ORAL ARGUMENT SCHEDULED FOR FEBRUARY 24, 2006

Case No. 05-5139

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

MARRITA MURPHY, *et al.*,

Plaintiffs/Appellants,

v.

INTERNAL REVENUE SERVICE, *et al.*,

Defendants/Appellees.

On appeal from the
U.S. District Court for the District of Columbia

REPLY BRIEF OF APPELLANTS

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Plaintiffs-Appellants, Marrita Murphy and Daniel J. Leveille, by and through counsel, hereby submit their reply brief.

REPLY TO JURISDICTIONAL STATEMENT

In footnote 2 of Appellees' brief, the government contends only the United States of America was a properly named defendant, and that the plaintiffs' request for non-monetary relief was barred and that the Administrative Procedure Act did not, as the district court held, allow plaintiffs to sue the Internal Revenue Service ("IRS"). That issue, however, was separately raised by the IRS in a motion to dismiss, which was properly denied. By failing to file a cross-appeal from the denial of its motion to dismiss, the IRS has waived this issue and it is not the subject of this appeal. *See* Fed. R. App. 4(a)(3).

APPELLEES' STATEMENT OF FACTS MISSTATES THE RECORD IN THE DISTRICT COURT AND DISTORTS THE DEPARTMENT OF LABOR'S HOLDING

This action was decided on the basis of summary judgment proceedings and the parties created a detailed factual record before the district court.[1] Notably, in the district court the IRS and United States (hereinafter, "IRS" or "defendants") failed to file any response contradicting, disputing, or objecting to plaintiffs' statement of material facts.

[1] First, the IRS submitted a Statement of Material Facts that was, in large part, based on the factual allegations set forth in the plaintiffs' Complaint. *See* J.A. 2, Docket # 10, Def.'s Stmt. of Material Facts (May 10, 2004). Second, plaintiffs filed a counter-statement of material facts in opposing defendants' motion for summary judgment and in support of plaintiffs' cross-motion for partial summary judgment. *See* J.A. 4, Docket # 20, Pltf.'s Stmt. of Material Facts (Oct. 25, 2004). Plaintiffs objected to 6 of the 13 paragraphs contained in defendants' statement of material facts, and plaintiffs submitted 41 detailed paragraphs citing to sworn affidavits and parts of the administrative record before the U.S. Department of Labor ("DOL") concerning Ms. Murphy's claim for compensatory damages in her whistleblower case.

Based on the ***undisputed summary judgment record***, the district court summarized the injuries sustained by Ms. Murphy as a result of the conduct of her former employer, the New York Air National Guard ("NYANG"), forming the basis for the DOL's compensatory damages award and made the following factual findings:

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

Murphy v. IRS, 362 F.Supp.2d 206, 211 (D.D.C. 2005) (emphasis added).

There was only one evidentiary hearing held before the DOL on Ms. Murphy's whistleblower claims on July 18 and 19, 1994, and all of the DOL decisions in plaintiff's Murphy's case were based on the testimony and evidence submitted at the July, 1994 hearing. *See* Docket #20, Pltf. Stmt. of Material Facts ("PSFOF"), ¶¶ 5, 31. Most notably, the DOL fully credited the July 1994 testimony of Ms. Murphy and her treating and expert psychologist, Dr. Carter, in awarding compensatory damages in her whistleblower case. *Id.*

Once again, in the district court the IRS did not dispute that both the DOL Administrative Law Judge ("ALJ") and Administrative Review Board ("ARB") decisions on Ms. Murphy's damages were "based on the original administrative hearing record created on July 18 and 19, 1994, and … based on Dr. Carter's testimony at the July 1994 hearing." *See* Docket #15, PSFOF, ¶ 31.

In this case, the district court found it was undisputed on summary judgment that Ms. Murphy was awarded compensatory damages for both "somatic" and "emotional" injuries. *Murphy,* 362 F.Supp.2d at 211. Notably, Dr. Carter testified at the July 1994 DOL hearing that as a result of NYANG's illegal blacklisting and retaliation, Ms. Murphy suffered "one of the worst cases of a negative reaction" he had seen in 20 years of practice, consisting of panic attacks and manifestations of stress, including "somatic references and body references." *See* Docket #15, PSFOF, ¶¶ 13, 17, citing Transcript, pages 148-149, of Dr. Carter's July 18, 1994 testimony before the DOL. This exact portion of Dr. Carter's July 1994 testimony was what the DOL ALJ cited when awarding Ms. Murphy compensatory damages. *See* Docket #15, PSFOF, ¶ 31.[2]

On review of the administrative record, the DOL ARB adopted the ALJ's recommended decision on compensatory damages, by stating that Ms. Murphy "testified that she experienced a variety of medical and personal problems after learning that she had been blacklisted," and that her testimony was supported by Dr. Carter, "who testified about the substantial effect the negative references had on Complainant." *Leveille v. New York Air National Guard,* 199 WL 966951, *3 (Oct. 25, 1999).[3] "Based on the level of harm experienced by" Ms. Murphy, "and comparing that harm with compensatory damages awards in other whistleblower cases," the ARB adopted the ALJ's recommendation on this aspect of the compensatory damages awarded to Ms. Murphy. *Id.*

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[2] *Also see Leveille v. New York Air National Guard,* ALJ Case Nos. 94-TSC-4 and 94-TSC-4, Recommended Decision and Order, at pp. 4-7 (Feb. 9, 1998), citing Transcript pages, 148-149, 165, of Dr. Carter's testimony as basis for compensatory damages award.

[3] Reprinted in Appellees' Br., Addendum, at 66.

Before the district court, plaintiffs also submitted the affidavit of Dr. Carter and, significantly, the IRS never contested, objected to, or opposed the admission of Dr. Carter's affidavit. *See* J.A. 38-42, Affidavit of Dr. Edwin N. Carter (Oct. 11, 2004).

In his affidavit, Dr. Carter explained that in order to reach his expert conclusions at the July 1994 DOL hearing that Ms. Murphy suffered from both "somatic" or body injuries as well as emotional injuries (testimony which was not re-butted before the DOL by NYANG, and which was expressly adopted by the DOL to award plaintiff $45,000 in emotional distress damages), he had reviewed Ms. Murphy's medical and dental records related to her complaints of physical pain and physical injuries prior to the July 1994 DOL hearing. J.A. 39-49, Carter Aff., ¶¶ 5, 9, and 11.

As explained by Dr. Carter, by "using the terms 'somatic references and body references' in [his] testimony before the [DOL] in July 1994, [he] was referring to Plaintiff's physical injuries such as the damage to her teeth that is reflected in her dental records." J.A. 39, Carter Aff., ¶ 7.

Dr. Carter specifically reviewed Ms. Murphy's "dental records (marked as DL&MM 13) and the Plaintiff's medical records (marked as DL&MM 21-39) prior to the July 1994 [DOL] hearing" in plaintiff Murhpy's whistleblower case. J.A. 40, Carter Aff., ¶ 9. Dr. Carter also stated in his un-rebutted affidavit in this case that his prior expert testimony at the July 1994 DOL hearing that Ms. Murphy "experienced somatic and body injuries is confirmed by the dental and medical records" referred to in paragraph 9 of his affidavit. *Id.,* ¶ 11.

Additionally, plaintiffs submitted the affidavit of Ms. Murphy's treating dentist. J.A. 43-45, Affidavit of Dr. Barry L. Kurzer (Oct. 11, 2004). Once again, the IRS did not contest, object to, or oppose the admission of Dr. Kurzer's affidavit.

Dr. Kurzer described in his affidavit his treatment of Ms. Murphy both prior to and following March 1994, in which he explained that Ms. Murphy has suffered from continuing and permanent physical damage to her teeth as a result of bruxism since it was first identified in March 1994. J.A. 43-44. The timing of Ms. Murphy's bruxism and physical damage to her teeth corroborates Dr. Carter's expert conclusions in July 1994 that Ms. Murphy suffered somatic and body injuries as a result of NYANG's conduct. Dr. Kurzer also confirmed that Ms. Murphy has suffered considerable and substantial physical damage since March of 1994 and she has needed continuing treatment to repair the damage resulting from this condition. J.A. 44-45.

Dr. Kurzer also confirmed that the dental records reviewed by Dr. Carter in 1994, on which Dr. Carter based his expert testimony at the July 1994 DOL hearing that Ms. Murphy sustained somatic or body injuries, were prepared by Dr. Kurzer or a member of his staff under his supervision. J.A. 45.

Consequently, on the basis of the undisputed summary judgment record, Ms. Murphy sustained both "somatic" or physical, and "emotional" injuries as a result of NYANG's illegal conduct, and those injuries were the basis for the DOL's award of compensatory damages in the amount of $45,000.

SUMMARY OF REPLY ARGUMENT

In its brief the IRS misconstrues relevant facts as well as the statutory authority to tax income. While conceding that the definition of "income" has "remained substantively unchanged" from its inception in the Revenue Act of 1913, the IRS completely ignores that prior to the passage of any statutory exclusion for personal injury damages in the Revenue Act of 1918, both the Attorney General and Treasury Department, following other Supreme Court cases, had already concluded that an amount received by an individual for personal injuries "is

not income" and cannot be taxed. As the Supreme Court has most recently noted after reviewing this statutory history of the tax code, it is not appropriate 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.'" *O'Gilvie v. United States,* 519 U.S. 79, 84-87, 117 S.Ct. 452, 455-56 (1996). The IRS has not provided any reason to justify such a drastic departure in this case.

Moreover, the IRS's claim that the statutory exemption for personal injuries first enacted by Congress was done only out of compassion as a matter of policy conflicts with the Attorney General's Opinion and the Treasury Department's ruling in 1918 stating that amounts received for personal injuries were not income under the tax code. If the IRS's view is accepted then Congress would have the power to tax all personal injury damages, including damages received for loss of an arm, a leg or even in cases of wrongful death.

In order to reach the conclusion that damages for personal injuries are taxable as income, as opposed to a restoration of a loss or return "human" capital, the IRS has advanced a nonsensical approach to the value of human life. As the IRS sees it, damages received for personal injuries should be taxed as income because it asserts there is no value in human capital and since the basis in "lost" human capital is "zero" all damages received for personal injuries must be considered a "gain" unless expressly excluded from gross income by Congress. The IRS's argument defies not only the history of our tax code, and the Attorney General opinion and the Treasury Department's ruling in 1918, but it also collides with centuries of jurisprudence assigning a monetary value to human losses to award damages for, *inter alia,* personal injuries for emotional distress or loss of professional reputation.

Whether this case is viewed under a statutory construction analysis, or in light of the 16th Amendment, the results are the same. The IRS cannot reconcile its unique theory that compensatory damages for personal injuries are a "gain" with the case law and other authorities, which recognize that personal injuries damages are a restoration of loss or return of capital. Nor can the IRS reconcile its theory of a "gain" with the facts of this case. In its brief, the IRS concedes the general principle that Congress cannot tax capital or a basis in capital, and it concedes that compensatory damages do not fit within the list of items included in the statutory definition of income in 26 U.S.C. § 61(a).

In concluding that none of Ms. Murphy's compensatory damages fall within the statutory exclusion of Section 104(a)(2), as amended in 1996, both the IRS and the district court ignored the uncontested summary judgment record, which demonstrated that Ms. Murphy's physical problem was more than a mere "symptom," it was a "long continued" physical injury constituting bodily harm in and of itself. However, the IRS went a step further and mischaracterizes the Department of Labor's record to wrongly assert that the DOL did not take into consideration, or base, its compensatory damages award on Ms. Muprhy's physical or somatic injuries.

Additionally, the IRS completely fails to respond to or address Ms. Murphy's arguments, raised in her opening brief, that her damages are excluded from gross income under the terms of the 1996 legislative history, and the district court's reliance on that legislative history conflicts with the terms of the amended statute, itself. Section 104(a), as amended in 1996, distinguishes between "physical injuries or physical sickness" and "emotional distress." If the amended statute is to have any meaningful purpose, there must be a distinction between "physical injuries or

physical sickness" and the term "physical symptoms" as used in the legislative history. Neither the district court nor the IRS address this critical flaw in their analysis.

ARGUMENT

I. THE IRS'S ARGUMENT THAT CONGRESS HAS THE POWER TO TAX PERSONAL INJURY DAMAGES INTENDED TO RESTORE A LOSS OR RETURN CAPITAL IS FACTUALLLY AND LEGALLY WITHOUT MERIT.

A. The IRS Ignored the Plaintiffs-Appellants' Non-Constitutional Arguments.

In its brief the IRS points out the principle that this Court should attempt to decide a case without reaching the constitutional issue.[4] However, the IRS focuses almost exclusively in its brief in arguing that Section 104(a)(2), as amended in 1996, is constitutional while ignoring the prior controlling opinions of the Attorney General and Treasury Department construing the statutory authority to tax income to exclude the taxing of damages for personal injuries. These authorities may be dispositive of the question before this Court without deciding the constitutional issue.

Both the IRS and the plaintiffs in this case agree that the definition of the word "income" in the tax code is based on the 16th Amendment granting Congress the power to tax income "from whatever source derived." U.S. Const., amend. XVI; 26 U.S.C. § 61(a). That is only the starting part of the analysis, however.

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[4] The IRS points to the unremarkable rule that Congress is "assume[d] to legislate in light of constitutional considerations." *See* IRS Br., p. 27, citation omitted. However, that is only half the story as the Supreme Court explained in *Commodity Futures Trading Commission v. Schor,* 478 U.S. 833, 841 (1986) (internal quotations emitted): "It is equally true, however, that this canon of construction does not give a court the prerogative to ignore the legislative will in order to avoid constitutional adjudication; although this Court will often strain to construe legislation as to save it against constitutional attack, it must not and will not carry this to the point of perverting the purpose of a statute…or judicially rewriting it." Regardless of which approach is used in this case, neither the statutory definition or constitutional definition would permit the taxation of Ms. Murphy's damages inasmuch as those damages compensated her for an actual loss.

In its recitation of the statutory construction of both 26 U.S.C. § 61(a) and the personal injury exclusion contained in 26 U.S.C. § 104(a)(2), the IRS has omitted some important events which show why Congress does not have the authority, under the tax code to tax the kind of non-physical personal injury damages awarded to Ms. Murphy. First and foremost, compensatory damages for personal injuries (whether physical or non-physical) do not fall within the statutory definition of gross income, 26 U.S.C. § 61(a), which the IRS concedes "has remained substantively unchanged ever since" the Revenue Act of 1913 was enacted. *See* IRS Br., p. 20.

Significantly, the original Revenue Act of 1913 did not contain any statutory exclusion for damages received on account of personal injury or sickness.[5] This critical fact was not even mentioned in the IRS's brief.

Following the passage of the original tax code in 1913 the Supreme Court decided a number of cases examining certain kinds of compensation to determine if it was "income" or a gain, on the one hand, or capital or a loss, on the other hand. *See*, *e.g., Doyle v. Mitchell Brothers Company*, 247 U.S. 179, 185 (1918); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918). In these cases, the Supreme Court held that "a restoration of capital was not income; hence it fell outside the definition of 'income'…" *O'Gilvie,* 519 U.S. at 84, 117 S.Ct. at 455.

As Justice Breyer noted in his recitation of this history in *O'Gilvie,* there were two other significant legal opinions concluding that an amount received for damages or compensation for personal injuries is not taxable income. *O'Gilvie,* 519 U.S. at 84-85, 117 S.Ct. at 455. Significantly, prior to the enactment of any statutory exclusion from income for personal injury damages in the tax code, both the U.S. Attorney General and the Department of Treasury

[5] *See e.g., O'Gilvie v. United States,* 519 U.S. 79, 84-87, 117 S.Ct. 452, 455-56 (1996) (noting the history of the text of the personal injury exclusion in Section 104(a) commencing in 1918).

separately concluded that such personal damages were not income under the original Tax Revenue Act of 1913. First, the Attorney General, citing to *Doyle* and other similar Supreme Court cases, issued a formal opinion concluding that the proceeds of an accident insurance policy for personal injuries are not taxable as income because "[t]hey merely ***take the place of capital in human ability which was destroyed by the accident***. ***They are therefore 'capital' as distinguished from 'income' receipts***." *See* 31 Op. Atty. Gen. 304, 308, 1918 WL 633 (U.S.A.G.) (June 26, 1918) (emphasis added). Second, the U.S. Treasury Department issued a more definitive ruling, stating, "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).

It is wrong to conclude, as the IRS does, that Congress simply enacted the personal injury exclusion in 1918 not because such damages were not income in the first instance but as a matter of "policy" out of legislative compassion. As shown, immediately prior to the enactment of the original statutory exclusion for personal injury damages in 1918, the Attorney General and the Treasury Department had each separately and specifically concluded, following Supreme Court cases arising in other contexts, that the definition of "income" contained in the Revenue Act of 1913 did not encompass an amount received by an individual for personal injuries.

Following the declaration by the Attorney General and the Department of Treasure that damages for personal injuries were not income under the tax code, Congress announced in the text of the legislative history for the statutory exemption for personal injuries passed in 1918, "***Under present law it is doubtful*** whether amounts received … 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." H.R. Rep. No. 767, pp. 9-10 (1918) (emphasis added).

Thus, even the broadest definition of "income" under the tax code does not encompass compensation received for personal injuries to restore a loss. There is nothing contained in the later Supreme Court cases to support the IRS's position that Congress could unilaterally act to tax damages received for personal injuries as "income" when the original interpretations of the meaning of "income" by the Attorney General and Treasury Department concluded that the tax code did not empower Congress to tax such damages for personal injuries.[6] There is no authority for Congress to unilaterally convert its authority to tax "income" in order to tax capital or tax amounts to restore a loss.

Accordingly, without even deciding whether the 1996 amendments to Section 104(a) run afoul of the 16th Amendment, Congress does not have authority under the tax code's definition of "income" to tax damages to restore a loss or make a victim whole to return capital.

B. The IRS' Understanding of the Facts Related to the 16th Amendment Argument Is Flawed and Misleading.

The IRS concedes, as it must, that a monetary recovery of a taxpayer's "basis" in property is not a taxable event. IRS Brief, p. 35. Consequently, the IRS was faced with a difficult legal and factual issue to resolve: How can the restoration of an initial "basis" in physical property be non-taxable, but a restoration of an initial "basis" in human life be taxable?

In order to distinguish the value of life from the value of property the IRS relied upon the proposition that the "concept" of "human capital" was, at best, "vague" and related only to the "abstract worth" of a person "in his or her well being." IRS Brief, pp. 35-36, The value of this

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[6] In fact, in *O'Gilvie,* the Supreme Court noted that "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.'" *O'Gilvie,* 519 U.S. at 86, 117 S.Ct. at 456.

"abstract worth" was placed at "zero." IRS Brief, p. 17 ("The tax basis in 'lost' 'human capital' is zero.").

The IRS cites no legal authority for its remarkable (and ethically troubling) conclusion that human life has no value and its tax "basis" is "zero." The reason for this failure to cite any authority is rather obvious – the IRS's position is not legally tenable. For example, in *Louis Pizitz Dry Goods Co. v. Yeldell,* 274 U.S. 112, 116 (1927), the Supreme Court recognized that life had value and although the method used to determine such value may not be as straight forward as a typical economic analysis, and held that it was permissible to permit a "jury to fix the amount of recovery" by exercising a "reasonable judgment" in "measuring the value of human life." In fact, in later decisions, courts have recognized the "noncontroversial assumption that the value of an individual's life exceeds the sum of that individual's economic productivity." *Smith v. Ingersoll-Rand Co.,* 214 F.3d 1235, 1244 (10th Cir. 2000).

Once the IRS's unsupportable assumption that the value of life is placed at "zero" is rejected, the IRS's entire argument falls apart. If a restoration of a "basis" in property is not subject to taxation, then necessarily the restoration of the "basis" in human life is not subject to taxation.

Following its flawed premise that human life has "zero" value, the IRS applied that concept to this case and made the following unsupportable conclusion:

> "No doubt, the damages awarded to Ms. Murphy here were intended, ***in an amorphous sense,*** to make here 'whole' be replacing her diminished emotional well-being with a monetary payment."

IRS Brief, p. 36 (emphasis added).

The key phrase in this factual presentation of the award to Ms. Murphy is the IRS's understanding that the compensatory damages ordered by the Secretary of Labor were "in an amorphous sense" related to her "diminished emotional well-being." This case has *nothing to do* with any factual finding that is "vague," "abstract" or "amorphous." The use of these terms in relationship to the specific tax claims raised by Ms. Murphy demonstrates a radical misunderstanding of the facts relevant to this case.

First, the Department of Labor conducted an extensive evidentiary hearing related to the specific damages for which Ms. Murphy was entitled. The on-the-record adjudication conducted by the Department of Labor (these procedures are codified in 29 C.F.R. Part 24), which required Ms. Murphy to demonstrate specific facts proving actual damages, and which permitted the defendant in her DOL case to contest all of these facts, and which thereafter required the Secretary of Labor to carefully review the record and make specific legally binding findings, did *not* result in any factual finding which could in any manner whatsoever be defined as "vague," "abstract" or "amorphous."

Second, the law upon which the Department of Labor adjudicated Ms. Murphy's claims permitted the DOL to provide damages to Ms. Murphy on the basis of both taxable income and non-taxable damages.[7] When the DOL heard Ms. Murphy's testimony (direct and cross), the testimony of her expert (direct and cross) and the testimony of NYANG's witnesses (on both direct and cross examination), and reviewed the documentary evidence, the Secretary of Labor could have legally awarded Ms. Murphy damages which were taxable. The Secretary could have

[7] The statutes upon which the Secretary of Labor based his damage rulings authorized the Secretary to award persons both taxable and non-taxable compensation, including back pay, exemplary damages or compensatory damages. *See, e.g.,* Toxic Substances Control Act, 15 U.S.C. §2622(b)(2)(B); Safe Drinking Water Act, 42 U.S.C. §300j-9(i)(2)(B)(ii).

reviewed the evidence and provided compensation for back wages (which are unquestionably taxable), front pay (which is unquestionably taxable) or exemplary damages (which are unquestionably taxable). But this did not happen.

After hearing all of the testimony, after reviewing all of the exhibits and after hearing legal argument from both sides in a hotly contested adversarial proceeding, the Secretary made factual findings which, under the rules of *res judicta* and *collateral estoppel* are binding on the parties in this proceeding. These factual findings held that Ms. Murphy was ***damaged***, not in a "vague," "abstract" or "amorphous" manner, but in a very real manner. The Secretary of Labor then awarded no lost-income related damages, but only awarded compensatory damages for an actual loss.

Third, because, in this case, there was an adjudicated factual finding that Ms. Murphy suffered actual damages, this case is not controlled by the academic debate related to "human capital." Although the usage of that term in various court decisions is very instructive in understanding why compensation for actual damages to a person does not constitute "income," this court need not address all of the legal or factual issues implied in the general academic debate related to that term. The role of the Court in this is much more narrow. In light of a binding factual determination of the United States Department of Labor, based on a full adjudication and evidentiary hearing into the actual physical and mental condition of the "person" at issue in this case (i.e. Ms. Murphy), can the IRS unilaterally declare that compensatory damages award as somehow based on a "vague," "abstract" or "amorphous" damage? The answer is clearly no.

Fourth, once the IRS's attempt to pettifog the actual factual record in this case by improperly defining Ms. Murphy's actual harm as "vague," "abstract" or "amorphous," it

become relatively straight forward to apply the *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426 (1955), definition of income to this case and conclude, as one must, that the actual damages awarded by the Secretary of Labor as a result of the adjudication of damages in Ms. Murphy's case were not made, in any manner, as compensation for lost income, lost wealth or lost gains. They were not made as part of any "accession to wealth." They were simply paid to "make her whole" compensate her for actual damages she was able to prove to restore her loss, after a trial on the merits in which an adversarial party was able to attack her medical or other testimonial/documentary evidence. Here, Ms. Murphy's compensatory damages were as real and as non-abstract or vague as the damage a home owner experiences when his or her house burns down.

C. Applying *Glenshaw Glass* to the Facts of this Case Unquestionably Demonstrates that Ms. Murphy's Compensatory Damages are Not Taxable.

As set forth above, the Department of Labor has already adjudicated the factual issue as to whether the damages awarded to Ms. Murphy were for lost wages or whether those damages were directly related to compensating Ms. Murphy for an actual loss to her physical and/or mental condition.

In *Glenshaw Glass,* the Supreme Court did not mandate that the IRS could tax all money – regardless of why it was received – unless Congress provided a specific exemption. *Glenshaw Glass* simply defined "income" broadly to include any "accession to wealth." *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 431 (1955).

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

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

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

Black's Law Dictionary's (8th Edition, 2004) definition of accession consistent with this: "A property owner's right to all that is *added* to the property, naturally or by labor . . . ." (emphasis added).

Bouviers Law Dictionary (Balwin's Edition 1934), p. 30, is also consistent with these basic definitions of the term "accession" as it was understood by the Supreme Court when it used that term to describe the concept of "income" under the 16th Amendment: "The right to all which one's own property produces."

On the basis of the record in this case, the compensatory damages award adjudicated by the Secretary of Labor concerning the losses suffered by Ms. Murphy, cannot, even using the IRS' own logic, be fit into any coherent or honest definition of "accession." The Secretary's award to Ms. Murphy did not, as a matter of fact, compensate Ms. Murphy for "all which one's own property produces." Compensation for such personal harm or a loss is not an "addition" to one's property, either "naturally or by labor." It was not the "addition" of property "by growth, increase, or labor." In short, an "accession to wealth" implies that the property in question has been increased or added to in some manner. If the property is merely restored to its prior condition due to a damage, there is no accession.

D. The IRS' legal understanding of *Eisner* and *Glenshaw Glass* is Flawed.

The IRS argues that the 16th Amendment would constitutionally permit the IRS to tax any compensation paid to a human being for loss to any part the human body or psyche. IRS Brief, p. 33, n. 8. This is based on the IRS's misunderstanding of how *Glenshaw Glass* modified *Eisner*. According to the IRS, *Glenshaw Glass* redefined "income" under the 16th Amendment as a "broad-sweeping concept" that "includes any accession to wealth, unless explicitly exempted by Congress." IRS Brief, p. 28.

The IRS essentially wants to read out of the tax code any limitation on the taxing authority of Congress implied by the inclusion of the word "income" in the 16th Amendment. However, the IRS misconstrues failed to understand that the Supreme Court's careful inclusion of the concept of an "accession to wealth" prevented Congress or the IRS from over-inferring the holding of *Glenshaw Glass* and clearly prevented Congress from taxing the original basis in property or life. Moreover, the IRS's analysis completely distorts the debate carried on within the U.S. Supreme court after the enactment of the 16th Amendment, which gave rise to both the *Eisner* and *Glenshaw Glass* precedent.

After the 16th Amendment became law, the Supreme Court had to define the meaning of the term "income" as used in that amendment and the subsequent codified tax code. One of the first cases which defined "income" stood for the proposition that restoration for a loss was not income. *Doyle v. Mitchell Bros.*, 235 F. 686, 688 (6th Cir. 1916) (monies paid to compensate for losses in a fire are not income). The *Doyle* precedent has not been questioned by the IRS.

Shortly after *Doyle* the Supreme Court decided *Eisner*. The *Eisner* Court defined "income" as a "gain derived from capital, from labor, or from both combined." 348 U.S. at 431. In that case, Justice Brandeis dissented. *Eisner v. Macomber*, 252 U.S. 189, 226 (1920) (J.

Brandeis dissenting). Justice Brandeis was concerned that the definition of income used by the Court did not include various means for which persons could obtain income which were not directly related to a gain from capital or labor. For example, what about earnings from gambling, gifts or inheritance?

However, Justice Brandeis did not dispute the *Doyle* holding and did not contend that monies obtained to compensate a person for a loss was income. In a 1924 case Justice Brandeis was very clear that the term "income" limited Congress' authority to tax citizens: Congress "cannot make a thing income which is not so in fact." *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114 (1925) (J. Brandeis writing for unanimous Court). *Accord., Taft v. Bowers,* 278 U.S. 470, 481 (1929) (taxation permitted for monies or profits "*properly* regarded as income").

In *Glenshaw Glass* the Court unquestionably permitted Congress to define income beyond the narrow classification set forth in *Eisner* and in that manner the *Glenshaw Glass* decision was consistent with Justice Brandeis' dissent in *Eisner*. However, by use of the term "accession to wealth" the *Glenshaw Glass* court was also sensitive to Justice Brandeis' concern that an overly broad definition of "income" could not be used by Congress to "make a thing income which is not so in fact." "Accessions," as understood by the courts, was an addition to wealth or property. It was not an all-encompassing term which would include monetary payments for restoration of a loss – be that a loss to a house or a hand.

II. ALTERNATIVELY, THE DISTRICT ERRED IN GRANTING SUMMARY JUDGMENT BECAUSE MS. MURPHY SUSTAINED PHYSICAL OR SOMATIC INJURIES AS A RESULT OF NYANG'S ILLEGAL ACTIONS.

In its brief the IRS goes to great pains to misconstrue the summary judgment record in order to argue that Ms. Murphy did not sustain any physical injuries and that the compensatory damages awarded by the DOL in her case did not represent damages to compensate for physical

injury or physical sickness. However, as a result of the IRS never opposing or contesting the plaintiffs' statement of material facts in the district court, it is not a matter of factual dispute that the illegal conduct that the DOL found was illegal in Ms. Murphy's DOL whistleblower case caused:

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

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

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

Murphy v. IRS, 362 F.Supp.2d at 211.

In fact, as noted above in reply to the IRS's statement of facts portion of its brief, it its decisions on damages the DOL specifically cited that portion of Ms. Murphy's treating and expert psychologist, Dr. Edwin Carter, where Dr. Carter testified unequivocally that Ms. Murphy sustained panic attacks and physical manifestations of stress as well as "somatic references and body references."[8] The IRS has misstated the DOL record, because the DOL expressly cited to and relied on that portion of Dr. Carter's expert testimony about Ms. Murphy's physical injuries

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

when the DOL justified the amount of Ms. Murphy's compensatory damages for emotional distress.

The IRS's argument must fail because it contradicts the summary judgment record and findings on which the district court based its summary judgment ruling in this case, and because the DOL specifically cited to Dr. Carter's expert testimony about Ms. Murphy's physical injuries to justify the amount of damages awarded for the category that DOL referred to in its opinion as damages for emotional distress, the IRS's arguments are without any factual support. Moreover, the IRS cannot be permitted to contradict on appeal the summary judgment record and findings entered by the district court that Ms. Murphy's injuries were both "somatic" and "emotional" injuries. *Murphy v. IRS,* 362 F.Supp.2d at 211.

The uncontested summary judgment record, as well as Judge Lamberth's factual findings based on that record, is binding on the IRS on appeal. Moreover, the IRS failed to file any objections or counter-statements of fact to contradict the un-contested statement of facts filed below by plaintiffs.

Consequently, to the extent the district court held, and the IRS argues on appeal, that Ms. Murphy did not receive damages on account of physical injuries or physical sickness, must be rejected on the basis of the summary judgment record to which the IRS did not object or contest. *See Commissioner v. Schleier,* 515 U.S. 323, 336-37, 115 S.Ct. 2159 (1995) (requiring a taxpayer to show under the second part of the *Schleier* test that the damages were received "on account of" a personal injury). As far as the district court's findings and conclusions were concerned regarding the application of the second part of the *Schleier* test, the district court did not find, as it could not on the basis of the summary judgment record, that Ms. Murphy did not sustain physical injuries or physical sickness, but rather the district court held, based on its

incorrect interpretation of the meaning of 26 U.S.C. §104(a)(2), as amended in 1996, that Ms. Murphy's physical problem "was only a symptom of her emotional distress and not the source of her claim." *Murphy,* 362 F.Supp.2d at 215.

The district court's error was reading into the statute words that do not exist in the statute itself. *See* Appellants' Br., pp. 32-45. By interpreting Section 104(a)(2), as amended in 1996, to mean that the exclusion from gross income only applies where physical injuries or physical sickness derive from a physical, as opposed to a non-physical source (such as emotional distress), the district court misinterpreted the revised statute.[9] The district court's conclusion that Ms. Murphy's injuries were not "*physical* in nature," *Murphy,* 362 F.Supp.2d at 214-215, is contradicted by the uncontested summary judgment factual record on which Judge Lamberth earlier in the same opinion found that Ms. Murphy sustained both "somatic" and "emotional" injuries. *Id.*, 362 F.Supp.2d at 211.

Despite that the IRS failed to contest the affidavit of Dr. Carter submitted to the district court, the IRS also now misstates its contents to argue that in his affidavit Dr. Carter "did not specify what somatic injury Ms. Murphy suffered." IRS Br., p 44, n. 14. In his affidavit, Dr. Carter stated that Ms. Murphy's somatic or physical injuries included the physical damage to Ms. Murphy's teeth as a result of her bruxism, J.A. at 39-41. What's more, Dr. Carter expressly stated in his affidavit that "[b]y using the terms 'somatic references and body references' in [his] testimony before the Department of Labor in July 1994 [he] was referring to Plaintiff's physical

[9] By contrast, the IRS also misconstrued the factual record to argue that the DOL's decisions on damages were not based on, or include an award for, the physical or somatic injuries of Ms. Murphy that Dr. Carter so aptly described at the DOL hearing in July 1994 and in his affidavit submitted in this case.

injuries such as the damage to her teeth that is reflected in her dental records." J.A. 39, Carter Aff., ¶ 7.

The IRS posits without any supporting authority "that the most natural reading of the phrase emotional distress would include all symptoms of such distress, be they physical or nonphysical." *See* IRS Br., p. 47. Such a sweeping and conclusory remark ignores both the plain meaning of Section 104(a), as amended in 1996, as well as the limited value of the scant legislative history to those amendments. More importantly, the IRS completely failed to respond to or address Ms. Murphy's arguments, raised in her opening brief, that her damages are excluded from gross income under the terms of the 1996 legislative history, and the district court's reliance on that legislative history conflicts with the terms of the amended statute, itself. *See* Appellant's Br., pp. 41-45. Section 104(a), as amended, distinguishes between "physical injuries or physical sickness" and "emotional distress." 26 U.S.C. §104(a). If the amended statute is to have any meaningful purpose, there must be a distinction between "physical injuries or physical sickness" and the term "physical symptoms" as used in the legislative history.

However, the IRS did not address this problem in its briefs and the district court did not come to grips with this problem of statutory construction concerning the meaning of the 1996 amendments to Section 104(a). If the legislative history merely clarifies the meaning of "emotional distress," as the IRS argues, the use of the words "physical symptoms" to attempt to define emotional distress, and the statute's contrasting use of the words "physical injuries" and "physical sickness" is similar to the approach under the *Restatement (Second) of Torts*, which draws a "line between mere emotional disturbance and physical harm which results from emotional distress." *Walters v. Mintec/International,* 758 F.2d 73, 77-78, citing *Restatement (Second) of Torts,* §§ 7, 402A, and 436A. The IRS completely failed to address Appellants'

argument that there is a difference long recognized in the law distinguishing between "transitory" symptoms such as "dizziness" or nausea, and other "long continued" physical problems that "may amount to a physical illness" and which, in themselves, constitute "bodily harm." *Restatement (Second) of Torts,* § 436A. *Also see* Appellants' Br., pp. 41-45, and authorities cited therein.

In reaching its erroneous conclusion that Ms. Murphy's physical or somatic injuries did not qualify for the exclusion from gross income under Section 104(a)(2), the district court simply concluded that because Ms. Murphy's "physical problem, bruxism… was only a symptom of her emotional distress, not the source of her claim." *Murphy,* 362 F.Supp.2d at 215. However, in reaching this conclusion the district court ignored the uncontested summary judgment record, which demonstrated that Ms. Murphy's physical problem was more than a mere "symptom," it was a "long continued" physical injury constituting bodily harm in and of itself. *See* J.A. 40-41, Carter Aff., ¶¶ 10-16 (providing unrebutted expert opinion that Ms. Murphy suffered "physical injuries and physical sickness," including "permanent physical injuries to her teeth as well as physical pain" as a result of NYANG's conduct); J.A. 44-45, Kurzer Aff., ¶¶ 8-15 (expert opinion that Ms. Murphy suffered from continuing "severe bruxing of the teeth," and "considerable and substantial physical damage to her teeth" since March 1994).

There is no requirement under Section 104(a)(2) that a taxpayer like Ms. Murphy who suffers a "physical injury" resulting from a non-physical stimulus can not be eligible for the exclusion. That would lead to absurd results not even contemplated or intended by the most reasonable reading of the legislative history. For example, if the courts follow the IRS's argument, a taxpayer who is continually harassed at work, but is never subject to physical contact by the harasser, then, as a result of the harassment, suffers a debilitating heart attack

cannot be eligible for Section 104(a)'s exclusion if he or she recovers damages from the harasser. However, another taxpayer who is harassed at work by being punched in the nose and, as a result, suffers a debilitating heart attack would be fully eligible for the exclusion.

Neither the statute nor the legislative history can be reasonably interpreted in such a way to provide for such disparate results from the same types of harm deriving from such similar conduct.

CONCLUSION

For the foregoing reasons, and for the reasons previously set forth by Appellants and the *Amicus Curiae* No Fear Coalition, in support of Appellants, the district court's order granting the government summary judgment and denying plaintiffs' cross motion for summary judgment should be reversed and this matter should be remanded.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This reply brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this reply brief contains less than 6,865 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This reply brief complies with the type face and type style requirements of Circuit Rule 32(a)(1)because this reply brief has been prepared in a proportionally spaced typeface using Microsoft Word 2002 in Times Roman and 12 point font.

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CERTIFICATE OF SERVICE

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