanent damage to her teeth, that is identifiable as separate and distinct from emotional distress.

The district court erred by finding that Ms. Murphy did not meet the second part of the *Schleier* test because the court held that her injuries were not "*physical* in nature." *Murphy,* 362 F.Supp.2d at 214-215 (emphasis in original). Ms. Murphy suffered physical injuries. Both the DOL ALJ and ARB specifically cited to, and relied upon, the testimony of Dr. Edwin N. Carter, Ms. Murphy's doctor, in awarding Plaintiff compensatory damages. Dr. Carter provided

unrebutted testimony about the nature of Plaintiff Murphy's physical injuries and illnesses. *Leveille,* Decision and Order on Damages, 1999 WL 966951 (Oct. 25, 1999); *See Leveille,* Recommended Decision and Order, p. 6 (ALJ Feb. 9, 1998).

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

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

Dr. Barry L. Kurzer, Ms. Murphy's dentist, has authenticated in his affidavit the validity of the dental records that were submitted to the IRS in December 2002, confirming that they are

his records of Ms. Murphy's dental history and that he has personally treated her since January 1993. *See* J.A. p. 45, Aff. of Dr. Kurzer, ¶14.

Consistent with Dr. Carter's uncontested findings, Dr. Kurzer verifies that Ms. Murphy has suffered permanent damage to her teeth requiring continuing treating for years to combat the effects of bruxing. J.A., pp. 44-45, Aff. of Dr. Kurzer, ¶¶ 9-15. Bruxism, a condition more commonly known as teeth grinding, causes physical pain and extensive physical tooth damage. J.A., p. 43, Aff. of Dr. Kurzer, ¶ 4.

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

In addition, the ALJ found "ample evidence" that Ms. Murphy was entitled to compensation, specifically noting "*physical* manifestations of stress," which included "anxiety attacks, shortness of breath, and dizziness." *See Leveille,* Recommended Decision and Order, p. 6 (ALJ Feb. 9, 1998) (emphasis added). The ARB affirmed the ALJ's decision, citing the "medical …problems" that Ms. Murphy suffered. *See Leveille,* ARB Decision and Order on Damages, p. 4, 1999 WL 966951 (Oct. 25, 1999).

Ms. Murphy's injuries, although not caused by a direct physical impact, qualify as physical injuries or physical sickness as a matter of well-established law. There is ample case law that clearly supports that substantial physical problems caused by emotional distress are considered physical injuries or physical sickness. *Walters v. Mintec/International*, 758 F.2d 73,

78 (3rd Cir. 1985) (finding severe physical problems and "bodily harm" resulting from emotional distress are compensable physical harm); *Payne v. General Motors Corp.,* 731 F.Supp. 1465, 1474-1475 (D.Kan. 1990) (constant "exhaustion" and "fatigue" resulting from plaintiff's depression, caused by defendant's discrimination, is considered as "physical injuries").

It is irrelevant that the cause of Ms. Murphy's physical injuries were attributable to emotional trauma rather than a direct physical impact because a physical injury may occur absent any external physical impact and as a result of emotional harm. There is nothing in the statute that limits the physical disability exclusion to a physical stimulus, and the I.R.S. regulations implementing 26 U.S.C. § 104(a) contain no such limitation. *See,* 26 C.F.R. § 1.104-1 (2002). Indeed, nowhere in the code or the accompanying Treasury regulations is the meaning of the term "personal physical injuries or physical sickness" defined. In fact, the Treasury regulations implementing the exclusions contained in 26 U.S.C. § 104(a)(2) state: "Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of *personal injuries or sickness*." *See,* 26 C.F.R. § 1.104-1 (2002). Thus, the Treasury's own implementing regulations do not require personal "physical injuries or physical sickness," they simply require a showing of damages for "personal injuries or sickness" in order to be eligible for the exclusion.

Notably, the Restatement (Second) of Torts conflicts with the district court's restrictive interpretation that tort-type damages caused by emotional distress cannot be considered as "physical" injuries. *See, e.g., Walters,* 758 F.2d at 77, citing *Restatement (Second) of Torts* §§ 7 and 402A(1) ("To the contrary, our review of the Restatement leads us to conclude that 'physical harm' can encompass bodily injury brought about *solely* by the internal operation of emotional distress.") (Emphasis added). Moreover, there is an entire section of the *Restatement (Section)*

of Torts entitled "Physical Harm Resulting from Emotional Disturbance," which evidences "that the drafters of the Restatement believed that emotional distress could cause physical harm." *Id.,* citing *Restatement (Second) of Torts* § 436.

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

Indeed, the amended statute does not state that physical injuries or physical sickness, like those suffered by Ms. Murphy, would not be eligible for the exclusion of Section 104(a)(2). For example, the permanent damage to Ms. Murphy's teeth is not "emotional distress" and there is no evidence to support such a conclusion, which would defy medical science and common sense. The statute simply states that "emotional distress" is not a physical injury or physical sickness. However, the statute as written does not bar an exclusion from gross income where, as here, the physical injuries or bodily harm suffered by plaintiff are the result of emotional distress.

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

When Congress amended Section 104(a)(2) of the Internal Revenue Code in 1996, not only were there no hearings held, but also there was no public debate on an amendment that was included at the eleventh hour in the Small Business Job Protection Act of 1996. *See* 1996 HR 3448 Sec. 1605. Thus, without the benefit of any public hearings or debate, Congress changed the exclusion contained in Section 104(a)(2), which had been in effect since 1918, to require that only compensation from awards or settlements received on account of "physical injuries and physical sickness" would be eligible for the exclusion from gross income, and Congress further stated that "emotional distress" shall not be treated as a "physical injury or physical sickness." 26 U.S.C. § 104(a).[8]

In this case, as noted above, the district court based its entire interpretation of the 1996 amendment to Section 104(a) on the legislative history without analyzing and applying the actual words of the statute itself. *Murphy*, 362 F.Supp.2d at 215. The district court's analysis must fail for three reasons.

First, the district court has not only read terms into the statute that exist only in the legislative history, the district court has over-inferred the significance of the legislative history.

Second, the district court misapplied even the legislative history because Ms. Murphy's permanent physical injuries, such as the damage to her teeth, are not the kind of transitory

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[8] Upon signing the bill that included the amendment to Section 104(a), President Clinton stated:

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

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

symptoms referred to in the legislative history. Thus, Ms. Murphy has satisfied even under the limitation on physical injuries or physical sickness suggested in the legislative history.

Third, the legislative history must be disregarded because it contradicts the statute itself. Once again, the district court improperly relied on the legislative history as if it was the statute, while at the same time the district court ignored the plain meaning of the statute itself.

"These uncertainties illustrate the difficulty of relying on legislative history." *Lamie,* 124 S.Ct. at 1034.

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

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

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

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

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

The district court misapplied the terms in the legislative history and even under the plain meaning of those legislative history terms Ms. Murphy's damages must be excluded from gross income. The district court's reliance on the scant legislative history of the 1996 amendment to Section 104(a)(2) is misplaced. The House Conference Report simply states that "the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress." H. Conf. Rep. 104-737, at 301 n. 56 (1996).

Among Ms. Murphy's physical injuries and physical sickness are the permanent damage to her teeth, which cannot be considered merely "symptoms" from emotional distress. Notably, the House Conference Report's attempted definition of "emotional distress" does not include permanent physical injuries or physical sickness, like the permanent damage to Ms. Murphy's teeth.

It is clear that the drafters of the 1996 amendment attempted to distinguish between serious and permanent physical injuries or physical sickness, like that suffered by Ms. Murphy, and the comparatively minor and transitory "symptoms" of emotional distress, like headaches, upset stomach and sleeplessness, which are not permanent in nature and which go away after a

period of time. Attempting to draw a line between physical injuries and emotional distress, as reflected by the legislative history to the 1996 amendment to Section 104(a), is not the same as stating that any physical injuries or physical sickness resulting from emotional distress is simply a "symptom of emotional distress" that can never be considered as a "physical injury or physical sickness" under Section 104(a)(2). Once again, the legislative history does not go so far as to state that any physical problems caused by emotional distress cannot be considered a "physical injury or physical sickness."

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

It is common sense that based on the ordinary meaning of the terms used by the drafters of the legislative history to describe "symptoms" such as "insomnia, headaches, stomach disorders" were intended to draw a line between transitory, non-recurring type maladies resulting

from emotional distress, which can be readily treated and would likely disappear, from chronic pain or other types of permanent physical damage which can also result from emotional distress. Indeed, the district court's reading of the statute, based solely on its interpretation of the legislative history to the 1996 amendment and not on the text of the statute, could lead to absurd results not intended at all by the drafters. For example, it is not inconceivable that a victim of whistleblower retaliation could suffer a heart attack, stroke or other serious debilitating physical ailment as a result of emotional distress caused by the illegal retaliation. *See Creekmore v. ABB Power Systems Energy Services, Inc.,* 93-ERA-24, Dec. & Order of Remand by SOL, p. 12 (Feb. 14, 1996) (awarding compensatory damages in whistleblower case where the "ALJ found that stress resulting from" an employment action "was the major contributing factor to his heart attack."). However, under the strained definition of "physical injuries or physical sickness" grafted onto the text of the amended statute by district court in this case, damages received for any kind of physical injury or physical sickness would be taxable because it was not the result of physical origin. That, of course, is not what the text of the statute says but that is the result of the district court's interpretation.

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

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

both on its face, and under the definition of "emotional distress" provided by the drafters of the amendment.

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

Even if it were determined that the legislative history is somehow relevant, the scant legislative history to the 1996 amendment, which suggests that certain "symptoms" which may result from emotional distress, such as "insomnia, headaches, stomach disorders" are not physical injuries or physical sicknesses, must be disregarded because it would contradict the statute itself. *See* H. Conf. Rept. 104-737 at 301 n. 56 (1996). *Also see, Recording Industry Ass'n of America, Inc. v. Verizon Internet Servs., Inc.*, 351 F.3d 1229, 1237 (D.C.Cir. 2003) ("Legislative history … cannot lead the court to contradict the legislation itself"). Accord., *Lamie,* 124 S.Ct. at 1034.

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

V. GENUINE ISSUES OF MATERIAL FACT AND INFERENCES FROM FACTS IN PLAINTIFF'S FAVOR PRECLUDE SUMMARY JUDGMENT.

The district court erred by simply concluding 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." *Murphy,* 362 F.Supp.2d at 215.

At a minimum, there exists a genuine issue of material fact as to whether Ms. Murphy's physical injuries are distinct from the symptoms of emotional distress such as "insomnia, headaches, stomach disorders" referred to in the footnote to the legislative history that is so heavily relied upon by Defendants and the district court. *See* Fed. R. Civ. P. 56(c); *Anderson*, 477 U.S. at 242-43, 105 S.Ct. at 2507.

Additionally, the district court grant of summary judgment must be reversed because the district court failed to draw inferences from the facts in the light most favorably to Ms. Murphy. *Adickes,* 398 U.S. at 157, 90 S.Ct. 1598 (1970).

As demonstrated by the record and by the supporting affidavits of Plaintiff's doctors, Ms. Murphy suffered permanent physical injuries such as "bruxism" which resulted in permanent damage to her teeth. *See, e.g.,* J.A., pp. 39-41, Aff. of Dr. Carter, ¶¶ 7, 11-14; J.A., pp. 43-45, Aff. of Dr. Kurzer, ¶¶ 4-15. Notably, Ms. Murphy's permanent physical damage to her teeth caused by NYANG's illegal conduct is much more significant than the list of minor or transitory emotional distress symptoms that are referred to in the legislative history's footnote. *Cf.,* H. Conf. Rept. 104-737 at 301 n. 56 (1996). Rather, the permanent physical damage to Ms. Murphy's teeth was the result of "bruxism" (also known as teeth grinding), it is not simply a "symptom of emotional distress" and it is a permanent physical damage. Additionally, ongoing treatment and restorative surgery has been required to repair the permanent physical damage to

Ms. Murphy's teeth, and she continues to suffer from this permanent physical harm. J.A., pp. 43-45, Aff. of Dr. Kurzer, ¶¶ 4-15. However, the district court trivialized Ms. Murphy's serious and permanent physical injuries and physical sickness as mere transitory "symptoms" as those stated in the legislative history.

The facts demonstrate there exists, at the very least, genuine issues or a dispute of material fact about whether or not Plaintiff experienced physical injuries or physical sickness. Accordingly, the United States' Motion for Summary Judgment must be denied. *See* Fed. R. Civ. P. 56(c); *Anderson*, 477 U.S. at 242-43, 105 S.Ct. at 2507; *Adickes,* 398 U.S. at 157, 90 S.Ct. 1598 (1970). The affidavits provided by Ms. Murphy's dentist, Dr. Kurzer, and Plaintiff's expert, Dr. Carter, confirm they firmly believe Ms. Murphy suffered physical injuries and physical sickness, and these injuries occurred shortly after Ms. Murphy learned of NYANG's illegal conduct. Moreover, Dr. Carter testified without contradiction that Ms. Murphy suffered these physical injuries as a result of NYANG's illegal acts. Notably, the Defendants did not present any evidence to contradict this evidence and the DOL credited Dr. Carter's testimony.

The district court erred by entering summary judgment because the factual record overwhelmingly demonstrates, at the very least a genuine issue of material dispute, that Ms. Murphy suffered serious physical injuries or physical sickness, including the permanent physical damage to her teeth as a result of her employer's illegal retaliation for which she was awarded compensatory damages. By failing to draw the proper inferences from the evidence submitted by Ms. Murphy that demonstrates she suffered serious physical injuries and physical sickness, including the permanent physical damage to her teeth, the district court improperly concluded that Ms. Murphy suffered only minor symptoms of emotional distress that do not rise to the level of being considered a physical injury or physical sickness.

Likewise, in ruling on Plaintiffs' Sixteenth Amendment argument, the district court also ignored the factual record which overwhelmingly shows that the nature of Ms. Murphy's entire award of "make whole" compensatory damages was for personal injuries, including that Ms. Murphy suffered physical injuries as well as non-physical harm. *See* J.A., pp. 39-41; J.A., pp. 43-45. Additionally, the district court ignored the un-rebutted testimony of Plaintiffs' expert, Dr. Carter, demonstrating that emotional distress itself is a physical injury. *See* J.A., p. 41, Aff. of Dr. Carter, ¶ 15.

CONCLUSION

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

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation set forth in FRAP 32(a)(7)(B)(i), and that it contains no more than 14,000 words.

By: _________________________
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 21st day of November 2005, two copies of the foregoing Brief and a copy of the Appendix was served by U.S. mail, first-class, postage pre-paid, to counsel for Appellees:

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ADDENDUM

A. U.S. Const., Amendment XVI.

Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

B. Statutes.

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

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

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

C. Regulations.

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

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

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