Letters to the Editor

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MORE ON THE TAXATION OF TORT DAMAGES.

To the Editor:

In the March 23, 1992 issue of Tax Notes (p. 1570), Professor William D. Popkin correctly notes the confused state of the law with respect to the scope of the section 104 personal injury exclusion. In commenting upon the Supreme Court's imminent decision in Burke, however, Professor Popkin concludes that "[t]he best solution is to tax the damages.

I believe this is incorrect for several reasons. Admittedly -- as Professor Popkin points out -- there has long been confusion over the physical versus nonphysical injury distinction, and indeed, over the metaphysical "tort-like" rubric. But the conclusion that such damages ought to be taxed (whether by judicial or congressional action) is flawed.

An extensive body of case law and rulings firmly establishes the notion that "tort" recoveries are excludable, whether physical harm results or not. Examples include the torts of negligent or intentional infliction of emotional distress and defamation. Although it may be pertinent in such cases to refer to physical consequences of the tort (i.e., loss of appetite, ulcers, etc.), the tort itself may involve no physical harm. Drawing a distinction between such classic tort cases and statutory causes of action based upon discrimination seems artificial.

What doubtless goads the Service (and some commentators) is that in an employment discrimination case such as Burke, the plaintiff may appear to be better off from a tax perspective when the smoke clears than he or she was prior to suffering the discrimination. Yet, this is true with any personal injury action, too. If one accepts the notion that the economic damages awarded fully compensate the tort (or discrimination) victim for the harm, the nontaxable character of the recovery truly makes the plaintiff better off. The Service has used this argument in the case law, generally without success. Yet its appeal explains why some courts have attempted to bifurcate the recovery in a discrimination suit between actual damages (taxable) and exemplary damages (excludable).

Professor Popkin may well be correct that there needs to be a legislative solution to this issue. I hope he is correct that Congress is more concerned with helping civil rights beneficiaries than with hurting them.

In any case, from a technical viewpoint, I see no principled basis upon which to distinguish statutory discrimination claims from more traditional tort causes of action. At a minimum, attempting to draw such a distinction invites the fabrication of physical or quasi- physical symptoms in response to statutory causes of action. It also invites paired causes of action in which traditional tort damages are claimed in addition to statutory discrimination damages.

It would be surprising to me if the Supreme Court does not uphold the excludability of Title VII recoveries in Burke, thus ending an inconsistency in the courts. That result would also end a deplorable lack of equity between the tax result in earlier racial discrimination cases (also brought under Title VII) and the current spate of gender discrimination cases. If I am right that the Supreme Court will opt for excludability, I am sure we all agree that the Service knows how to approach Congress to change the rule.

Sincerely,

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Editor's Note: Mr. Wood is also the author of Taxation Damage Awards and Settlement Payments (Tax Institute

1991), which was reviewed in the December 2, 1991 edition of Tax Notes, p. 1083. The book is available from Tax Institute, PO Box 192026, San Francisco, CA 94119, or by calling 1-800-852-5515.