I Think, Therefore I Am; I Feel, Therefore I Am Taxed: Déscartes, Tort Reform, and the Civil Rights Tax Relief Act

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[A] society’s choice of a system of taxation speaks volumes about what that society values and believes.¹

[I]mposing a tax—any tax—is both powerful and manipulative.²

I. INTRODUCTION

I want to thank you for including me today, especially as everything I don’t know about U.S. tort law could fill several large textbooks, and almost everything I do know, I learned from watching re-runs of Judging Amy³ and The Practice.⁴ As you will have seen from even a casual glance at the Symposium poster, I come at our topic today from the perspective of tax law. I have been interested for some time in how tax law and the tort system work together in the context of non-economic, non-physical, personal injury claims⁵ (such as unlawful discrimination or

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² Id., at 36.
³ “Judging Amy” ©1999-2005 Twentieth Century Fox Film Corporation & CBS Worldwide Inc.
⁵ There have been several articles written in the last ten years about the tax treatment of non-physical injury damages, including the attorneys’ fees portion of those awards. See, e.g., J. Martin Burke, Getting
intentional infliction of emotional distress) to produce and perpetuate stereotypes “and habitual ways of [valuing] nondominant groups in our society.”

In the last twenty-five years, feminists and critical race scholars have begun to document the normative, class-based, racialized and gendered nature of U.S. tort law, especially so-

8 “[M]inority men receive significantly lower damage awards than white men in personal injury and wrongful death suits,” confirming that “a higher value is placed upon the lives of white men and that injuries suffered by this group are worth more than injuries suffered by other less privileged groups in society.” Chamallas, The Architecture of Bias, supra note __, at 464-465. See also Frank M. McClellan, The Dark Side of Tort Reform: Searching for Racial Justice, 48 Rutgers L. Rev. 761 (1996).
9 Over time tort law has tended “to produce and reproduce gender disparities both in the types of legally recognized injuries and in the value placed on certain losses.” Chamallas, The Architecture of Bias, supra note __, at 469.
called “tort reform.” Their analyses reveal that initiatives with adverse consequences for


11 Finley, Female Trouble, supra note __; Finley, Hidden Victims, supra note __; McClellan, The Dark Side, supra note __. One of the central weaknesses of contemporary tort reform is that it’s aimed at
women, children, people living in poverty, people of color, and other minorities include caps for non-economic loss and punitive damages, the legislative extension of immunities for what reducing claims rather than injuries. Professor Finley makes this point with respect to products liability reform:

Legislators no longer attribute the problem of confronting our legal system to the number of accidents, harmful products or insufficiently tested drugs and devises adversely affecting public health and individual well-being; rather, they now attribute the problem to the excessive number of claims brought by injured people.

Finley, Female Trouble, supra note __, at 848. See also Finley, Hidden Victims, supra note __.

Professor Finley has demonstrated that non-economic loss damage caps adversely affect women:

I have conducted empirical research from several states on how juries in medical malpractice and other tort suits allocate their damage awards between economic loss and noneconomic loss damages. I then compared cases in which men are the victims and cases in which women are the victims. This research demonstrates that while overall men tend to recover greater total damages, juries consistently award women more in noneconomic loss damages than men, and that the noneconomic portion of women’s total damage awards is significantly greater than the percentage of men’s tort recoveries attributable to noneconomic damages. Consequently, any cap on noneconomic loss damages will deprive women of a much greater proportion and amount of a jury award than men.

would otherwise be tortious conduct, proposed rule revisions on class-action lawsuits, the judicial (re)interpretation of causation in the context of toxic torts, and the Bush

Lawyer’s Ingenuity. Try to Limit Damages, N.Y. Times, Mar. 6, 2005 (reporting Catherine Sharkey’s recent study analyzing jury verdicts in 22 states in 1992, 1996, and 2001; Sharkey concluded that “non-economic damages caps have no statistically significant effect on the size of overall compensatory jury verdicts or final judgments.”). Sharkey’s findings will be published by N.Y.U. Press in May 2005. Her findings should be used with caution, however; there are a variety of reasons which might explain the findings. For example, it may be that caps influence the types of cases brought on behalf of plaintiffs. Id.

13 See Thomas Koenig & Michael Rustad, His and Her Tort Reform: Gender Injustice in Disguise, 70 Wash. L. Rev. 1 (1995); and Cady, supra note __.

14 This includes products liability limitations, particularly in the pharmaceuticals context, as well as assumption of risk in the context of ski resorts and air travel.


[the measure would prohibit state courts from hearing many kinds of cases they now consider, transferring them to federal courts. Experts say many cases will wind up not being brought because federal judges have been constrained by a series of legal precedents from considering large class actions involving varying law of different states.]

Id. According to Mr. Bush, these changes further his goal of “keep[ing] America the best place in the world to do business.” Cited by Mr. Labaton, id. Consumer rights groups fear it makes the United States an increasingly dangerous place to be a consumer.
Administration’s near-hysterical campaign to convince voters that the high cost of medical malpractice insurance premiums can be visited on frivolous claims, unethical lawyers and out-of-control juries, rather than some combination of a hard insurance market, inflation and the number of tortfeasors.


18 Colorado’s damages cap provisions begin with the following statement:

The general assembly finds, determines, and declares [just to be clear!] that awards in civil actions for noneconomic losses or injuries often unduly burdens the economic, commercial, and personal welfare of persons in this state; therefore, for the protection of the public peace [????], health, and welfare, the general assembly enacts this section placing monetary limitations on such damages for noneconomic losses or injuries.

C.R.S.A. § 13-21-102.5 (1). It seems to me that a case could be made that awards for economic losses often unduly burden tortfeasors, as well, but of course economic loss damages have been “relatively immune from attack by the proponents of tort reform.” Finley, Hidden Victims, supra note __, at 1280. It also seems to me that if an injury is determined by a properly instructed jury to be X, where X is extremely high, the problem might be the seriousness of the injury not the jury. Again, Professor Finley knows more about this than I; see Finley, Hidden Victims, supra note __, and Finley, Female Trouble, supra note __.
As with the tort system, there are innumerable ways in which the Tax Code\textsuperscript{19} works to the disadvantage of women and minorities. Important work has already begun on exposing and analyzing these provisions.\textsuperscript{20} Beverly Moran and William Whitford, for example, demonstrate


how gift taxes, the mortgage interest deduction, IRAs, and the tax treatment of employer-
provided health insurance plans can discriminate against African Americans;\(^{21}\) Patricia Cain has 
written about the privileging of heterosexual married couples in the Tax Code;\(^{22}\) and several 

\(^{21}\) Moran & Whitford, A Black Critique, supra note __. See also Dorothy A. Brown, The Marriage 
Bonus/Penalty in Black and White, in Brown & Fellows, supra note __, at 45; Dorothy A. Brown, Race, 
Class, and Gender Essentialism in Tax Literature: The Joint Return, 54 Wash. & Lee L. Rev. 1469 
(1997); John A. Powell, How Government Tax and Housing Policies Have Racially Segregated America, 
in Brown & Fellows, supra note __, at 80; Moran, Exploring the Mysteries, supra note __; Moran, Setting 
the Agenda, supra note __; and Jones, Mapping Tax Narratives, supra note __.

\(^{22}\) See e.g., Patricia A. Cain, Taxing Lesbians, 6 S. Cal. Rev. L. & Women’s Stud. 471 (1997); Patricia A. 
Cain, Heterosexual Privilege and the Internal Revenue Code, 34 U.S.F. L. Rev. 465 (2000); Patricia A. 
Cain, Death Taxes: A Critique From the Margin, 48 Clev. St. L. Rev. 677 (2000); and Patricia A. Cain, 
Dependency, Taxes, and Alternative Families, 5 J. Gender Race & Just. 267 (2002). See also Nancy J. 
scholars—Karen Brown23 and Mary Louise Fellows24 among them—have documented the ways in which several gender-neutral tax provisions adversely affect women in the United States.25

I am interested in the intersection of tax and torts, and in particular: Section 104(a)(2) of the Internal Revenue Code26 and the Civil Rights Tax Relief Act of 2004,27 together which provide for the taxation of damages awarded on account of non-physical personal injuries.28 As some of you know, the Tax Code generally excludes from income all damages (except punitive damages) flowing from a physical personal injury,29 but taxes as income all damages flowing from a non-physical personal injury.30

23 See, e.g., Karen Brown, Not Color- Or Gender-Neutral, supra note __; and Brown & Fellows, Taxing America, supra note __.

24 See, e.g., Mary Louise Fellows, Rocking the Tax Code: A Case Study of Employment-Related Child-Care Expenditures, 10 Yale J.L. & Feminism 307 (1998), and Brown & Fellows, Taxing America, supra note __.

25 It seems clear that “gender-neutral” tax-cuts under the Bush Administration work to the disadvantage of the poorest Americans, a group made up disproportionately of women, children and minorities. There have been hundreds of editorials on this subject in the last four years; as just one example, see Paul Krugman, Bush’s Class-War Budget, N.Y. Times, Feb. 11, 2005.


28 When I say non-physical personal injury claims, I mean traditional tort suits (including common law and statutory claims), as well as civil rights, sexual harassment and other discrimination claims.

29 This includes damages for economic damages for lost income, as well as non-physical personal injuries damages flowing from the physical injury, but it does not include punitive damage awards. Regardless of
I am going to start today with some discussion about the historical and philosophical origins of two assumptions underpinning the tort system and our conceptions of non-economic harm, namely: that it makes sense to talk about physical and non-physical personal injury as distinct categories; and that physical injury is somehow more important, more legitimate, and more real than non-physical personal injury. That discussion leads me, like others, to question the legal distinction between physical and non-physical harm, at least for the purposes of tax policy.

I will move from that discussion to a summary of the tax treatment of personal injury damages in the United States. Thinking about tax in the context of non-economic, non-physical harm is important: tax law, like tort law, signals “what our society values and deems worth protecting.”\textsuperscript{31} I will conclude with a brief discussion of the new \textit{Civil Rights Tax Relief Act of} the underlying injury, punitive damages are included in gross income (26 U.S.C. § 104(a)(2)), and when I refer to personal injury damages throughout this article, I do not mean punitive damages unless stated otherwise.

\textsuperscript{30} This includes physical symptoms of the non-physical injury, as well as any economic damages including lost income. In other words, provided the primary or initial injury is non-physical, everything that flows from it is taxable to the claimant. See my discussion infra, Part VI.

\textsuperscript{31} Finley, \textit{Hidden Victims}, supra note __. at 1279. Professor Finley uses this phrase in the context of non-economic loss damages:

Noneconomic loss damages, no less than economic loss damages, are the tort system’s way of signaling what our society values and deems worth protecting. A society that regards only the wage earning and medical bill paying aspects of life worth defending would be a diminished and impoverished society.

\textit{Id.}
2004—signed into law by President Bush as part of the American Jobs Creation Act last October—and why it does not go nearly far enough to address the problems created by the tax treatment of non-physical personal injury damage awards.

II. THE (DIS)EMBODIED MIND: I THINK, THEREFORE I AM; I FEEL, THEREFORE I AM TAXED

It seems that as a species we have been obsessed with the relationship between our minds and our bodies from time infinitum. I oversimplify, but theories accounting for this relationship divide into roughly three categories. Either body and mind are two parts or dual aspects of a single, larger, fundamental whole (monism); body and mind are merely two among many different and overlapping sorts of things or categories of things making up many different “wholes” (pluralism); or body and mind are two fundamental, distinctly different entities that make up the single domain “human being” (dualism). It is the mind-body dualism that gives us so much trouble with respect to the taxation of personal injury damages.

While the mind-body dualism can trace its origins in Western thought as far back as the Greeks, it is Rene Dés-cartes, a seventeenth century French rationalist, with whom we credit the

32 Add cite


34 Décartes was a French mathematician, philosopher, and physiologist, born in 1596. For a succinct summary of his life, see Wozniak, supra note __; available on-line at http://sserendip.brynmawr.edu/Mind/ (last visited Feb. 10, 2005). If you are interested in reading Décartes, a terrific place to start is Dés-cartes, Philosophical Writings (Elizabeth Anscombe and Peter Thomas Geach, trans. & eds.) (1954).
“systematic account of the mind/body relationship.” Déscartes’ radical dualism(s) ‘entrenched the oppositions between reason and passion, freedom and bondage, and the mind and the body.’

He is perhaps most famously known for the expression, “I think, therefore I am.”

In thinking about or responding to the assertion of a mind-body dualism, philosophers have developed theories like interactionism, double aspect theory, psychophysical

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35 See Wozniak, id.
36 See Gatens, supra note __, at 22.
37 Cogito ergo sum; cited in Johnston, supra note __.
38 Interactionism suggests that the mind is distinct from the body, and that the two causally interact.

parallelism, materialism, immaterialism, and epiphenomenalism. These are big words, I


One must either acknowledge that it is beyond one’s powers to understand how body and mind are united, how they interact, or, if one claims to have any understanding, attribute it, not to philosophical insight, but having learnt the lessons of ‘ordinary life and conversation’. This is the Cartesian Impasse…

As a direct challenge to interactionism, double-aspect theory suggests that the mind and body are not distinct substances, but instead two aspects of a single whole. Most famously, Benedictus de Spinoza believed that human beings are conceived “as part of a unitary, dynamic and interconnected whole.” Moira Gatens, Modern Rationalism, in Alison M. Jagger & Iris Marion Young (eds), A Companion to Feminist Philosophy 21, 26 (2000). Unlike Déscartes, “Spinoza conceive[d] of the human body as a relatively complex individual, which is open to, and in constant interchange with, its environment.” Id., at 27. From this perspective, one cannot talk about a sexless soul attached to a sexed body. Id. See also Moira Gatens, Towards a feminist philosophy of the body, in B. Caine, E. Grosz, and M. de Lepervanche (eds), Crossing Boundaries: Feminists and the Critique of Knowledges (1988);

Genevieve Lloyd, Women as other: sex, gender and subjectivity, in Australian Feminist Studies 10 (1989); and Wozniak, supra note __.

Parallelists believe that our minds and bodies are so dissimilar that it makes no sense to talk about them as “interacting” or causally related. Instead, the most that can be said is that events between our minds and our bodies are correlated. “That they should behave as if they were interacting would seem to be a bizarre coincidence.” Howard, supra note __, at Part 3.3. Gottfried Wilhelm Liebnitz adapted this theory to argue that the harmonious correlation can be explained by the fact that our minds and our bodies exist in a harmony “that has been pre-established by God from the moment of creation.” Wozniak, supra note __.
__, at Part 2. Professor Gatens sees Liebnitz’s theory as one that holds promise for “imaginative future feminist explorations of alternative, non-dualistic ontologies.” Gatens, supra note __, at 29. In Liebnitz’s world, “progress and change result from the forces inherent to nature rather than from the domination and exploitation of nature by culture.” Id.

41 Wozniak describes materialism as follows:

Materialism, which dates back to antiquity, holds that matter is fundamental. Whatever else may exist, if it exists, it depends on matter. In its most extreme version, materialism completely denies the existence of mental events… In a less extreme form, materialism makes mental events causally dependent on bodily events, but does not deny their existence. This was the view offered a century after Descartes by Julien Offray de la Mettrie (1709-1751).


42 Immaterialism denies any distinction between the body and the mind. What we think of as the body is “merely the perception of the mind.” Wozniak, supra note __, at Part 3. Like other theories addressing themselves to these issues, immaterialist denials of a distinction between mind and body take many forms, but they are perhaps best represented by the work of George Berkeley (1685-1753) in his A Treatise Concerning The Principles of Human Knowledge, cited in Wozniak, id., and described more fully in Lisa Downing, George Berkeley, in Edward N. Zalta (ed.), The Stanford Encyclopedia of Philosophy (Winter 2004 Edition), available at: http://plato.stanford.edu/archives/win2004/entries/berkeley/ (last visited Jan. 29, 2005).

43 The first modern articulation of epiphenomenalism is attributed to Shadworth Holloway Hodgson, The Theory of Practice (1870), cited in Wozniak, supra note __, at Part 4. Epiphenomenalism is the view that
know; but we don’t have to be philosophers to be familiar with the ways in which this issue presents itself in our daily lives. For example, you have probably asked or been asked or heard someone ask questions such as: Does your soul leave your body when you die? Do we have an “essence” that is somehow severable from our “physical” selves? Can we die from a broken heart? Is it a “sin” to think “bad” thoughts, if one doesn’t act on them? As lawyers, you or

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Comparing mental states to the colors laid on the surface of a stone mosaic and neural events to the supporting stones, Hodgson asserted that just as the stones are held in place by one another and not by the colors they support, events in the nervous system form an autonomous chain independent of accompanying mental states. Mental states are present only as ‘epiphenomena,’ incapable of reflecting back to affect the nervous system.


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44 Apparently, we can. See Rob Stein, Study Suggests You Can Die of a Broken Heart, Wash. Post, Feb. 10, 2005, p.A03; Denise Grady, Sudden Emotional Stress Can Effect Heart, Researchers Say, N.Y. Times, Feb. 8, 2005. Interestingly, nearly all the victims were female. Id.
one of your colleagues is likely to have dealt with a living will, which often leaves directions about whether someone wants to “live” if she is “brain-dead.” Indeed, the Florida Supreme Court had to consider the relationship between mind and body in its recent decision about whether a Florida statute, giving the Governor authority to issue a one-time stay preventing doctors from “pulling the plug” on a woman in a “persistent vegetative state,” was unconstitutional.⁴⁶ As athletes or coaches or teachers or parents, you are likely to have had discussions about will-power: the mental or emotional force that apparently allows us to “overcome” our bodies if we just set our “minds” to it. Almost no area of our lives remains immune from questions about the supposed oppositional relationship between our minds and our bodies. This is true for law as well.⁴⁷

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⁴⁵ Some Christians, for example, believe that lesbians and gay men cannot help their thoughts and feelings, and should not be judged for having them; these same lesbians and gay men “sin,” however, if they commit a “homosexual act.”


⁴⁷ Most criminal law convictions, for example, require both a particular mental state (mens rea) and an overt act (actus reus). That is a policy choice, and says something about us as a society. It also means that
There are three points I want to make about the mind-body dualism for the purposes of my presentation today. First, Déscartes believed that in order to attain knowledge or reason, one had to detach one’s essential self—or mind—from one’s passionate and irrational self—or body. In Déscartes’ view, passion was quite literally “disqualified” from “supplying any constructive content to human knowledge.” This rational mind/irrational body dichotomy will sound familiar to some of you: it has had a tremendous influence on our understanding of gender stereotypes.

Whereas [before Déscartes], women were conceived on a continuum of rationality—as less rational then men—[after Déscartes] they [came] to be conceived as having souls or minds identical to men. Sexual difference [was] thus located in bodily difference. However, maleness does not carry the same metaphorical or symbolic associations with body, nature, and passion. Historically, embodiment has been conceived as especially associated with women. Reason, understood as involving a transcendence of the bodily, is thus conceptually at odds with what women have come to symbolize… Reason [] [has come] to represent the transcendence of the feminized corporeality.

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criminal courts regularly engage in deciding what is mental and what is physical. Family law courts have historically punished physical abuse to a greater degree than mental abuse. First Amendment jurisprudence regularly engages in deciding whether and in what circumstances actions are speech. Tort remedies often require determinations of fact about whether injuries are physical or non-physical.

48 Gatens, supra note __, at 22.

49 Id., at 23, summarizing the work of Genevieve Lloyd, The Man of Reason: “Male” and “Female” in Western Philosophy (1984) and Genevieve Lloyd, Maleness, metaphor and the crisis of reason, in L.
So, while it may seem that Descartes’ valuing of the mind over the body might have led to a greater valuing of mental and emotional injuries over “merely” physical injuries, instead it led to a highly gendered valuing of reason (men) over emotion (women). Men became associated with the rational mind, women with the irrational body. Over time, that oppositional association came to simply be: men are rational; women are irrational; men are reasonable; women are emotional. Therefore, men’s injuries are reasonable and compensable; women’s injuries are unreasonable, if not imaginary.50

Second, although DÉscartes’ understanding of reason, and the capacity for reason, rested on an apparently gender-, race-, and class-neutral understanding of the “mind,” in fact very few men and even fewer women would have had the opportunity to learn or practice the method presented by DÉscartes as “necessary to the cultivation of truth and virtue.”51 In other words, accessing the ability to be reasonable and virtuous was limited to a small class of privileged men. This privileging of some men as potentially “reasonable” is not to be underestimated. When we talk in just a minute about the taxation of personal injury damages, you will see traces of this in


50 For a wonderful account of how men’s injuries are more highly valued and compensated, at least in the Australian context, see Reg Graycar, Sex, golf and stereotypes: Measuring, valuing and imagining the body in court, 10 Torts L. J. 1 (2002).

the valuing of injuries associated with some men over the injuries associated with women and male minorities (that is, everyone else).\textsuperscript{52}

Finally, I told you all that so I could tell you this: it doesn’t matter, or it shouldn’t matter. I do believe that in challenging social or legal norms, it is important to understand as much as possible where they came from. We have learned to think about rationality, reason, neutrality and injury in gender- and race- and class-specific ways. D\textsuperscript{\i}\textsc{\i}cartes and other rationalists contributed to this; and thinking about how we learned about the things we “know,” is critical to thinking about how we might unlearn them. Many of the arguments in favor of the status quo rely, in some measure, on the coherence of the mind-body dualism.

But having said all that, I think the actual substance of these philosophical theories is completely beside the point in tort law and in tax law. We cannot win the philosophical debate because there is no one demonstrably correct answer, and we cannot live with the current dualist default that is daily deployed on behalf of the powerful few. As with physics, where it is now commonly accepted that light behaves like a wave when it’s measured as a wave and like a particle when it’s measured as a particle,\textsuperscript{53} we “know” that the materialists and immaterialists, phenomenalists and epiphenomenalists, monists and and dualists and pluralists, are all right or sometimes right or arguably right (or impossible to prove wrong) depending on how we measure their theses. But the law need not and should not weigh in on the debate. The harm of non-physical personal injury does not pose an abstract or nuanced question about the make-up of the

\textsuperscript{52} In the tort context, this valuing is documented by Chamallas, Finley, Graycar, and others. See generally the articles listed, supra notes 6-10, and 50.

\textsuperscript{53} This is true even though light cannot “be” both a wave and a particle.
universe;54 it is neither subtle nor mysterious. It is real, and decisions about whether to recognize
and value it are not a matter of philosophy, but policy.

Mindful of the underlying philosophical conversation and the manner in which it
intersects with and furthers misogyny and racism, it is far more important that we go back to first
legal principles and think through our approaches to tort and tax in the context of compensating
victims. What are our goals, and how can we best achieve them? “[T]oward what end is this
activity directed?”55

III. THE TAX TREATMENT OF PERSONAL INJURIES: PUTTING THE VERTICAL
AND HORIZONTAL BACK IN EQUITY

The activity to which I refer, of course, is the tax system. I’m going to start this part of
my talk with a short, sort-of “Tax 101” lesson. I apologize if it’s too basic for those of you
familiar with these aspects of federal income tax law, but I’m told that the remainder of my talk
makes no sense without it.

1. In the United States, income tax is theoretically concerned with two sorts of equities:
   vertical and horizontal.

2. Vertical equity concerns itself with the “vertical” allocation of tax burdens among
taxpayers, imposing higher taxes on those with the ability to pay more (a sort of

54 Professor MacKinnon makes a similar point about feminist legal theory being grounded in the gendered
and real) harms experienced by women more generally. Catharine MacKinnon, Points Against

(1936–37).
substantive or redistributive equality). The theory is “based on the premise that a person’s greater ability to pay makes it ‘fair’ to require that person to bear a larger portion of the country’s overall revenue needs.” This is commonly known as progressive taxation.

3. Horizontal equity seeks to tax similarly-situated taxpayers, similarly (a sort of formal equality). Theoretically, “all persons who earn essentially the same amount of income in a given year should be obligated to pay the same amount in taxes.”

4. Tax analysts and scholars use horizontal and vertical equity to measure the fairness, effectiveness and desirability of tax measures, including the Federal income tax.

5. Federal income tax is imposed annually on a net figure known as “taxable income.”

6. “Taxable income” is “gross income,” less certain authorized deductions.

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58 Id., citing Charles H. Gustafson et al., Taxation of International Transactions 23 (2d ed. 2001).


60 Id.
7. “Gross income” is defined as all income from whatever source derived.61

8. The Supreme Court has told us that “all income” means all income—that is, any increase or accession in wealth, clearly realized, and over which a taxpayer has control.62 It is much broader, for example, than our every-day understanding of income as “wages” or “profits.”

9. Damages paid on account of personal injury fall within the breadth of “all income from whatever source derived” unless specifically exempt.

10. Section 104(a)(2) of the Code provides that “gross income does not include ... the amount of damages (other than punitive damages)63 received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness”64 arising out of a tort or tort-like claim.65

11. In other words, once those two criteria are satisfied—there is a physical injury or sickness and the claim is tort or tort-like—all compensatory damages flowing from that

63 As mentioned above, supra note __, punitive damages are taxed as income regardless of the category of underlying personal injury.
64 26 U.S.C. § 104(a)(2) (emphasis added).
injury are excluded from gross income,\textsuperscript{66} or tax-free to the plaintiff, whether they are on account of economic or non-economic loss, physical or non-physical loss.\textsuperscript{67}

12. On the other hand, if the personal injury is non-physical (such as emotional distress,\textsuperscript{68} mental anguish, loss of reputation, et cetera), all damages flowing from that injury, whether they are on account of economic or non-economic loss, physical or non-physical harm, are taxed as income to the plaintiff.\textsuperscript{69} This is true even if a plaintiff develops physical symptoms as a result of a non-physical injury.\textsuperscript{70}

I’m going to illustrate these points by reference to specific examples, but first I want to provide you with some statutory history.

\textsuperscript{66} Except punitive damages, of course. Supra note __.

\textsuperscript{67} See Conference Report of H.R. 3448, Small Business Job Protection Act of 1996 (House of Representatives—August 1, 1996), at 56: “Because all damages received on account of physical injury or physical illness are excluded from gross income, the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness.”

\textsuperscript{68} But see 26 U.S.C. § 104(a): “damages not in excess of the amount paid for medical care… attributable to emotional distress” are not included in gross income. In other words, if a plaintiff incurs actual out-of-pocket medical expenses as a result of an emotional distress injury, any damages awarded up to that amount are not included in the calculation of gross income.

\textsuperscript{69} 26 U.S.C. § 104(a).

\textsuperscript{70} See Conference Report of H.R. 3448, supra note __, at 56: “It is intended that the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress.”
Section 104(a)(2) was first enacted in 1918.\textsuperscript{71} From 1918 until 1996, it simply excluded from gross income “damages on account of personal injury.”\textsuperscript{72} The insertion of the word “physical,” as limiting the kinds of personal injuries protected by the section, happened as part of the Small Business Job Protection Act of 1996.\textsuperscript{73} A careful reading of congressional reports and hearings in the years leading up to the amendment offers little in the way of explanation for that amendment. The Conference Report from the House of Representatives contained this reference:

 Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to physical injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits.\textsuperscript{74}

I could find no other Congressional reference attempting to explain the amendment.\textsuperscript{75} But here’s what I think we can surmise from that quote:

\textsuperscript{71} Add cite
\textsuperscript{72} See 26 U.S.C.A. § 104, Historical and Statutory Notes.
\textsuperscript{74} Conference Report, supra note __, at 54.
\textsuperscript{75} Karen Brown has written that despite the existence of some evidence that Congress viewed the amendment as a way to simplify the taxation of employment discrimination damages, simplication alone does not explain the amendment. Brown, Not Color- Or Gender-Neutral, supra note __, at 258-59.
(a) Congress was apparently surprised that the words “personal injury” might include non-physical personal injury (even though it had been interpreted to include non-physical personal injury since at least 1927);  

(b) Congress allegedly believed that non-physical personal injuries were more, not less, likely to include economic damages, and in particular lost wages or profits (of course, if Congress were really concerned about this, it would have made more sense to leave personal injury as it was, and add a provision providing for the taxation of that portion of damage awards representing back-pay, front-pay, or other lost income); 

(c) Congress was well aware of the fact that inserting the word “physical” before “personal injury” would mean that discrimination damages would be taxed; but  

(d) Congress did not explicitly consider the effect of the change on other non-physical personal injury torts (or if they did, they did it behind closed doors). 

You may remember that it was not until 1991 that the Civil Rights Act was amended to give claimants (1) the right to a jury trial and (2) expanded remedies, including compensatory

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76 Hawkins v. Commissioner of Internal Revenue, 1927 W.L. 1082, 6 B.T.A. 1023 (U.S. Bd. Tax App.) (personal injury included non-physical personal injury); Chapman, supra note __, at 411.

damages\textsuperscript{78} (such as pain and suffering, humiliation, embarrassment and emotional distress), for sex and age discrimination. Almost immediately upon the extension of remedies in Civil Rights and non-physical harm cases, the Republican Congress first attempted (and twice failed) to amend Section 104(a)(2) to limit the exclusion from gross income to physical injury damages. I am suspicious of this coincidence. Congress was eventually successful in 1996 by burying it in an Act increasing the minimum wage (among other things), thus making it very difficult for President Clinton to veto.\textsuperscript{79} Given this country’s long history with discrimination, it doesn’t seem a stretch to suggest that the amendment was made\textsuperscript{80} precisely to limit the benefit and effectiveness of the newly extended Civil Rights remedies.

\textsuperscript{78} Id.; see also John M. Husband & Jude Biggs, The Civil Rights Act of 1991: Expanding Remedies in Employment Discrimination Cases, 21 Colo. Law. 881 (1992). Key changes included:

(a) compensatory and punitive damages—previously available only to racial and ethnic minorities—for victims of intentional discrimination based on sex, religion or disability;

(b) provision for jury trials where a plaintiff claims compensatory or punitive damages;

(c) changes in the burden of proof required in disparate impact cases; and

(d) an expansion of 42 U.S.C. §1981 to include claims of racial discrimination in the form of on-the-job harassment and discharge.

\textsuperscript{79} Small Business Job Protection Act § 1605(a)-(c).

\textsuperscript{80} That is not to say that everyone in Congress is or was motivated by animus with respect to civil rights claims. Clearly, different Congresspeople were motivated for different reasons in voting for or against the Small Business Protection Act of 1996. I am suggesting, however, that the architects of the Section 104(a)(2) amendment were motivated by a desire to protect business from employee and other claims;
Section 104(a)(2) is easier to understand in the context of specific examples, so let’s move to that.

(a) Suppose A was physically injured in an automobile accident as a result of the negligence of another motorist. His physical injuries were not serious—he sprained his wrist and broke one finger—and he fully recovered. Let’s say his pain and suffering for those injuries were worth $5,000. But his mental anguish was relatively severe, worth perhaps $100,000. He is a concert pianist and while his finger was healing, he was very anxious about his career; even though it all turned out fine, newspapers had been printing stories suggesting he would never be as good again, and his long-time lover left him. His lost wages were $500,000 (he was a well-paid pianist).

By operation of Section 104(a)(2), his entire award of $605,000 (including lost wages) would have been excluded from gross income (or tax free), because he was physically injured in the accident. Let’s assume that in the year of his award, he earned $50,000 as a store manager at the Gap (his finger was not well enough to play the piano yet), so that his total “accession to wealth, clearly realized, and over which he [arguably] had control”\(^8\) for that year was $655,000. Because of Section 104(a)(2), however, his “gross income” was $50,000. He probably paid between $10,000 and $13,000 in federal income tax and that they knew full well that the effect of this amendment would be to tax and thereby discourage non-physical personal injury claims.

\(^{8}\) See supra note __, and accompanying text.
(depending of course on his deductions), leaving him with at least $642,000 (before paying any state income tax).

Assuming A owed his lawyers a contingency fee of approximately $200,000 (ie, one third), he would have been left with approximately $440,000.

(b) Suppose B, on the other hand, was sexually harassed by a man from her apartment building over the course of eight months; he verbally harassed her, left her degrading notes, followed her, and hung sexually explicit pictures on her front door. She was frightened, humiliated, and found herself unable to work. As a result, she developed physical symptoms, including headaches, stomachaches, insomnia, a bleeding ulcer, and other signs of anxiety, including weight loss. She spent some time in the hospital, and she felt unable as a result to continue with her job. Let’s assume she stated a claim in tort and the jury awarded her $605,000 in personal injury damages ($100,000 for the non-

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83 Section 104(a) tells us that for the purposes of 104(a)(2), “emotional distress shall not be treated as a physical injury or physical illness.” 26 U.S.C. § 104(a).

84 Note that she is entitled to deduct from gross income the “amount of damages not in excess of the amount paid for medical care… attributable to emotional distress.” 26 U.S.C. § 104(a).
physical injury, $405,000 for the pain and suffering associated with her physical symptoms,85 and $100,000 for lost income).

Like A, she earned $50,000 in the year of her award, bringing her total “income” for that year to $655,000. Unlike A, her gross income was exactly that: $655,000. She probably paid at least $230,000 in combined federal and state income taxes (or approximately 35%).

This brings her total down to $425,000, before paying her attorneys and any state income taxes. Let’s assume that like A, she owed her lawyers $200,000 on a contingency fee basis (I’m going to come back to the issue of taxation and contingency fee awards in a moment), so that in this scenario B would have been left with $225,000 (compared to A’s $440,000).

Let’s add another fact: B lives in Colorado, where non-economic damages are capped at $250,000 (except in unusual circumstances).86 So, let’s assume the

85 I am somewhat artificially dividing the pain and suffering damages for the purposes of our discussion. In actuality, juries don’t usually categorize damages this way, unless they are asked to by statutes imposing damages caps.

86 I am talking in my example about a tort or tort-like claim. In Colorado, for example, C.R.S.A. §13-21-102.5(3)(a) provides:

In any civil action other than medical malpractice actions in which damages for noneconomic loss or injury may be awarded, the total of such damages shall not exceed the sum of two hundred fifty thousand dollars, unless the court finds justification by clear and convincing evidence therefore. In no case shall the amount of noneconomic loss or
judge entered a judgment notwithstanding the verdict of $350,000 ($250,000 pain and suffering, $100,000 lost income). All other things being equal, B would still be in the highest tax bracket; assuming she earned $50,000 in the year of the award, she would pay combined federal and state income tax of approximately $140,000. Assuming she owed her lawyer a one third contingency fee of approximately $115,000, she would be left with $135,000—less than one third of A’s net gain in roughly similar circumstances. In our example, a non-economic damages cap of $250,000 would make no difference to A.

Note also that in the damages cap scenario, B’s lawyer received $115,000, while A’s lawyer received $200,000.

injury damages exceed five hundred thousand dollars. The damages for noneconomic loss or injury in a medical malpractice action shall not exceed the limitations on noneconomic loss or injury specified in section 13-64-302.

But for intentional employment discrimination under 42 U.S.C. §2000e-5, the damages cap for future economic loss, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses, and punitive damages is $50,000 in the case of a respondent with more than 14, but fewer than 101 employees. That number goes up to $100,000 in the case of a respondent with more than 100, but fewer than 201 employees; $200,000 in the case of a respondent with more than 200, but fewer than 501 employees; and $300,000 in the case of a respondent with more than 500 employees. 42 U.S.C. §1981b-3.

In fact, in many cases, the AMT has meant that B’s tax liability may well exceed her portion of the award after attorney’s fees. See Polsky, supra note __, at __.
Okay, what will hopefully be obvious from this very brief (but highly illuminative!) tax lesson is this: Section 104(a)(2) raises both vertical and horizontal equity questions. With respect to horizontal equity—that is, the notion that similarly-situated taxpayers be taxed similarly—clearly Section 104(a)(2) taxes personal injury claimants differently, not based on the amount of damages (that is, accession to wealth); not based on the types of all damages awarded\textsuperscript{88} (that is, economic or non-economic, physical or non-physical); not based on whether the accession to wealth is “clearly realized” (as it obviously is in both A’s and B’s cases); but based on the nature or category of the underlying injury—the first domino, so to speak. This just makes no sense—not even on Déscartes’ view of the world (although that doesn’t let him off the hook!).

In addition to the differential tax treatment of personal injury damages, there is another horizontal equity question on the facts of our example. You will remember that A and B each earned $50,000 from employment income in the year of their respective awards. Because A’s gross income was just that—$50,000—A would have been in a different tax bracket than B, whose gross income included her award. This means that not only would she be taxed on her personal injury damages, but that her $50,000 employment income would be taxed at a higher marginal rate than A’s $50,000 employment income (ie, even though they earned the exact same amount at work).

The vertical equity implications are slightly more complex, and we don’t have time today to fully explore them, but suffice it to say that if: (1) it’s true that women, children and minorities are more likely to suffer torts for which non-economic, non-physical personal injury loss

\textsuperscript{88} Provided, of course, that the underlying injury is physical.
damages are awarded;\textsuperscript{89} (2) non-economic, non-physical personal injury loss awards tend to be more difficult to prove and less well compensated;\textsuperscript{90} and (3) these same types of damages are increasingly capped and/or unavailable;\textsuperscript{91} then (4) an argument could be made that by taxing these damages (and not taxing physical personal injury awards), Section 104(a)(2) is not only \textit{not progressive}, it is \textit{regressive}—and it is gendered and racialized. The people who are least able to pay are arguably required to pay more. This has both tangible (that is, economic) and intangible consequences. They pay more in tax; they are \textit{discouraged} by the Tax Code from bringing civil rights and other non-physical personal injury claims.\textsuperscript{92} And the message they receive is that their injuries—if not, themselves—are less important, less real, and less valuable.\textsuperscript{93}

Finally, these adverse effects are compounded by the fact that where there is a significant damages cap, plaintiffs have more difficulty finding counsel.\textsuperscript{94} Certainly, as between A’s case and B’s case, many counsel would be more likely to take A’s case: similar amount of work,

\begin{thebibliography}{99}

\bibitem{89} Finley, Hidden Victims, \textit{supra} note \_, at \_.

\bibitem{90} \textit{Id.}

\bibitem{91} \textit{Id.}

\bibitem{92} For constitutional purposes, it should be irrelevant whether or not Congress intended this result, although I think a case for intent could be made.

\bibitem{93} Nantell, \textit{supra} note \_.

\bibitem{94} See UB News Service, Caps on Non-Economic Loss, \textit{supra} note \_, citing Finley’s research for the proposition that “[c]aps on non-economic damages … make it more difficult for victims to find legal representation.” Apparently, lawyers “are less willing to bring suits acknowledged to be meritorious unless they cross a certain threshold of economic damages,… no matter how devastating the injury or how compelling the proof of negligence or medical error.” \textit{Id.}
\end{thebibliography}
almost twice the fee. And plaintiffs’ lawyers unfamiliar with the tax implications of Section 104(a)(2) and the new Civil Rights Tax Relief Act of 2004 (which we’re about to discuss) might be even more reluctant to take a non-physical loss case.95

IV. CIVIL RIGHTS TAX RELIEF ACT: NOT REALLY

It was not long after Section 104(a)(2) was amended in 1996 to limit the exclusion to “physical personal injury and sickness” that a veritable panoply of unjust results began to make themselves known. In addition to the examples just discussed, other problems included:

1. The simultaneous operation of amended Section 104(a)(2) and the Alternative Minimum Tax (AMT) provisions of the Tax Code often required successful non-physical personal injury plaintiffs to pay income tax on the attorneys’ fee portion of awards, even if the award had been paid directly to their lawyers—that is, on money plaintiffs never possessed96 and on which their lawyers would also pay income tax.

Explaining the Alternative Minimum Tax provisions for calculating taxable income is

95 At least one commentator has argued that the taxation of contingency attorney’s fees in the hands of the plaintiff raises very “significant ethical, fiduciary duty, and malpractice issues for lawyers handling these sorts of claims.” Polsky, The Contingent Attorney’s Fee Tax Trap, supra note __. Trial lawyers, he argues, have an ethical duty to advise their clients about the tax consequences in employment and civil rights law suits. Id.

96 Thinking back to the Supreme Court’s test for “income”—any accession in wealth, clearly realized, over which a taxpayer has control—it seems to me that this arguably offends the requirement that it be within the taxpayer’s “control”. Supra note __.
beyond the scope of this presentation, so you will just have to trust me on this. But thinking back to our earlier example, you will remember that A paid no tax on any portion of his award, attorneys’ fees included. B, on the other hand, paid tax on her entire award, attorneys’ fees included. So, if B’s $605,000 award was deposited into her attorneys’ trust account, from which the attorneys deducted a $200,000 contingency fee and then wrote a check to B (her client) for $405,000, B would have still had to include the entire $605,000 in her gross income for federal income tax purposes. In laypeople’s terms, we say that she paid her lawyers with “after-tax” dollars. Her lawyers would then have to include that $200,000 (less allowable deductions, et cetera) in their taxable income.

2. The simultaneous operation of amended Section 104(a)(2), the AMT, and the types of relief commonly awarded in civil rights cases (such as injunctions or nominal damages for pain and suffering) resulted in cases where the amounts owed by successful plaintiffs to their lawyers and the U.S. Treasury together exceeded the amount of the actual award. Suppose C is awarded nominal damages for race discrimination, let’s say $10,000. It is complicated litigation (but worth it to C, 


because he also got his job back), and his attorney’s fees are $100,000. He is awarded his attorney’s fees, bringing his total award to $110,000. In the year of the award, C earns $25,000 from employment income, bringing his total gross income for that year to $135,000. Whereas C would normally be in one of the lowest tax brackets with an annual income of $25,000, $135,000 puts him in a much higher bracket. He might pay as much as 35% combined federal and state income tax, or $47,250. That would bring C’s debt for attorney’s fees and taxes to $147,250 (on income of $135,000).

3. Because damages have to be included in gross income in the year of receipt (this is still true), lump sum lost-income damage awards put plaintiffs in higher tax brackets than they would otherwise be. In the case of physical personal injury awards, the lost income portion of the damages is tax-free, so it doesn’t matter to the plaintiff that an award for lost income is made as a lump sum. In the case of non-physical personal injury awards—which are taxable—a lump sum lost-income award would put a plaintiff in a much higher tax bracket than she would otherwise be in the year of the award, meaning that she is taxed at a higher rate on lost income than she would have been taxed on that income, had she received that money over several years in the usual course. Not only that, of course, but as I just mentioned, it affects the tax rate payable on income from other sources as well.99

4. Finally, the well-documented hierarchies of tort law were not only reinforced, but perpetuated. That is, it became clear that Section 104(a)(2) not only reflected entrenched bias, but created it anew.

99 Some courts have awarded gross-ups in order to remove or address these bunching problems. See Polsky & Befort, supra note __, at __.
In 2001, when I first became interested in the intersection of tax policy and tort damages, two proposed amendments to Section 104(a)(2) had been referred to House and Senate Committees for consideration. One amendment would have simply deleted the word “physical” from amended Section 104(a)(2) and redefined “personal injuries” to include “emotional distress,” putting all personal injury plaintiffs in the same position regardless of whether their injuries were physical or non-physical.100

The other proposed amendment, called the Civil Rights Tax Relief Act of 2001,101 would have excluded from gross income (a) the non-economic loss portion of unlawful discrimination awards and (b) the attorneys’ fee portion of the award. In addition, (c) it would have allowed plaintiffs to average awards for front-pay and back-pay over the number of years for which they were being compensated,102 thus addressing at least some of the concerns just mentioned. Even so, I was preparing to write an article describing why that Civil Rights Tax Relief Act was inadequate. Only unlawful discrimination claims were included (all other non-physical, personal injury awards would still be taxed in their entirety, and it therefore left vertical equity problems unanswered); even unlawful discrimination awards would still be treated differently than physical personal injury loss awards (leaving several horizontal equity issues); and the mind-

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100 H.R. 878, 107th Congress, An Act To Amend the Internal Revenue Code of 1986 to restore the exclusion from gross income for damage awards for emotional distress.


102 Id.
body/reason-passion dualities were left firmly in place, reinforcing the devaluation of non-
physical personal injuries (and the people who suffer them).

In the middle of my writing that article, however, Congress enacted a much reduced version—the Civil Rights Tax Relief Act of 2004—dealing only with the taxation of attorneys’ fees for unlawful discrimination claims. Other than excluding the attorneys’ fee portion of unlawful discrimination awards from gross income, the remainder of Section 104(a)(2) remains intact. Although the Act bears the same name as earlier proposals, it is obviously nowhere near as extensive and should not be confused with earlier versions.

We don’t have time today to discuss all of the problems with the new Act, but suffice it to say that its primary failings include the fact that (1) it retains the distinction between physical and non-physical personal injuries for the purposes of differential tax treatment (that is, the use of a tort standard to determine the tax treatment of recovery); (2) it penalizes unlawful discrimination and other non-physical tort plaintiffs by failing to address all but one of the concerns discussed above; and (3) it leaves the group most empowered to push for change—lawyers—with the impression that no further changes are necessary.

103 Supra note __.

104 By contrast, “employers are under-taxed” or rewarded. Karen Brown, Not Color- Or Gender-Neutral, supra note __, at 264.

The cost incurred by the employer in discriminating, measure in part by the recoveries of workers who pursue their claims, are deductible. Given the strong anti-discrimination policies expressed in society and the law, a deduction for expenses connected to discriminatory conduct seems a reward. The Code ignores those policies and sanctions a deduction for any
V. CONCLUSION

In the present political climate, I am not surprised at the state of the law. I am not surprised that no adequate amendment has been proposed. I am not surprised that women and minorities bear the costs. Last night, Professor Occhialino asked me what I would like to see happen. The critical aspect of my work is to say: lawyers need to inform themselves about the tax consequences of their choices and their clients’ choices in the context of non-physical personal injury loss. The Civil Rights Tax Relief Act of 2004 does not go nearly far enough to redress the inequities created by Section 104(a)(2). I realize that the “tax implications of non-physical personal injury loss for plaintiffs” is not a sexy topic, like “double taxation” or “tort reform”, but it is critical to consider if we are committed to horizontal and vertical equity—in both tax law and society at large.

What else can we do? Challenge the constitutionality of Section 104(a)(2) as violating equal protection clauses (particularly under State constitutions with strong Equal Rights expense, short of a fine or penalty, related to business activity even if it violates strong public policy. The Code thus provides no incentive to treat all workers fairly. Id., at 264 (footnotes omitted).

Prior to its enactment, Professor Polsky had opined, “[p]erhaps if the trial lawyers began to appreciate their ethical duty to advise their clients fully of the [tax] trap, as well as their potential exposure to liability, these lawyers might be motivated to use their political clout to encourage Congress to fix the AMT trap.” Polsky, supra note __, at 22.

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Amendments, such as New Mexico\textsuperscript{107}); when we lose, challenge it again. Testify before legislatures. Do empirical research and make it widely available. Represent non-physical personal injury plaintiffs on a pro bono basis. Appreciate that the breadth of tort reform includes other areas of law, and be mindful of that when challenging tort reform measures. There are surely other ideas, of course, but my point is: Section 104(a)(2) and the \textit{Civil Rights Tax Relief Act of 2004} leave us in the rationalist mind-body quagmire for no rational or fair purpose.

\footnote{\textsc{N.M. Const.} art. II, §18. State income tax is usually calculated by reference to federal income tax calculations, so Section 104(a)(2) could arguably violate a state constitution, even though it is federal legislation.}