

COMMENTS

Does the Tax Code Believe Women?: Reexamining 26 USC § 104(a)(2) in the #MeToo Era

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Since 1918, the tax code has included 26 USC § 104(a)(2), an exclusion from gross income for civil lawsuit damages for “personal injuries or sickness.” In 1996, by adding one word—“physical”—to the provision (twice), Congress narrowed the exclusion’s scope dramatically. Now, damages compensating for a broken arm (a “personal physical injury”) are tax-free, but those arising out of claims for, say, sexual harassment or race discrimination are fully taxable. Such injuries, the statute says, are insufficiently “physical” to merit exclusion from income.

Using the recent #MeToo movement as a jumping-off point and borrowing the language and methodologies of feminist legal theory, this Comment scrutinizes the ways in which § 104(a)(2) systematically disadvantages the people most likely to bring such harassment and discrimination claims—female and minority taxpayers. By analyzing every § 104(a)(2) Tax Court case in the past decade, I first find quantitative support for the proposition that female and minority taxpayers are indeed disproportionately impacted by § 104(a)(2). With this on-the-ground impact in mind, I then critically analyze the doctrines courts use to apply § 104(a)(2), highlighting inconsistencies in the provision’s application that impose an additional layer of costs on these same disadvantaged taxpayers. In an effort to resolve these inconsistencies, I propose two classes of solutions. First, I suggest a number of tactical and interpretive strategies that lawyers and judges can employ to ensure the provision is applied more equitably. And second, I recommend an amendment to § 104(a)(2) that would equalize its disparate impacts and align it more closely with Congress’s stated purposes for enacting it. These solutions would help bring the policy expressed by § 104(a)(2) more closely in line with the priorities of the society that must abide by it.

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INTRODUCTION

*The law that is applied . . . to all women was not written by women, white or Black, rich or poor. It has not been based on women’s experiences of life, everyday or otherwise. No one represented women’s interests as women in creating it, and few have considered women’s interests as women in applying it[,] . . . yet we are presumed to consent to its rule. It was not written for our benefit, and it shows.*¹

¹ Catharine A. MacKinnon, *Women’s Lives, Men’s Laws* 33 (Harvard 2005).

In 2001, six years after becoming a choral music teacher at Malcolm Price Laboratory School in Cedar Falls, Iowa, Linda Sharp received tenure.² In 2003, she was demoted to secretary.³

So began a long pattern of events that “conspired to make [Sharp]’s work life unmanageable.”⁴ After a successful grievance procedure, Sharp was reinstated as a music teacher. But over the next several years, Sharp alleged that her supervisors and colleagues repeatedly harassed her, creating a hostile work environment in a concerted attempt “to force [her] to quit her job.”⁵ Tensions boiled over in April 2007 when Sharp had a mental health breakdown—she “developed muscle tension and migraine headaches, became afraid to go to the university, developed a fear of people, had nightmares and was eventually hospitalized for depression.”⁶ She was “diagnosed with severe clinical depression, anxiety disorder and posttraumatic stress disorder” and advised not to return to work.⁷ Sharp sued the school for workers’ compensation and gross negligence, and the parties settled for \$210,000.⁸

Sharp’s last day at Malcolm Price came more than a decade before October 15, 2017, when the actress Alyssa Milano issued the online call-to-action⁹ that began the #MeToo era.¹⁰ But while Sharp’s story predated the #MeToo movement, her claims were of a piece with the countless tales of workplace harassment brought to light since the movement’s birth. In the year after Milano’s tweet, the hashtag #MeToo was used over nineteen million times on Twitter alone,¹¹ and, by one count, “at least 200 prominent men

² See Ryan Foley, *University of Northern Iowa to Pay \$210k in Settlement with Ex-Professor* (Waterloo–Cedar Falls Courier, Feb 11, 2011), archived at <https://perma.cc/2Z9E-W5QL>.

³ *Sharp v Commissioner of Internal Revenue*, TC Memo 2013-290, *3.

⁴ Id at *2.

⁵ Id at *4.

⁶ Id at *3.

⁷ *Sharp*, TC Memo 2013-290 at *3.

⁸ Id at *3–4.

⁹ See Alyssa Milano (@Alyssa_Milano), (Twitter, Oct 15, 2017), archived at <https://perma.cc/T3YF-8NTR> (“If you’ve been sexually harassed or assaulted write ‘me too’ as a reply to this tweet.”).

¹⁰ See Anna Codrea-Rado, *#MeToo Floods Social Media with Stories of Harassment and Assault* (NY Times, Oct 16, 2017), archived at <https://perma.cc/JD75-CMPX>. Milano’s tweet came just days after the revelation of years of sexual assault and harassment allegations against film producer Harvey Weinstein. See Jodi Kantor and Megan Twohey, *Harvey Weinstein Paid Off Sexual Harassment Accusers for Decades* (NY Times, Oct 5, 2017), archived at <https://perma.cc/J7YL-D3DL>.

¹¹ See Dalvin Brown, *19 Million Tweets Later: A Look at #MeToo a Year After the Hashtag Went Viral* (USA Today, Oct 13, 2018), archived at <https://perma.cc/2Z79-TGDW>.

[] lost their jobs after public allegations of sexual harassment.”¹² The movement “shook, and is still shaking, power structures in society’s most visible sectors.”¹³

Legislators took note, too. In December 2017, just two months after the #MeToo movement exploded, Congress passed the Tax Cuts and Jobs Act¹⁴ (TCJA), an overhaul of the federal tax code that also included a new provision: 26 USC § 162(q), disallowing corporate tax deductions for “any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement.” Aligning with #MeToo’s goal of shining light on workplace sexual harassment, this provision, known popularly as the “Weinstein Tax,”¹⁵ incentivizes employers against requiring nondisclosure agreements in such settlements.¹⁶

But while § 162(q) indicates Congress was likely cognizant of the #MeToo movement when it enacted the TCJA, at least one other part of the tax code remains ripe for reexamination in light of the lessons of #MeToo. This provision, untouched by the TCJA, is 26 USC § 104(a)(2), which excludes from gross income civil damages paid to compensate for “personal physical injuries or physical sickness.” Critically, this focus on “physical” injuries means that damages for claims of emotional distress, sex discrimination, and workplace harassment—without an accompanying physical injury—are usually not excludable.

In *Sharp v Commissioner of Internal Revenue*,¹⁷ the Tax Court held all \$210,000 of Linda Sharp’s settlement taxable: her injuries, which the court determined consisted only of “emotional

¹² Audrey Carlsen, et al, *#MeToo Brought Down 201 Powerful Men. Nearly Half of Their Replacements Are Women*. (NY Times, Oct 29, 2018), archived at <https://perma.cc/Z78J-HC8A>.

¹³ *Id.*

¹⁴ Pub L No 115-97, 131 Stat 2054 (2017).

¹⁵ See Robert W. Wood, *Ironically, Weinstein Tax on Sexual Harassment Settlements May Hurt Plaintiffs Too* (Forbes, Jan 3, 2018), archived at <https://perma.cc/55FV-75SB>. Some commentators initially noted that § 162(q) left unclear whether it (perhaps unintentionally) would prevent recipients—and not just payors—of sexual harassment settlements from claiming deductions. See *id.* But in June 2019, the IRS issued guidance clarifying that § 162(q) does not preclude the recipient of such settlements from deducting related attorney’s fees. Internal Revenue Service, *Section 162(q) FAQ* (Jun 28, 2019), archived at <https://perma.cc/H3MC-BH85>.

¹⁶ See, for example, Margaret Ryznar, *#MeToo & Tax*, 75 Wash & Lee L Rev Online 53, 58 (2018) (arguing that § 162(q) “aligns with other tax provisions that prevent deductibility . . . on public policy grounds” of business expenses such as “illegal bribes, kickbacks, and other payments; certain lobbying and political expenditures; and fines and penalties”).

¹⁷ TC Memo 2013-290.

distress,”¹⁸ were insufficiently physical to merit § 104(a)(2) exclusion.¹⁹ Meanwhile, a slip-and-fall plaintiff awarded that same amount would be entitled to exclude the full \$210,000, even if the bulk of those damages were awarded for emotional distress.²⁰ Because Sharp’s settlement was paid in three annual installments of \$70,000,²¹ this result may have cost her (but not the slip-and-fall plaintiff) as much as \$18,707 in each of those three years.²² As this Comment will show, § 104(a)(2) thus operates to unequal effect, rendering taxable damage awards arising from causes of action brought predominantly by women, racial minorities, and other protected classes, while traditional tort damages for physical harms remain excludable.

At its core, the #MeToo movement sought to make society “believe women.”²³ This Comment, by critically analyzing § 104(a)(2)’s history and effect, will suggest that the provision’s current formulation enshrines in the tax code a test of sincerity that systematically disadvantages the victims of harassment and

¹⁸ Id at *11. “Emotional distress” damages alone are expressly made nonexcludable under the statute. See 26 USC § 104(a) (flush language) (“For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.”) However, “damages not in excess of the amount paid for medical care . . . attributable to emotional distress” are excludable. Id. See discussion at notes 202–03 and accompanying text. I use the phrase “flush language” throughout to refer to the portion of § 104(a)’s text located below subparagraphs § 104(a)(1)–(6) because it is “flush” with the text above. This nomenclature has been adopted by the Tax Court itself. See, for example, *French v Commissioner of Internal Revenue*, TC Summ Op 2018-36, *24.

¹⁹ *Sharp*, TC Memo 2013-290 at *11. Sharp was able, however, to claim a 26 USC § 67 miscellaneous itemized deduction for her litigation costs—a deduction available to all taxpayers. Id at *2 n 2. But under the TCJA, Congress suspended all such deductions for the taxable years 2018–2025. See 26 USC § 67(g).

²⁰ See 26 CFR § 1.104-1(c) (“[D]amages for emotional distress attributable to a physical injury or physical sickness are excluded from income under section 104(a)(2).”); *Small Business Job Protection Act of 1996*, HR Rep No 104-737, 104th Cong, 2d Sess 301 (1996) (“If an action has its origin in a physical injury or physical sickness, then all damages . . . that flow therefrom are treated as payments received on account of physical injury or physical sickness.”).

²¹ *Sharp*, TC Memo 2013-290 at *4.

²² 26 USC § 1 sets out the applicable marginal income tax rates, and Rev Proc 2009-50 provides the rates and deductions in effect for tax year 2010. I assume for simplicity that Sharp was an unmarried individual taxable under § 1(c) and that she took a personal exemption for herself and the standard deduction. Sharp’s annual salary when she departed Malcolm Price in 2007 was \$62,000. Foley, *\$210k in Settlement with Ex-Professor* (cited in note 2). Assuming that, by 2010 (when the settlement first paid out), she was able to find work for the same amount of money, the \$70,000 settlement payment would have brought her taxable income from the third § 1(c) bracket (owing \$9,344) to the fourth bracket (owing \$28,051), an increase of \$18,707 per year.

²³ See Marie Solis, *When Believing Women Isn’t Enough to Help Them* (Vice, Oct 9, 2018), archived at <https://perma.cc/5EBU-R46U>.

discrimination of all types. The tax code, as currently formulated, does not believe women.²⁴

Of course, the tax code is not animate; it cannot *believe* anything. But our laws serve an expressive as well as a regulatory function, and what the tax code *can*—and should—do is reflect the priorities of the society that enacted it. While our society has in recent years made strides toward recognizing the severity of the harms caused by discrimination and harassment, the tax code, as amended in 1996, penalizes those who suffer such harms. This is the “disbelief” of which I will occasionally speak: § 104(a)(2) makes it the expressed policy of the United States that discrimination and harassment do not inflict harms that are “physical” enough—worthy enough—to merit preferential tax treatment. For that, you’ll need a bruise.²⁵

This Comment’s core argument is twofold. First, I will present evidence, via a survey of a decade’s worth of Tax Court cases, that § 104(a)(2) in practice imposes a disproportionate tax burden on female and minority taxpayers. And second, I argue that the provision and the doctrines employed to interpret it are suffused with unconscious bias that both perpetuates and obfuscates these gender and race disparities. To solve these dual problems, I suggest, on the one hand, a set of strategies for litigation and interpretation that aims to root out unconscious bias in the provision’s application, and, on the other, a legislative change designed to undo the unconscious bias built into the provision itself. Section 104(a)(2) subordinates harms experienced primarily by women and people of color, and so, nearly twenty-five years after it went into effect, no longer reflects the priorities of the society that must live with it each day.

This Comment proceeds in three parts. Part I examines the history of § 104(a)(2) as enacted in 1918 and as amended in 1996 and discusses the doctrines that guide judicial interpretation of the provision today. Part II seeks to recast this history in light of feminist legal theory. First, Part II.A briefly surveys relevant feminist theory, discussing the methods of feminist interpretation that will be applied. Next, to provide quantitative and descriptive

²⁴ While this Comment draws inspiration from the #MeToo movement, its ultimate claim is that § 104(a)(2) disadvantages both women *and other minorities*. This Comment thus employs the lenses and language of #MeToo and feminist legal theory as jumping-off points for addressing this larger pattern of discrimination. For further discussion, see Part II.A.

²⁵ For discussion of the “bruise rule,” see Part I.C.2.

evidence of the provision's disparate impacts, Part II.B surveys every Tax Court case from the past decade dealing with the § 104(a)(2) excludability of civil damages. With these quantitative impacts in mind, I argue in Parts II.C and II.D that both the text of § 104(a)(2) and the line-drawing exercises undertaken by courts applying it yield results that systematically disadvantage female and minority taxpayers. Lastly, Part III proposes two classes of solutions to these problems. Part III.A first provides tactical and interpretive strategies that lawyers and judges can employ to ensure the provision is applied more equitably. And second, Part III.B canvasses potential legislative remedies for § 104(a)(2)'s disparate impacts—"equalizing up" by returning to the version of § 104(a)(2) that existed before 1996, "equalizing down" by removing the exclusion altogether, or a middle-ground solution that taxes only damages awarded for lost wages, regardless of the nature of the injury—and concludes that this latter option best achieves the dual aims of fostering equality in the tax code and crafting sensible tax policy.

I. BACKGROUND LAW: § 104(a)(2), THEN AND NOW

1996 marks a clear dividing line in the history of § 104(a)(2). As such, this Part proceeds in three sections, discussing in turn the provision's history before the 1996 amendment, the amendment itself, and the state of the law in the years since.

A. Section 104(a)(2) as Originally Enacted and Interpreted

Ratified in 1916, the Sixteenth Amendment grants Congress the "power to lay and collect taxes on incomes, from whatever source derived."²⁶ Accordingly, Congress taxes an individual's gross income, defined as "all income from whatever source derived."²⁷ But Congress has always carved out exceptions to this broad language,²⁸ and beginning with the Revenue Act of 1918²⁹ it excluded from gross income "[a]mounts received . . . as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of

²⁶ US Const Amend XVI.

²⁷ 26 USC § 61(a).

²⁸ These exceptions are numerous. See, for example, 26 USC § 102 (gifts); 26 USC § 107 (housing expenses for ministerial employees); 26 USC § 117 (academic scholarships); 26 USC § 139 (disaster relief payments).

²⁹ 40 Stat 1066.

such injuries or sickness.”³⁰ This exemption was reworded and codified at 26 USC § 104(a)(2), which until 1996 exempted from gross income “the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of *personal injuries or sickness*.”³¹

Commentators have traditionally rationalized the § 104(a)(2) exemption on the grounds that damages for personal injuries do not make injured parties better off, but simply compensate for the costs of injury.³² The Supreme Court implicitly adopted this “human capital theory” of income in *Commissioner of Internal Revenue v Glenshaw Glass Company*,³³ defining income as any “accession[] to wealth, clearly realized, and over which the taxpayer[] [has] complete dominion.”³⁴ *Glenshaw Glass* therefore requires that “income” make the person receiving it better off (in the sense of generating realized economic gain) than she was before.³⁵ Because tort damages compensate losses caused by tortious injury, they do not (so the theory goes) result in increased income. Instead, they merely replace capital the tort victim lost because of the injury.³⁶

Until § 104(a)(2) was amended in 1996,³⁷ courts interpreted its exemption for “personal injuries or sickness” broadly to exempt damages for “injuries . . . affecting the emotions, reputation, or character; intangible as well as tangible harms; emotional distress; mental pain and suffering; injury to personal and professional reputation; distress, humiliation, and mental anguish; intentional infliction of emotional distress; and the intangible

³⁰ 40 Stat 1066, § 213(b)(6).

³¹ 26 USC § 104(a)(2) (effective to Aug 20, 1996) (emphasis added).

³² See, for example, Mark J. Wolff, *Sex, Race, and Age: Double Discrimination in Torts and Taxes*, 78 Wash U L Q 1341, 1406–08 (2000); Kurt A. Leeper, Note, *Arguably Arbitrary: Taxation and the Physical Injury Requirement of I.R.C. Section 104(a)(2)*, 55 Case W Res L Rev 1039, 1044–48 (2005).

³³ 348 US 426 (1955).

³⁴ *Id* at 431.

³⁵ See *id* at 432 n 8 (noting the “long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital,” and distinguishing punitive damages, which were held taxable because they “cannot be considered a restoration of capital for taxation purposes”). See also *O’Gilvie v United States*, 519 US 79, 84, 86 (1996) (noting that the Court had “decided several cases based on the principle that a restoration of capital was not income” and that § 104(a)(2) therefore reaches only “those damages that . . . ‘return the victim’s personal or financial capital’”).

³⁶ See Leeper, Note, 55 Case W Res L Rev at 1044–46 (cited in note 32).

³⁷ See Part I.B.

harms of discrimination.”³⁸ But in three decisions in the 1990s, the Supreme Court began to narrow the scope of § 104(a)(2)’s personal injury exclusion.

First, in *United States v. Burke*,³⁹ a group of female plaintiffs brought a claim under Title VII of the Civil Rights Act of 1964,⁴⁰ alleging that their employer had discriminated on the basis of sex in paying their salaries.⁴¹ The plaintiffs were awarded back pay, which they attempted to exclude under § 104(a)(2). The Supreme Court held that the exclusion applied only to “action[s] based upon tort or tort type rights,” and Title VII did not protect such rights.⁴² It was “beyond question that discrimination in employment on the basis of sex, race, or any of the other classifications protected by Title VII is . . . an invidious practice that causes grave harm to its victims.”⁴³ Nevertheless, because the statute at the time limited plaintiffs’ remedies solely to back wages that, “if paid in the ordinary course, would have been fully taxable”⁴⁴—as distinct from the “traditional” tort remedy of compensatory damages⁴⁵—these amounts were not excludable under § 104(a)(2).⁴⁶

Justice Sandra Day O’Connor dissented, arguing that the Court’s focus on Title VII’s statutory remedies was overly formalistic.⁴⁷ Justice O’Connor noted that allowing exclusion of Title VII back pay would not “give victims of employment discrimination a [tax] windfall,” as the majority claimed.⁴⁸ Instead, it would “simply put[] them on an equal footing with others who suffer personal injury,” who may claim exclusion “even if all or a part of the[ir] recovery is determined with reference to the income lost

³⁸ G. Christopher Wright, Comment, *Taxation of Personal Injury Awards: Addressing the Mind/Body Dualism That Plagues § 104(A)(2) of the Tax Code*, 60 Cath U L Rev 211, 220 (2010) (quotation marks and citations omitted) (collecting cases).

³⁹ 504 US 229 (1992).

⁴⁰ 42 USC § 2000e-2.

⁴¹ *Burke*, 504 US at 230–31, 241–42.

⁴² *Id.* at 234, quoting 26 CFR § 1.104-1(e) (1991).

⁴³ *Burke*, 504 US at 238.

⁴⁴ *Id.* at 241.

⁴⁵ See *id.* at 238–39.

⁴⁶ *Id.* at 242. Congress amended Title VII as part of the Civil Rights Act of 1991 to provide a “compensatory and punitive damages” remedy for workplace discrimination. Pub L No 102-166, 105 Stat 1071, codified at 42 USC § 1981a(a)(1). As thus amended, Title VII claims satisfy *Burke*’s tort-type rights requirement, and damages paid on account of such claims would be excludable under the old § 104(a)(2). See Part II.D.1. See also generally Jody R. King, Comment, *A Case Frozen in Time: Does Title VII’s 1991 Amendment Strip United States v. Burke of Its Precedential Value?*, 28 New Eng L Rev 109 (1993).

⁴⁷ See *Burke*, 504 US at 249 (O’Connor dissenting).

⁴⁸ *Id.* at 252.

because of the[ir] injury.”⁴⁹ Justice O’Connor could “see no inequity in treating Title VII litigants like other plaintiffs who suffer personal injury.”⁵⁰

Second, in *Commissioner of Internal Revenue v Schleier*,⁵¹ the Court built upon *Burke*, setting out a two-prong test for § 104(a)(2) excludability: “First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is ‘based upon tort or tort type rights’; and second, the taxpayer must show that the damages were received ‘on account of personal injuries or sickness.’”⁵² Here, the plaintiffs sought § 104(a)(2) exclusion of a settlement award for back pay and liquidated damages arising out of a claim under the Age Discrimination in Employment Act of 1967.⁵³ The Court again conceded that “[age] discrimination causes . . . personal injury,” but determined that “[t]he amount of back wages recovered is completely independent of the existence or extent of any personal injury.”⁵⁴ Thus, the back-pay award could not have been paid “on account of” a personal injury for purposes of § 104(a)(2).⁵⁵

Finally, in *O’Gilvie v United States*,⁵⁶ the Court clarified that § 104(a)(2)’s “on account of” language required more than simply “but-for” causation—instead, excluded damages must have been awarded “by reason of, or because of, the personal injuries.”⁵⁷ Thus, while the punitive damages at issue would not have been awarded *but for* the underlying personal injury, they were not paid *on account of* it because they served to punish the defendant rather than compensate the plaintiff.⁵⁸ The Court likewise

⁴⁹ *Id.*

⁵⁰ *Id.* at 252–53.

⁵¹ 515 US 323 (1995).

⁵² *Id.* at 337.

⁵³ Pub L No 90-202, 81 Stat 602, codified as amended at 29 USC §§ 621–34. See *Schleier*, 515 US at 325–27.

⁵⁴ *Schleier*, 515 US at 330. Justice O’Connor again dissented.

⁵⁵ *Id.* at 330–31. In so holding, the Court avoided deciding whether *Schleier*’s injury met the first (tort or tort-type rights) prong of the inquiry. See *id.* at 333–34. Under *Schleier*, even though the amended Title VII creates tort-type rights, the *Burke* plaintiffs would still lose because their back-pay award could not have been paid “on account of” those rights. See note 46.

⁵⁶ 519 US 79 (1996).

⁵⁷ *Id.* at 83.

⁵⁸ See *id.* at 83–84. Justice Antonin Scalia, joined by Justices O’Connor and Clarence Thomas, dissented, finding this distinction unpersuasive. *Id.* at 94 (Scalia dissenting) (“It seems to me that the personal injury is as proximate a cause of the punitive damages as it is of the compensatory damages; in both cases it is the *reason* the damages are awarded. That is *why* punitive damages are called *damages*.”).

reaffirmed its commitment to the human capital theory, determining that permitting exclusion of punitive damages would be inconsistent with the principle that the statute reaches only “those damages that . . . ‘return the victim’s personal or financial capital.’”⁵⁹

In sum, *Burke*, *Schleier*, and *O’Gilvie* narrowed the scope of § 104(a)(2)’s exclusion considerably. After *Burke*, only damages based on a tort or tort-type right were excludable. The relevance of this holding, as the next Section will explain, would be short lived. But *Schleier* and *O’Gilvie* produced two more lasting changes. First, back pay and punitive damages were now nonexcludable as a matter of law. And second, under *O’Gilvie*, taxpayers were now required to satisfy a heightened causation standard to earn the excludability of *any* damages. But the real sea change would come from Congress.

B. Section 104(a)(2) as Amended in 1996

Congress amended § 104(a)(2) as part of the Small Business Job Protection Act of 1996⁶⁰ (SBJPA). The amended provision contained two critical changes. First, Congress added the word “physical” twice, so that the exclusion now applies only to damages for “personal *physical* injuries or *physical* sickness.”⁶¹ Second, Congress clarified that under the new provision, “emotional distress shall not be treated as a physical injury or physical sickness.”⁶²

According to the legislative record, Congress enacted these amendments to counteract court rulings that had “interpreted the exclusion . . . broadly” to “appl[y] to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness”—cases in which damages “generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits.”⁶³ Congress thus seemed primarily concerned with allowing the exclusion of damages for lost wages and back pay, income

⁵⁹ *O’Gilvie*, 519 US at 86.

⁶⁰ Pub L No 104-188, 110 Stat 1755, amending various sections of Titles 19 and 26.

⁶¹ 26 USC § 104(a)(2) (emphasis added).

⁶² 26 USC § 104(a) (flush language). The legislative conference report further clarified that “[i]t is intended that the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress.” HR Rep No 104-737 at 301 n 56 (cited in note 20).

⁶³ HR Rep No 104-737 at 300 (cited in note 20). Congress did not cite to any specific cases for this proposition.

which would be taxable if earned outside the context of litigation. It therefore appeared persuaded by *Burke's* reasoning that allowing exclusion of such damages would constitute a tax "windfall."⁶⁴ In attempting to reach this result, however, Congress applied something of a rule of thumb rather than addressing the problem directly: because nonphysical harms were more likely to be compensated via lost wages, they should not be excludable. But the amendment is underinclusive, as it continues to allow the exclusion of awards for lost income that arise from personal physical injuries.⁶⁵

It is clear from the House Committee Report that this was not just sloppy draftsmanship. Instead, Congress had a particular sort of plaintiff in mind: those bringing employment discrimination claims.⁶⁶ As the record makes clear, "the exclusion from gross income does not apply to any damages . . . based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress."⁶⁷ It is hard to ignore—and hard to imagine Congress could have ignored—the reality that these claims are brought disproportionately by women and minorities.⁶⁸

⁶⁴ 504 US at 252 (O'Connor dissenting).

⁶⁵ See HR Rep No 104-737 at 301 (cited in note 20) ("If an action has its origin in a physical injury or physical sickness, then all damages . . . that flow therefrom are treated as payments received on account of physical injury or physical sickness.").

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ This commonsense claim is supported by official statistics and social science research. According to the Equal Employment Opportunity Commission (EEOC), in fiscal year 2014, more than 74 percent of Title VII sex discrimination claims were brought by women. US Equal Employment Opportunity Commission, *Women in the American Workforce*, archived at <https://perma.cc/27G4-8Q2F>. Moreover, between the years of 2010 and 2019, women also consistently filed between 82 and 84 percent of EEOC charges alleging sexual harassment. US Equal Employment Opportunity Commission, *Charges Alleging Sex-Based Harassment (Charges Filed with EEOC) FY 2010 – FY 2019*, archived at <https://perma.cc/W99Z-ZDCD>. While no similar government statistics appear to be available for race-based discrimination and harassment claims, some social science research has found that, unsurprisingly, "perceived racial/ethnic discrimination was significantly more prevalent among Black and Hispanic employees than among White employees," suggesting these groups are more likely to ultimately bring such claims. Derek R. Avery, Patrick F. McKay, and David C. Wilson, *What Are the Odds? How Demographic Similarity Affects the Prevalence of Perceived Employment Discrimination*, 93 J Applied Psych 235, 244 (2008). And another study helpfully summarized its findings as such: "Women experienced more sexual harassment than men, minorities experienced more ethnic harassment than Whites, and minority women experienced more harassment overall than majority men, minority men, and majority women." Jennifer L. Berdahl and Celia Moore, *Workplace Harassment: Double Jeopardy for Minority Women*, 91 J Applied Psych 426, 426 (2006).

Courts initially interpreted the amendment not to alter *Schleier*'s two-prong test,⁶⁹ but in 2012 the IRS amended its § 104(a)(2) guidance and “abandoned the *Schleier* language requiring a ‘tort or tort-type right.’”⁷⁰ Thus, under the new standard, damages are excludable whenever they are received “on account of personal physical injuries or physical sickness,”⁷¹ regardless of whether “[t]he injury . . . [is] defined as a tort.”⁷²

C. The State of § 104(a)(2) After 1996

After 1996, damages are excludable under § 104(a)(2) if they are paid on account of a personal physical injury or physical sickness.⁷³ If the damages are paid as part of a settlement, as appears to be the case in the vast majority of discrimination and harassment cases,⁷⁴ damages will be excludable if a court determines that (1) the payor intended to compensate the plaintiff for (2) a physical injury that was (3) not merely a symptom of emotional distress.⁷⁵ This Section discusses the doctrines underlying these three requirements.

1. The intent of the payor.

Under *Schleier*, the key question in most § 104(a)(2) cases is whether the funds were paid “on account of” an excludable injury. In answering this question, courts “look to the written terms of the settlement” for evidence that some portion of the award was for personal physical injuries or physical sickness.⁷⁶ “If the settlement agreement allocates clearly the settlement proceeds between tortlike personal injury damages and other damages, the allocation is generally binding for tax purposes.”⁷⁷ But if the written settlement is ambiguous about which injuries it compensates,

⁶⁹ See *Amos v Commissioner of Internal Revenue*, TC Memo 2003-329, *9-10; *Murphy v Internal Revenue Service*, 493 F3d 170, 174 (DC Cir 2007).

⁷⁰ *Perez v Commissioner of Internal Revenue*, 144 TC 51, 58 (2015).

⁷¹ *Id.*, quoting 26 CFR § 1.104-1(c).

⁷² TD 9573, 77 Fed Reg 3107 (Jan 23, 2012), codified at 26 CFR § 1.104-1(c)(2).

⁷³ *Id.*

⁷⁴ See text accompanying note 252.

⁷⁵ See, for example, *Parkinson v Commissioner of Internal Revenue*, TC Memo 2010-142, *13, 15 (finding a portion of the petitioner's settlement excludable because (1) “the medical center intended the settlement payment to compensate petitioner for (2) his alleged physical injuries,” which it determined were (3) not “mere subjective sensations or symptoms of emotional distress”).

⁷⁶ *McMillan v Commissioner of Internal Revenue*, TC Memo 2019-108, *21.

⁷⁷ *Green v Commissioner of Internal Revenue*, TC Memo 2005-250, *21.

courts “look to the intent of the payor, based on all the facts and circumstances of the case, including the complaint that was filed and the details surrounding the litigation.”⁷⁸ Such a rule makes sense because, unlike the payee, the payor theoretically has no incentive for dishonesty about what the settlement compensates.

The burden is on the payee to present “objective and credible evidence” that the payor intended to compensate her for a physical harm.⁷⁹ Beyond the words of the settlement, relevant evidence includes the terms of the complaint,⁸⁰ evidence that the injury was mentioned during settlement negotiations,⁸¹ and evidence that the payor was otherwise aware of the payee’s alleged physical injury.⁸²

Nevertheless, even when the taxpayer produces such evidence, courts generally apply this doctrine strictly, precluding any exclusion absent a clear allocation: “Where a settlement agreement is silent as to what portion, if any, of a settlement payment should be allocated towards damages excludable under 26 U.S.C. § 104(a)(2), the courts will not make that allocation for the parties.”⁸³ Thus, while courts nominally consider “all the facts and circumstances of the case,”⁸⁴ this approach has rarely benefitted taxpayers in practice.⁸⁵

2. The “bruise rule.”

Assuming the taxpayer can show that the payor intended to compensate her for some discrete injury, she must prove that her injury is *sufficiently physical* to warrant exclusion. This line-drawing inquiry is the core difficulty of the § 104(a)(2) jurisprudence. In the new provision’s early days, the IRS issued nonbinding guidance⁸⁶ noting its belief that § 104(a)(2) exclusion requires

⁷⁸ *McMillan*, TC Memo 2019-108 at *22.

⁷⁹ *Dulanto v Commissioner of Internal Revenue*, TC Memo 2016-34, *7.

⁸⁰ See, for example, *id.*; *McMillan*, TC Memo 2019-108 at *22; *Mumy v Commissioner of Internal Revenue*, TC Summ Op 2005-129, *14.

⁸¹ See, for example, *Domeny v Commissioner of Internal Revenue*, TC Memo 2010-9 at *11; *French*, TC Summ Op 2018-36 at *14–16, 27–28.

⁸² See, for example, *French*, TC Summ Op 2018-36 at *27–28.

⁸³ *Taggi v United States*, 835 F Supp 744, 746 (SDNY 1993).

⁸⁴ *McMillan*, TC Memo 2019-108 at *22. But see discussion at Part II.C (arguing that courts have inconsistently applied this doctrine).

⁸⁵ See discussion at Part II.C.1.

⁸⁶ This guidance took the form of “private letter rulings,” or PLRs. See Internal Revenue Service, *Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts* (Oct 24, 2019), archived at <https://perma.cc/7JUM-NW92> (defining a private letter ruling as a “written statement issued to a taxpayer that interprets and applies tax laws to the

that the taxpayer show “direct unwanted or uninvited physical contacts resulting *in observable bodily harms* such as bruises, cuts, swelling, and bleeding.”⁸⁷ Physical diseases, such as cancer caused by asbestos exposure, would also qualify.⁸⁸

While the Tax Court has not officially adopted the “bruise rule,” it has largely abided by it in practice. For example, in *Stadnyk v Commissioner of Internal Revenue*,⁸⁹ a bank labeling error led to a criminal complaint against Brenda Stadnyk for passing a bad check that turned out not to be bad.⁹⁰ Stadnyk was arrested and taken to a detention center, where she was “hand-cuffed, photographed, and confined to a holding area,” “searched via pat-down and with the use of an electric wand,” and “required to undress to her undergarments, remove her brassiere in the presence of police officers, and wear an orange jumpsuit.”⁹¹ Stadnyk sued the bank for, among other things, false imprisonment, and the parties settled.⁹² The Tax Court held that Stadnyk’s injuries were not “physical” under § 104(a)(2) because, while she was “physically restrained against her will,”⁹³ she “was not grabbed, jerked around, or bruised” and “did not suffer physical harm.”⁹⁴ The court concluded that “the deprivation of personal freedom [is not] a physical injury for purposes of section 104(a)(2).”⁹⁵

The difficulty of determining how physical is physical *enough* for § 104(a)(2) pervades the case law, and courts have yet to conjure a rule that yields consistent results.

3. Physical manifestations of emotional distress.

Adding more confusion to the excludability question is the doctrine of “physical manifestations of emotional distress,” which holds that some injuries, even if they are sufficiently physical standing alone, are nonexcludable because they are *symptoms* of

taxpayer’s represented set of facts,” which “may not be relied on as precedent by other taxpayers”).

⁸⁷ IRS PLR 200041022, *4 (Oct 13, 2000) (available on Westlaw at 2000 WL 33120245) (emphasis added).

⁸⁸ IRS PLR 200121031, *2, 4 (May 25, 2001) (available on Westlaw at 2001 WL 564931).

⁸⁹ TC Memo 2008-289.

⁹⁰ *Stadnyk*, TC Memo 2008-289 at *3.

⁹¹ *Id* at *3–4.

⁹² *Id* at *5.

⁹³ *Id* at *4.

⁹⁴ *Stadnyk*, TC Memo 2008-289 at *15.

⁹⁵ *Id* at *15.

emotional distress.⁹⁶ This convoluted reasoning stems from Congress's definition of "emotional distress" in the § 104(a)(2) House Committee Report as including "symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress."⁹⁷ Thus, in *Lindsey v Commissioner of Internal Revenue*,⁹⁸ the settlement award for a plaintiff who "suffered from hypertension and stress-related symptoms, including periodic impotency, insomnia, fatigue, occasional indigestion, and urinary incontinence" was nonexcludable because it "relate[d] to emotional distress, and not to physical sickness."⁹⁹ And in *Goode v Commissioner of Internal Revenue*,¹⁰⁰ though the plaintiff alleged "various debilitating physical ailments (i.e., migraine headaches, stomachaches, and hand numbness),"¹⁰¹ the court nonetheless did not exclude related damages because that "illness, although evidently grievous, [] emanat[ed] from a physical manifestation of emotional distress."¹⁰²

* * *

All told, the current state of § 104(a)(2) is one of considerable doctrinal uncertainty that, as we will see, paradoxically results in near-total uniformity in outcomes: female and minority plaintiffs are disproportionately excluded from claiming the exclusion.¹⁰³ The next Part critically examines these on-the-ground effects.

⁹⁶ See, for example, *Sanford v Commissioner of Internal Revenue*, TC Memo 2008-158, *9 ("Damages received on account of emotional distress, even when resultant physical symptoms occur, are not excludable from income under section 104(a)(2).").

⁹⁷ HR Rep No 104-737 at 301 n 56 (cited in note 20).

⁹⁸ 422 F3d 684 (8th Cir 2005).

⁹⁹ Id at 688.

¹⁰⁰ TC Memo 2006-48.

¹⁰¹ Id at *11.

¹⁰² Id at *13.

¹⁰³ See discussion at Part II.B.

II. “ASKING THE WOMAN QUESTION”: A FEMINIST PERSPECTIVE ON § 104(a)(2)

The #MeToo movement brought with it a great cultural reckoning and an opportunity for everyone—from major corporations to the United States Supreme Court¹⁰⁴—to rethink, reconsider, and reevaluate the ways our society treats women. In this spirit, this Part critically examines the ways in which § 104(a)(2) disadvantages female and minority plaintiffs in practice. First, Part II.A outlines this Comment’s methodologies and the feminist legal theory from which it draws. Part II.B then surveys every § 104(a)(2) Tax Court case of the past ten years to gauge the provision’s impact on plaintiffs. Next, Part II.C analyzes the problematic judicial application of the interpretive doctrines that plaintiffs must confront when seeking exclusion. Finally, Part II.D critically examines the history and statutory context of the provision itself.

A. Methodology

In analyzing the ways in which § 104(a)(2) disadvantages women and minority plaintiffs, this Comment looks for guidance from the theories and methodologies of feminist legalist scholarship.

First, this Comment takes inspiration from Professor Catharine MacKinnon’s exposition of a “substantive theory of [] inequality” that seeks “an explanatory analysis of its particular content, function, and driving dynamics: what makes it go and why it exists.”¹⁰⁵ Per MacKinnon, “Law is substantive first, everything else it is and claims to be second.”¹⁰⁶ At its core, this theory, like much feminist scholarship, is consequentialist: “Sex equality is fairly common as a legal guarantee,” she notes, and yet “the inequality of the sexes thriv[es] alongside it.”¹⁰⁷

While MacKinnon’s substantive focus is a helpful start, other feminist scholars have criticized her brand of radical feminism for perpetuating “gender essentialism—the notion that a unitary, ‘essential’ women’s experience can be isolated and described

¹⁰⁴ See John G. Roberts Jr, *2017 Year-End Report on the Federal Judiciary* *11 (2017), archived at <https://perma.cc/H8DD-WX2V> (acknowledging that “[e]vents in recent months have illuminated the depth of the problem of sexual harassment in the workplace, and . . . the judicial branch is not immune”).

¹⁰⁵ MacKinnon, *Women’s Lives, Men’s Laws* at 3 (cited in note 1).

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 44.

independently of race, class, sexual orientation, and other realities of experience.”¹⁰⁸ Indeed, insofar as § 104(a)(2)’s disparate impacts result from the taxation of damages in civil rights suits, the provision disadvantages minority groups as well as women—and, of course, minority women.¹⁰⁹ Thus, this Comment adopts the view of postmodern and intersectional feminist scholars that the law owes greater deference to “individuals’ lived experiences, perspectives, and positions in the world.”¹¹⁰ In so doing, this Comment makes a “deliberate choice to see the world from the standpoint of the oppressed”:¹¹¹ those taxpayers disadvantaged by § 104(a)(2), be they women, people of color, religious minorities, disabled persons, or some combination thereof.

Feminist theory provides not only this Comment’s substantive, intersectional lens; it also supplies its methodologies. First this Comment applies the most fundamental of feminist methodologies—asking the “woman question,”¹¹² reframed in light of this Comment’s broader intersectional focus as “the [q]uestion of the [e]xcluded.”¹¹³ To ask the woman question is to “identify[] and challeng[e] those elements of existing legal doctrine that leave out or disadvantage *women and members of other excluded groups*.”¹¹⁴ Asking the woman question is thus shorthand for investigating the provision’s exclusionary impacts more generally.¹¹⁵ This Part therefore does what Congress did not do when it amended § 104(a)(2) in 1996: it asks what effects the law will have on the people who must abide by it.

Second, in framing potential solutions in Part III, this Comment applies Professor Katharine Bartlett’s “feminist practical reasoning,” which rejects “abstract, formalistic reasoning” in favor of a more fact-based, holistic approach: “[T]he particular facts

¹⁰⁸ Angela P. Harris, *Race and Essentialism in Feminist Legal Theory*, 42 *Stan L Rev* 581, 585 (1990).

¹⁰⁹ Claims of intersectional discrimination—say, discrimination on the basis of the plaintiff’s being a *black woman*—are notoriously difficult to win. See generally Yvette N. A. Pappoe, *The Shortcomings of Title VII for the Black Female Plaintiff*, 22 *U Pa J L & Soc Change* 1 (2019). Admittedly, given these structural impediments to securing damages at all, whether damages are taxable is surely a secondary concern for such plaintiffs.

¹¹⁰ Nancy Levit and Robert R.M. Verchick, *Feminist Legal Theory: A Primer* 36 (NYU 2d ed 2016).

¹¹¹ Mari J. Matsuda, *When the First Quail Calls: Multiple Consciousness as Jurisprudential Method*, 14 *Women’s Rts L Rep* 297, 299 (1992).

¹¹² Katharine T. Bartlett, *Feminist Legal Methods*, 103 *Harv L Rev* 829, 837 (1990).

¹¹³ *Id.* at 847.

¹¹⁴ *Id.* at 831 (emphasis added).

¹¹⁵ See *id.* at 847–49.

of a case do not just present the problem to be solved, but also instruct the decisionmaker about what the ends and means of law ought to be.”¹¹⁶ Importantly, feminist practical reasoning “respects, but does not blindly adhere to, legal precedent,” and recognizes that the court in any given case is “an active participant in the formulation of legal authority.”¹¹⁷

B. A Survey of § 104(a)(2)’s Effects, 2009–2019

The simplest way to determine how women and minorities are actually affected by § 104(a)(2) is to count. In this Part, I survey every Tax Court case from 2009 to 2019 concerning the § 104(a)(2) excludability of civil lawsuit damages—fifty-three cases in total.¹¹⁸

Two key limitations bear up-front mention. First, this survey necessarily omits cases where the taxpayer’s claim for exclusion was not litigated, which are surely the bulk of § 104(a)(2)’s applications. Disputes that go to court tend to be closer calls, so the survey misses cases in which § 104(a)(2) obviously does or does not apply—cases in which the Commissioner allowed the taxpayer’s exclusion, or in which the taxpayer did not challenge the Commissioner’s deficiency determination. Second, taxpayers can bring § 104(a)(2) claims in United States District Court or the Court of Federal Claims as well as in the Tax Court; practical concerns required limiting the survey’s scope to Tax Court cases. As such, this survey does not purport to be an exhaustive study of § 104(a)(2)’s impacts, and its results can only suggest—not prove—that the provision disproportionately disadvantages certain taxpayers.

Nevertheless, the results are striking: Of the fifty-three cases in which a taxpayer challenged the Commissioner’s deficiency determination, more than 83 percent (forty-four cases) involved underlying claims of discrimination, harassment, damages for emotional distress, or some combination thereof. And of these forty-four cases, 86 percent (thirty-eight cases) involved a plaintiff who was female, disabled, or a member of a racial, religious, or ethnic minority.¹¹⁹ The Tax Court allowed § 104(a)(2) exclusion

¹¹⁶ Bartlett, 103 Harv L Rev at 858–60 (cited in note 112).

¹¹⁷ *Id.* at 860.

¹¹⁸ See Appendix.

¹¹⁹ Of the underlying forty-four claims, 59 percent were brought by women, 25 percent by people of color, 23 percent by disabled individuals, and 7 percent by religious minorities. Twenty-seven percent of plaintiffs fell into more than one such category. And,

of a portion of the taxpayer's damages award or settlement in just *three* of these forty-four cases—only 7 percent.

In each of these three cases, the Tax Court excluded some portion of the plaintiff's settlement in the absence of express language allocating funds to physical injuries. In *Domeny v Commissioner of Internal Revenue*,¹²⁰ Julie Domeny alleged that a hostile work environment aggravated her multiple sclerosis.¹²¹ The Tax Court excluded the portion of her settlement allocated to “[n]onemployee compensation” on the grounds that, because the defendant knew of Domeny's multiple sclerosis, her employer must have paid that portion to compensate her for those symptoms.¹²² Similarly, in *Parkinson v Commissioner of Internal Revenue*,¹²³ the court excluded settlement funds allocated to “noneconomic damages” arising from a suit for intentional infliction of emotional distress “manifested by permanent, irreparable physical harm”—a heart attack.¹²⁴ It struck the court as “self-evident that a heart attack and its physical aftereffects constitute physical injury or sickness rather than *mere subjective sensations or symptoms* of emotional distress.”¹²⁵ Finally, in *Simpson v Commissioner of Internal Revenue*,¹²⁶ a hostile work environment resulted in Kathleen Simpson being “diagnosed with clinical depression, irritable bowel syndrome, and fibromyalgia.”¹²⁷ In the absence of any clear allocation of funds, the court “use[d] [its] best judgment and [found] that 10% of the settlement” was excludable.¹²⁸ This represented a significant departure from the typical rule that, when the settlement does not apportion its funds to

other than gender, these numbers are likely understated: if a black female plaintiff alleged only sex discrimination, the Tax Court's opinion would not likely mention her race, and she would not be scored as a racial minority.

¹²⁰ TC Memo 2010-9.

¹²¹ *Id.* at *4. Domeny suffered mounting stress after a new supervisor curtailed her duties and allegedly embezzled company funds, which Domeny repeatedly reported to no avail. Eventually, her doctor determined that her symptoms had intensified so much that she required a leave from work. See *id.* at *3–5.

¹²² *Id.* at *11–12.

¹²³ TC Memo 2010-142.

¹²⁴ *Id.* at *4–5. The court determined that one-half of the settlement was excludable. See *id.* at *15–16. *Parkinson* appears to be the only post-SBJPA case granting exclusion to damages stemming from an injury framed in the complaint as a physical manifestation of emotional distress.

¹²⁵ *Id.* at *13 (emphasis added).

¹²⁶ 141 TC 331 (2013).

¹²⁷ *Id.* at 333.

¹²⁸ *Id.* at 347.

particular harms, “the courts will not make that allocation for the parties.”¹²⁹

Setting aside these three exceptions—to which I return in Part II.C.1—the overall picture painted by this survey of § 104(a)(2)’s last ten years is one of women and minority plaintiffs being denied exclusion for claims of harassment and discrimination. This is not to say that, as a normative matter, all of these plaintiffs *should* be allowed to exclude their damages from taxable income. I only argue that, as a factual matter, identical damages *would* be excludable if they stemmed from physical torts. *Rajcoomar v Commissioner of Internal Revenue*¹³⁰ is a good example: while Lloyd Rajcoomar alleged discrimination based on race and disability status, he did not allege any other injuries, and his settlement was clearly awarded only for lost wages.¹³¹ Earned in the normal course, Rajcoomar’s wages would be taxable, so his award should quite certainly be taxed as well.¹³² But then, so should the lost wages awarded to a slip-and-fall plaintiff.

Of course, Congress may simply have determined that preventing exclusion for nonphysical harms, even though it is underinclusive, was a close-enough rule of thumb for solving the problem of granting tax exemptions for lost wages. Additionally, perhaps it sought to provide courts with an easily administrable bright-line rule to follow. But these arguments miss the mark. First, as the next Section will show, the “bright line” that Congress purported to draw has not proved easily administrable for courts, and in most cases, courts actually work to *avoid* applying it at all. Second—and more importantly—the § 104(a)(2) rule of thumb is both underinclusive and *overinclusive*: it allows exclusion of lost-wages awards for slip-and-fall plaintiffs, but it also taxes *non-wage-related* awards for discrimination and harassment plaintiffs. From a tax base perspective, these effects might net out to zero. But from an equity perspective, this latter class of plaintiffs, the bulk of whom are women and minorities, are simply made to subsidize the windfall of the former. Whether Congress intended this effect or merely achieved it subconsciously is of little moment today: either Congress failed to ask the woman question of § 104(a)(2) in 1996, or it asked it and ignored the answer.

¹²⁹ *Taggi v United States*, 835 F Supp 744, 746 (SDNY 1993).

¹³⁰ TC Memo 2017-129.

¹³¹ See *id.* at *8 (noting that the parties even agreed that a Form W-2 would issue for the income).

¹³² See discussion at Part III.B.

Either way, as the results of this Part's survey make clear, women and minority taxpayers bear the brunt of a crudely constructed statute that purports to aim at lost wages but misses badly. The goal of seeking to tax lost wages is a worthy one. But in 2020, there is no sensible way to justify the disparate treatment of lost-wages awards in slip-and-fall and discrimination cases when the result is to inflict a lopsided tax burden on women and minorities.

C. Dissecting the Doctrine

With these quantitative impacts of § 104(a)(2) in mind, this Section now casts a critical eye on the core doctrines of the § 104(a)(2) case law that help produce the disparate impacts just described.

1. The intent of the payor and the bruise rule.

Because most of the Tax Court's § 104(a)(2) cases concern the excludability of settlement awards,¹³³ much of the provision's disparate impact turns on how courts choose to read these agreements. The doctrine governing this question—that courts should look to the intent of the payor—is problematic on two key fronts.

First, in light of the #MeToo movement, formalistic application of the intent-of-the-payor doctrine is particularly discomfiting in cases of sexual harassment and workplace discrimination. While payors generally lack incentive to dissemble about the payee's injuries when crafting settlements, this may not hold true in harassment cases. In such cases, the payor may have settled in part precisely to avoid a full airing of the facts about the plaintiff's injuries.¹³⁴ Resource inequality means that settlement negotiations between employees and employers already give employers a structural advantage,¹³⁵ and this advantage is likely exacerbated in harassment and discrimination cases. Seeking to avoid public criticism, sexual harassment defendants with structural bargaining advantages will likely push for vague, nonspecific settlement

¹³³ Of the fifty-three cases surveyed in this Comment, just eight (less than 15 percent) involved a jury verdict.

¹³⁴ The tendency to subject such settlements to NDAs, acknowledged by Congress in § 162(q), lends support to this assertion.

¹³⁵ See Owen M. Fiss, Comment, *Against Settlement*, 93 Yale L J 1073, 1076 (1984) (explaining that in the settlement bargaining process, resource disparities disadvantage the poorer party, who has less access to information required to forecast litigation outcomes, experiences pressure to recoup damages quickly, and possesses limited resources for financing litigation efforts).

language—for a “general release that is broad and inclusive.”¹³⁶ Giving controlling legal weight to such language merely reinforces this power imbalance. In such cases, it is particularly important that courts give credence to “objective and credible evidence of the payor’s intent” beyond the plain terms of the settlement.¹³⁷

And second, courts have inconsistently applied the doctrine, often alternating between hardline deference to settlement terms and a more permissive inquiry into the totality of the circumstances.

Typical of the hardline stance is *Mumy v Commissioner of Internal Revenue*,¹³⁸ in which Louise Mumy filed a sexual harassment claim against her employer, seeking damages for “anxiety, embarrassment and humiliation as a result of the harassment, and pain from [a] pinch” inflicted by a coworker.¹³⁹ The pinch on Mumy’s arm left a bruise that lasted two weeks, but the court noted that Mumy “did not seek medical care for her battery.”¹⁴⁰ In finding the entire settlement taxable, the court determined that, “[i]nstead of the pinch being the basis for a separate and stand-alone cause of action, . . . the complaint treats the pinch as a *symptom of the harassment*.”¹⁴¹ Because the settlement award was not “paid *solely* as a result of the pinch,” the court reasoned that none of the award was excludable under § 104(a)(2).¹⁴²

*Devine v Commissioner of Internal Revenue*¹⁴³ similarly places little value on injuries that seem obviously physical. Theresa Devine was a civilian employee of the National Guard.¹⁴⁴ After she became pregnant, Devine alleged that she was “ordered to continue working in an area where she would be exposed to toxic chemicals,” as a result of which she “developed a rash” and was “denied leave to receive medical treatment.”¹⁴⁵ Over the next two years, she was subjected to a pattern of sexual harassment and retaliation, including one incident in which an officer “came up

¹³⁶ *Mumy v Commissioner of Internal Revenue*, TC Summ Op 2005-129, *12 (noting that “[t]he nature of the underlying claims cannot be determined” from such a release, and that, as a result, the court could not allocate any portion of the settlement to the plaintiff’s alleged physical injuries).

¹³⁷ *Dulanto v Commissioner of Internal Revenue*, TC Memo 2016-34, *7.

¹³⁸ TC Summ Op 2005-129.

¹³⁹ Id at *11 (quotation marks omitted).

¹⁴⁰ Id at *3.

¹⁴¹ Id at *14 (emphasis added).

¹⁴² *Mumy*, TC Memo 2005-129 at *11, 14 (emphasis added).

¹⁴³ TC Memo 2017-111.

¹⁴⁴ Id at *3.

¹⁴⁵ Id.

behind [her] and violently threw himself into [her,] giving [her] a hug” that “was forceful enough that it actually hurt.”¹⁴⁶ The Tax Court held none of the ensuing settlement excludable, because while it had “considerable sympathy” for these “unfortunate incidents,” they were merely “cited . . . as evidence of pregnancy-based discrimination,”¹⁴⁷ and Divine did not separately “allege a physical injury of any kind or demand compensation for any physical injury.”¹⁴⁸

On the other end of the spectrum is *Amos v Commissioner of Internal Revenue*,¹⁴⁹ which found a physical injury despite an ambiguous settlement. Here, Eugene Amos alleged that he was “kicked in the groin” by basketball player Dennis Rodman when Rodman fell into the crowd during a game.¹⁵⁰ The pain from the kick quickly subsided and an unrelated medical visit the next day turned up no evidence of swelling nor any mention of pain, but Amos nevertheless reached a \$200,000 settlement with Rodman.¹⁵¹ As in *Mummy*, the agreement spoke in general terms, settling “any and all claims” that Amos might bring against Rodman.¹⁵² Here, however, the court simply assumed without analysis that Amos’s injury was sufficiently physical to satisfy § 104(a)(2), and, applying the intent of the payor principle, determined that “Rodman’s dominant reason in paying [Amos] . . . was to compensate him for his claimed physical injuries.”¹⁵³ The court allowed Amos to exclude \$120,000 of the \$200,000 settlement based on its estimates of the relative values of his various claims.¹⁵⁴

Amos—taken together with *Domeny*, *Parkinson*, and *Simpson*¹⁵⁵—shows that courts are occasionally willing to look beyond a settlement’s plain language to allow exclusion, but *Mummy* and *Devine* indicate that courts will only do so sometimes. We are left to speculate about how courts draw the line between which injuries merit looking beyond the plain terms of the settlement and which do not, for they rarely explain their decisions on this

¹⁴⁶ Id at *6.

¹⁴⁷ *Devine*, TC Memo 2017-111 at *13–14.

¹⁴⁸ Id at *12.

¹⁴⁹ TC Memo 2003-329.

¹⁵⁰ Id at *3.

¹⁵¹ Id at *3–5.

¹⁵² Id at *5.

¹⁵³ *Amos*, TC Memo 2003-329 at *15.

¹⁵⁴ Id at *16.

¹⁵⁵ See Part II.B.

point. But two things *are* clear. First, the intent-of-the-payor doctrine invites judges to fall back on unconscious bias about the severity of certain harms: if the judge does not believe, say, that Post-Traumatic Stress Disorder (PTSD) constitutes a physical injury, perhaps she is more likely to find the payor did not intend to compensate it. And second, the former approach—looking beyond the settlement’s plain language where other evidence is present—is a more faithful means of discovering the *actual* intent of the payor: Surely Rodman paid Amos because of the kick, even though the settlement didn’t expressly say so. But can it really be said that Devine’s assault (or her rash) or Mumy’s pinch did not factor into their respective settlements at all? The *Mumy* court’s reasoning is particularly suspect given that Mumy’s complaint specifically sought damages for “pain from [a] physical injury”—namely, the pinch.¹⁵⁶

In this sense, the intent-of-the-payor doctrine begins to blend with the bruise rule. That is, when courts believe the plaintiff’s injury is sufficiently physical—and not “mere subjective sensations”¹⁵⁷—they will tend to find that the payor intended to compensate it, regardless of whether the settlement contains express language to that effect. But when courts seem skeptical that the plaintiff’s injury is actually physical, they tend to avoid deciding the question by simply holding that, in any event, the settlement did not allocate funds to that injury with sufficient clarity. In the Tax Court, this latter class of cases has consisted primarily of claims of harassment and discrimination.

2. Physical manifestations of emotional distress.

Much like the intent-of-the-payor doctrine, the physical-manifestations-of-emotional-distress doctrine provides another avenue for courts to avoid deciding on the merits whether an injury is sufficiently physical for purposes of § 104(a)(2). On their faces, physical-manifestation cases like *Lindsey* or *Goode*¹⁵⁸ stand for the proposition that, no matter how “grievous” or “debilitating” a plaintiff’s injuries may be, if they “emanat[e] from a physical manifestation of emotional distress,” they are nonexcludable.¹⁵⁹ But a closer examination of these physical-manifestation

¹⁵⁶ *Mumy*, TC Memo 2005-129 at *3.

¹⁵⁷ *Parkinson*, TC Memo 2010-142 at *13.

¹⁵⁸ See text accompanying notes 98–102.

¹⁵⁹ *Goode*, TC Memo 2006-48 at *11–13.

cases reveals that this doctrine, too, is often subsumed by the intent-of-the-payor analysis.

In *Goode*, the key consideration was not that the plaintiff's injuries emanated from emotional distress, but rather that the "[defendant] *conceived of [Goode]'s illness . . . as emanating from a physical manifestation of emotional distress.*"¹⁶⁰ Likewise in *Lindsey*, the court's conclusion that the plaintiff's "health symptoms relate to emotional distress, and not to physical sickness,"¹⁶¹ was not critical to its holding. Ultimately, because "the payor . . . was never made aware Lindsey was suffering any physical sickness," Lindsey could not show that any portion of the settlement was paid to compensate such sickness.¹⁶²

Another key case in this line is *Murphy v Internal Revenue Service*,¹⁶³ in which Marrita Murphy alleged that she was black-listed by her employer after complaining about unsafe working conditions.¹⁶⁴ Murphy sought damages for various stress-related injuries, including "'bruxism,' or teeth grinding often associated with stress, which may cause permanent tooth damage."¹⁶⁵ The court held none of the resulting settlement excludable.¹⁶⁶ Here, as in *Goode* and *Lindsey*, while the court adopted the "physical manifestations" language, the holding turned on the fact that the court could not "say the [defendant], notwithstanding its clear statements to the contrary, actually awarded damages because of Murphy's bruxism and other physical manifestations of stress."¹⁶⁷ So, had the settlement clearly allocated damages for Murphy's bruxism, it appears that the court would have excluded those damages.

This brings us back to *Parkinson*, in which the initial complaint sought damages expressly for, among other things, "emotional distress . . . manifested by . . . [a] heart attack."¹⁶⁸ Despite this framing, the court determined that Parkinson's heart attack was a "physical injury or sickness rather than [a] mere subjective sensation[] or symptom[] of emotional distress."¹⁶⁹ Having so

¹⁶⁰ Id at *13 (emphasis added).

¹⁶¹ *Lindsey*, 422 F3d at 688.

¹⁶² Id at 688–89.

¹⁶³ 493 F3d 170 (DC Cir 2007).

¹⁶⁴ Id at 172.

¹⁶⁵ Id.

¹⁶⁶ Id at 176.

¹⁶⁷ *Murphy*, 493 F3d at 176.

¹⁶⁸ TC Memo 2010-142 at *4 (emphasis added).

¹⁶⁹ Id at *13.

concluded, the court went on to allow exclusion, even though the settlement agreement only stated that payment was made for “noneconomic damages and not [] wages or other income.”¹⁷⁰ The court found that the payor must have intended to compensate Parkinson for his heart attack.

How to square *Parkinson* with *Murphy*? At bottom, the cases reveal that the three governing doctrines of § 104(a)(2) blend into one. If the court determines that the plaintiff’s injury merits exclusion, it will sidestep the words of the complaint and settlement to find the related damages excludable. But if the court does not consider the injuries serious enough—and again, just how courts ultimately draw this line is impossible to know—it will tend to obfuscate this conclusion by reference to the intent-of-the-payor or physical-manifestations doctrines. Because, as discussed in Part II.B, the vast majority of claims seeking damages for emotional-distress-related harms appear to be brought by women or minority-group members, these doctrines systematically disadvantage those plaintiffs.

These obfuscating effects impose additional costs on the legal system. Courts must draw a line somewhere, and bruxism may justifiably fall on the nonphysical side of that line. But by resolving most cases on the questions of physical manifestations or the intent of the payor, courts avoid making merits judgments about the bruise rule—that is, they avoid deciding precisely the meaning of “physical” in § 104(a)(2). As a result, taxpayers are less able to predict which injuries will be excludable, resulting in more § 104(a)(2) litigation and an increased burden on the Tax Court. As this Comment has shown, the increased litigation costs resulting from this uncertainty are borne disproportionately by women and minorities, further compounding § 104(a)(2)’s harms.

These increased costs are part and parcel of the larger harm caused by the way courts apply and interpret § 104(a)(2). The intent-of-the-payor doctrine introduces profound uncertainty into the system, placing a one-sided burden on women and minorities. As an abstract matter, the rule may seem innocuous: it incentivizes litigants to craft clearer settlements. But in practice, the case law indicates that most litigants do not—or perhaps cannot—respond to this incentive. Settlements regularly fail to clearly allocate funds to particular harms. And yet, courts disproportionately penalize just one class of taxpayers for this failure: those seeking

¹⁷⁰ *Id.* at *5.

exclusion of settlements arising from discrimination and harassment claims.

Why is this? Section 104(a)(2), as I have argued, is a crude, rule-of-thumb solution. But applied faithfully, it would at least have the virtue of being outcome determinative. Injuries are either “physical” within the meaning of the statute, or they are not; taxpayers would know where they stand. The intent-of-the-payor doctrine, on the other hand, leaves taxpayers in the lurch. Deciding bruise-rule questions on the merits may in some cases be an uncomfortable task for judges, and the intent-of-the-payor rule gives them an easy escape route. Rather than come out and say that Julie Devine’s assault didn’t inflict a serious-enough harm to merit exclusion, judges can simply decide that the *defendant* didn’t see the harm as sufficient. This result—shifting the burden to the plaintiff, shifting the blame to the defendant—is something verging on judicial abdication.

The greatest harm wrought by the intent-of-the-payor doctrine, however, is systemic. Because courts so rarely decide on the merits precisely which injuries § 104(a)(2) actually deems to be physical, they also prevent the public from evaluating *the statute* on *its* merits. In this sense, the *Stadnyk* court’s conclusion—that “the deprivation of personal freedom [is not] a physical injury for purposes of section 104(a)(2)”¹⁷¹—is admirable. This is the considered policy decision that the drafters of § 104(a)(2) sought to express: such harms *do not warrant* an exclusion from taxes. That proposition should be debated and, I argue, rejected. But courts have stifled that debate. By suppressing the statute’s critical policy expression under the guise of the payor’s intent, courts not only disserve the individual plaintiffs before them—they also forestall a much-needed reevaluation of the content of that expression. As a result, they have entrenched in the status quo the statute’s inherent disbelief of women.

D. The Test of Sincerity: Reading § 104(a)(2) in Full Context

This Part so far has examined how the amended § 104(a)(2) has disadvantaged female and minority plaintiffs and has been unevenly applied by courts. This final Section scrutinizes the legislative history and statutory context of the 1996 amendment to show that the inconsistencies of § 104(a)(2) are not just the

¹⁷¹ *Stadnyk*, TC Memo 2008-289 at *15.

product of judicial obfuscation, but rather inhere in the words of the statute itself.

1. Did Congress's means achieve its stated ends?

Congress's professed reasoning for adding the "physical" language is dubious. The House Committee Report rightly notes that damages in employment discrimination suits "generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits."¹⁷² But if the mere prospect of tax windfalls were the impetus, then the amendment has failed to achieve its purposes. First, as to back pay, the amendment was unnecessary after *Schleier*, which held as a matter of law that back-pay awards could not be paid "on account of" any injury.¹⁷³ And second, as to lost wages, the amendment only addresses the problem for certain plaintiffs. As Justice O'Connor noted in dissent in *Burke*, ordinary physical-injury tort plaintiffs may still exempt their damages even if they are calculated entirely based upon lost wages that would otherwise have been taxable.¹⁷⁴ And even accepting as true Congress's lost-wages rationale, it should be possible to separate out damages awarded to an employment discrimination plaintiff for lost wages alone from those awarded for emotional distress and related symptoms.¹⁷⁵ By preventing the exclusion of damages from these claims completely, Congress's means do more than address their stated ends. As this Comment has argued, any purported administrability gains from this rule-of-thumb solution—and I suggest that these are highly limited—are outweighed by the inequities it creates.

Particularly in light of Congress's decision to pass the Civil Rights Act of 1991 and expand the remedies available under Title VII to include compensatory relief, thereby making workplace discrimination suits "tort-type" claims under *Burke*,¹⁷⁶ the 1996 § 104(a)(2) amendment seems puzzling: the first change incentivizes more discrimination litigation, but the second incentivizes less.

¹⁷² HR Rep No 104-737 at 300 (cited in note 20).

¹⁷³ *Schleier*, 515 US at 330.

¹⁷⁴ *Burke*, 504 US at 252 (O'Connor dissenting).

¹⁷⁵ See HR Rep No 104-737 at 301 n 56 (cited in note 20) (differentiating excludable emotional damages resulting from physical injury or physical sickness from nonexcludable physical symptoms of emotional distress).

¹⁷⁶ As discussed in note 46, see 42 USC § 1981a(a)(1) (adding a "compensatory and punitive damages" remedy for workplace discrimination).

How might we explain this disparity? Professor Mark Wolff notes that “conscious and unconscious gender bias” runs throughout much of the common law from its inception and argues that, as a result, “unconscious discrimination played a part in the 1996 amendments to § 104(a)(2).”¹⁷⁷ Wolff also notes that the stated “congressional purpose for the changes to § 104(a)(2) was to raise revenues needed to fund tax incentives created by the [SBJPA].”¹⁷⁸ Thus, recalling MacKinnon, perhaps the 1996 amendment was just another case of “women’s lives, men’s laws.”¹⁷⁹ The House that passed the Act included just forty-eight women, and the Senate included just nine.¹⁸⁰ With other goals in mind, and a need to raise revenue to meet them, Congress may simply have deemed it expedient to amend a little-known tax provision in the interest of scoring a big legislative victory, without considering the consequences of that action on women and minorities.

2. The curious case of § 104(a)(1), (3), and (4).

Section 104(a)(2) is not the only exemption for personal injury and sickness in the tax code; indeed, § 104 creates four such exceptions. Section 104(a)(1) exempts “amounts received under workmen’s compensation acts as compensation for *personal injuries or sickness*.”¹⁸¹ Section 104(a)(3) exempts “amounts received through accident or health insurance . . . for *personal injuries or sickness*.”¹⁸² And § 104(a)(4) exempts “amounts received as a pension . . . for *personal injuries or sickness* resulting from active service in the armed forces.”¹⁸³ Curiously, § 104(a)(2) was the only § 104 exemption to which Congress added the “physical” requirement in 1996.

There is no legislative history indicating why these other provisions were left unchanged in the face the § 104(a)(2) amendments, and these provisions are rarely litigated. But the result is surely a strange one. For example, while *Sharp* signals that PTSD is likely nonphysical under § 104(a)(2),¹⁸⁴ a disability

¹⁷⁷ Wolff, 78 Wash U L Q at 1465, 1482 (cited in note 32).

¹⁷⁸ Id at 1346.

¹⁷⁹ See generally MacKinnon, *Women’s Lives, Men’s Laws* (cited in note 1).

¹⁸⁰ See *History of Women in the U.S. Congress* (Center for American Women and Politics), archived at <https://perma.cc/AJ9V-PDC2>.

¹⁸¹ 26 USC § 104(a)(1) (emphasis added).

¹⁸² 26 USC § 104(a)(3) (emphasis added).

¹⁸³ 26 USC § 104(a)(4) (emphasis added).

¹⁸⁴ See *Sharp*, TC Memo 2013-290 at *3, 11–12.

pension paid on account of combat-induced PTSD likely *would* be excludable under § 104(a)(4).¹⁸⁵ And § 104(a)(1) allows exclusion of workers' compensation paid for emotional injuries, which, as of 2015, were compensable in thirty-two of the fifty states.¹⁸⁶ So while a Delaware man's workers' compensation payment for "headaches, flashes of light in his eyes, blackouts, nausea, vomiting, and hives"¹⁸⁷ would be excludable under § 104(a)(1),¹⁸⁸ a civil settlement compensating those same injuries would likely be fully taxable under § 104(a)(2).

One may be able to rationalize this disparity on the grounds that injuries compensable under workers' compensation or military pensions, because of the circumstances under which such injuries typically arise, may on balance be more likely to be "physical" than injuries compensated through civil lawsuits. This is not self-evidently true, however, of insurance claims under § 104(a)(3). In any event, to the extent nonphysical injuries *are* compensable under any of these provisions, they are excludable from gross income. And whatever the reasoning behind singling out § 104(a)(2), the effect is once again to disadvantage women and minority plaintiffs. As for § 104(a)(1), one study of workers' compensation claims in West Virginia found that roughly 71 percent of compensable claims were filed by men, despite the fact that men made up just 57 percent of the workforce.¹⁸⁹ And as for § 104(a)(4), women make up only 15 percent of active duty armed forces.¹⁹⁰

¹⁸⁵ See, for example, *Kiourtsis v Commissioner of Internal Revenue*, TC Memo 1996-534, *9 (disallowing the exclusion of the taxpayer's disability retirement pension under § 104(a)(4), but implying that the result might be different if "the specific finding of [combat-induced PTSD] had not been "incidental to the finding that he was disabled").

¹⁸⁶ See Ashley R. Bailey, Comment, *Stress Is [Not] Part of the Job: Finding the Appropriate Balance Between Fairness and Efficiency to Compensate Posttraumatic Stress Disorder Under Workers' Compensation Statutes*, 2015 Wis L Rev 507, 514–18 (surveying the approaches taken in all fifty states).

¹⁸⁷ See *State v Cephas*, 637 A2d 20, 21–22 (Del 1994).

¹⁸⁸ It is worth noting that § 104(a)(1) claims are also subject to an intent-of-the-payor analysis. Recall that in *Sharp*, one of Linda Sharp's two claims was a workers' compensation claim. TC Memo 2013-290 at *3. See also text accompanying note 8. The settlement she reached covered both that claim and her gross negligence claim, but stated that it compensated for "emotional distress damages only." *Sharp*, TC Memo 2013-290 at *4. The court disallowed any exclusion under § 104(a)(1), just as it did under § 104(a)(2), because Sharp had not "proven that the university intended to pay her the settlement proceeds in exchange for her settling a [workers compensation] claim." *Id* at *8.

¹⁸⁹ Syed S. Islam, et al, *Gender Differences in Work-Related Injury/Illness: Analysis of Workers Compensation Claims*, 39 Am J Indust Med 84, 86 (2001).

¹⁹⁰ Judy L. Dye, et al, *Characterization and Comparison of Combat-Related Injuries in Women During OIF and OEF*, 181 Military Med 92, 92 (2016).

None of these other provisions are problematic on their own; there are surely justifications for each.¹⁹¹ But viewing § 104(a)(2) alongside its statutory compatriots is striking. Taken together, these provisions imply that Congress is not unwilling to exclude compensation for emotional distress per se, but only those emotional distress damages awarded to a particular class of taxpayer—civil lawsuit plaintiffs, and, in particular, “employment discrimination” plaintiffs,¹⁹² a group overwhelmingly made up of women and minorities.

In order to claim any of § 104’s exemptions, taxpayers with nonphysical harms must overcome a test of sincerity—they must prove that their injuries are, in some sense, *real*. In most parts of the statute, however, Congress delegates this test of sincerity to another entity: to a workers’ compensation board, in § 104(a)(1); to an insurance company, in § 104(a)(3); or to the military, in § 104(a)(4).

Only for claims under § 104(a)(2) does Congress’s skepticism about nonobvious harms require an extra showing by the taxpayer. She must show not only that her harms were *real*; she must show that they were *real enough* to merit exclusion.¹⁹³ As this Section has shown, the § 104(a)(2) dual standard operates to preclude the exclusion of damages from claims brought disproportionately by women and minority plaintiffs. There is no persuasive reason, from a tax perspective, for treating with greater esteem the judgments of workers’ compensation boards than the judgments of

¹⁹¹ For example, accident insurance premiums are taxable in the sense that they are paid with after-tax dollars. So perhaps § 104(a)(3)’s exemption for insurance payouts makes sense because recipients have, in a sense, already paid taxes on these amounts: on balance and across taxpayers, nondeductible premiums will equal nontaxable benefits, and the tax system breaks even. Alternatively, perhaps § 104(a)(3) is justified because insurance pays out when one loses something unexpectedly, and so the payout may thus be thought of as a return of capital; paying for insurance is like paying for a capital-recovery service. For some evidence that this is the rationale behind the rule, see Frank J. Doti, *Personal Injury Income Tax Exclusion: An Analysis and Update*, 75 Denver U L Rev 61, 65–66 (1997) (noting a 1918 opinion of the US Attorney General relying upon the human capital theory in concluding that accident insurance proceeds are not taxable). But these are questions for another Comment.

¹⁹² HR Rep No 104-737 at 300 (cited in note 20).

¹⁹³ Indeed, § 104(a)’s flush language allows exclusion of emotional distress damages to the extent the taxpayer can show some “amount paid for medical care . . . attributable to emotional distress.” No similar showing is required for the exclusion of damages for physical injuries. And even *this* exclusion is governed by the intent of the payor. See *Save v Commissioner of Internal Revenue*, TC Memo 2009-209, *7 (denying exclusion because the plaintiff “failed to show that the [defendant] intended any part of her settlement proceeds to be allocated to her medical expenses that she alleges were attributable to emotional distress”).

civil juries. The plaintiff's responsibility to overcome this test of sincerity should end when the jury awards her damages, or when the defendant agrees to settle.

* * *

Asking the woman question of § 104(a)(2) is illuminating. Congress enacted the new provision expressly to prevent exclusion of claims brought primarily by women and minorities, and in so doing left untouched parallel provisions—§ 104(a)(1), (3), and (4)—granting exclusion primarily to men. Moreover, surveying the provision's on-the-ground effects suggests that women and minorities are in fact disadvantaged by § 104(a)(2). And viewing the law from the standpoint of those disadvantaged persons raises a number of additional concerns. At a basic level, making exclusion contingent on the payor's intent is problematic, especially in the harassment and discrimination context. More concerning than the doctrine itself, however, is its arbitrary application. Not only must the *payor* "conceive[] of" the plaintiff's injury as physical¹⁹⁴—the *judge* must do so, too. What is more, this arbitrary application creates uncertainty costs that once again fall disproportionately on women and minorities.

One of the rallying cries of the #MeToo movement was a simple exhortation: "Believe women."¹⁹⁵ Section 104(a)(2) not only bakes disbelief of women and minorities into the tax code, it imposes a financial penalty based on that disbelief.

III. FIXING § 104(a)(2): A BAND-AID AND A CURE

As illuminated in Part II, the text and application of § 104(a)(2) disadvantage women and minorities. This Part proposes solutions to both prongs of this problem. First, to counter the disparate impacts caused by § 104(a)(2) as applied by courts, Part III.A lays out a number of suggested tactics that judges and plaintiffs can employ to apply the provision more equitably. Part III.B then acknowledges that these suggestions provide a stopgap solution at best, and argues that, to fully ameliorate the harms caused by § 104(a)(2), Congress must act to amend it.

¹⁹⁴ *Goode*, TC Memo 2006-48 at *13.

¹⁹⁵ See Solis, *Believing Women Isn't Enough* (cited in note 23).

A. The Band-Aid: Interpretive and Tactical Suggestions for Judges and Plaintiffs

While judicial application of § 104(a)(2) is rife with inconsistencies, this Section applies the methods of feminist practical reasoning to argue that plaintiffs and judges can work within existing doctrines to more fully ensure that the law “tak[es] into account the perspectives of the excluded.”¹⁹⁶ Because feminist practical reasoning recognizes that “the resolution of [a] problem” depends on “the specifics of [each] situation,”¹⁹⁷ this Section does not attempt to offer a one-size-fits-all solution. Instead, it provides a number of suggestions that plaintiffs and judges can apply to the facts before them to yield more equitable results.

1. A plaintiff’s guide to litigating § 104(a)(2).

The case law provides helpful guidance to harassment and discrimination plaintiffs seeking to improve their chances of successfully claiming § 104(a)(2) exclusion. I do not suggest that plaintiffs should simply make things up.¹⁹⁸ Rather, these suggestions are simply meant to maximize the chances that a plaintiff with a valid claim for exclusion actually receives it.

First. Plaintiffs negotiating with defendants should seek settlement terms that, as much as possible, specifically tie damages to the discrete harms suffered. Increasing the clarity of settlement agreements will have two related benefits. First, it gives plaintiffs an easy win on *Schleier*’s “on account of” test, allowing them to bypass the payor’s-intent analysis altogether. And second, clear allocations leave courts no choice but to decide whether the plaintiff’s harms are sufficiently physical for exclusion. The § 104(a)(2) case law is replete with courts skirting this line-drawing question by deciding that, even if the plaintiff’s harms *were* sufficiently physical, the damages were not awarded *on account of* those harms.¹⁹⁹ Forcing courts to decide on the merits

¹⁹⁶ Bartlett, 103 Harv L Rev at 850 (cited in note 112).

¹⁹⁷ Id at 851.

¹⁹⁸ In any event, for plaintiffs playing fast and loose with facts, Federal Rule of Civil Procedure 11 looms.

¹⁹⁹ See, for example, *Zinger v Commissioner of Internal Revenue*, TC Summ Op 2018-33, *7, 11, 15 (denying exclusion because, even though Zinger’s complaint alleged that she “suffered from medical issues and conditions to include chest pains, shortness of breath[], hypertension due to stress, high blood pressure, and high white blood cell count[.]” “[t]he settlement agreement d[id] not refer to any personal physical injuries”); *Mumy*, TC Summ Op 2005-129 at *14 (denying exclusion because, “[f]rom the evidence, the Court conclude[d] that it was not DaimlerChrysler’s intention to compensate [Mumy] for the

whether certain injuries are physical within the meaning of § 104(a)(2) will both hold courts accountable by requiring them to explain their reasons for denying exclusion and give future taxpayers clearer guidance on whether their § 104(a)(2) claims are likely to succeed.

Second. Given the difficulty of obtaining clear allocations, plaintiffs should litigate claims and structure settlement negotiations with an eye toward providing courts with “objective and credible evidence”²⁰⁰ that the payor intended to compensate a physical injury. Plaintiffs must show that their payors were “aware” that they were compensating for physical injury.²⁰¹ The following suggestions help in this effort.

Third. In their initial claims, plaintiffs should allege with particularity any physical symptoms or injuries they suffer. Claims for generalized emotional distress will never be excludable under § 104(a)(2)’s plain language.²⁰²

Fourth. When a long pattern of harassment or abuse includes some discrete incidents of physical harms, plaintiffs should seek damages not just for emotional distress generally, but also for pain and suffering stemming from such incidents. This is far from a sufficient condition for exclusion of resultant damages— “[t]he mere mention of a physical injury in a complaint does not determine the nature of the claim[]”²⁰³—but it may be a necessary condition.²⁰⁴

Fifth. Plaintiffs should leverage the teachings of modern neuroscience to argue that they suffer not from “mere subjective sensations,”²⁰⁵ but rather from concrete harms with traceable

physical injury, in other words, the pinch”); *Devine*, TC Memo 2017-111 at *14 (denying exclusion because the plaintiff’s alleged battery was “cited . . . as evidence of pregnancy-based discrimination, retaliation, and a hostile working environment,” rather than as a discrete physical injury).

²⁰⁰ *Dulanto v Commissioner of Internal Revenue*, TC Memo 2016-34, *7.

²⁰¹ *Domeny*, TC Memo 2010-9 at *11.

²⁰² See notes 61–62 and accompanying text.

²⁰³ *Mumy*, TC Summ Op 2005-129 at *11.

²⁰⁴ See, for example, *Devine*, TC Memo 2017-111 at *12 (denying exclusion in part because “[a]t no point . . . did [Devine] allege a physical injury of any kind or demand compensation for any physical injury,” despite the fact that she suffered both a work-related rash and a battery by another employee); *Hellesen v Commissioner of Internal Revenue*, TC Memo 2009-143, *3 (denying exclusion because “[p]etitioner did not allege a cause of action in the lawsuit for personal physical injuries or sickness”); *French v Commissioner of Internal Revenue*, TC Summ Op 2018-36, *27 (denying exclusion because “French could have included in the complaint a claim for damages for [her] personal physical injuries or physical sickness *but did not*”) (emphasis added).

²⁰⁵ *Parkinson*, TC Memo 2010-142 at *13.

neural correlates. For example, studies show that PTSD leads to observable changes in the brain's structure and circuitry, resulting in memory impairment, reduced function in certain brain regions, and even long-lasting changes in the size of certain regions.²⁰⁶ Similar results have been found for other neurological disorders, such as depression and anxiety.²⁰⁷ Of course, for most plaintiffs, the costs of obtaining MRI evidence will be prohibitive. But plaintiffs who suffer from these sorts of recognized psychological disorders should argue—say, by presenting testimony from medical experts—that, in light of contemporary understandings of mental illness, the defendant's conduct created lasting physical changes to the plaintiff's brain, and that these changes are so severe as to constitute a physical injury or physical sickness. A plaintiff like Linda Sharp, who suffered from “severe clinical depression, anxiety disorder and posttraumatic stress disorder,”²⁰⁸ might significantly increase her chances of earning exclusion by introducing evidence of this sort. It is admittedly not clear how receptive judges will be to such evidence—although I argue in the next Section that they ought to be—but at least one court so far has signaled its approval.²⁰⁹

Sixth. Finally, plaintiffs should enter into evidence any medical expenses incurred due to the defendant's conduct, both because § 104(a) allows exclusion of damages “not in excess of the amount paid for medical care . . . attributable to emotional distress,”²¹⁰ and because the Tax Court often cites a plaintiff's decision to seek medical care (or not) for an injury as implicit evidence that the injury was sufficiently physical (or not) to merit exclusion.²¹¹

²⁰⁶ See J. Douglas Bremner, *Traumatic Stress: Effects on the Brain*, 8 *Dialogues in Clinical Neuroscience* 445, 446–53 (2006). Certain effects, such as decreased gray matter volume, appear to be exacerbated in people who have suffered sexual assault and then develop PTSD and engage in self-blame. See Zohar Berman, et al, *Assault-Related Self-Blame and Its Association with PTSD in Sexually Assaulted Women: An MRI Inquiry*, 13 *Soc Cognitive and Affective Neuroscience* 775, 779–80 (2018).

²⁰⁷ See, for example, Youjin Zhao, et al, *Gray Matter Abnormalities in Non-Comorbid Medication-Naïve Patients with Major Depressive Disorder or Social Anxiety Disorder*, 21 *EBioMedicine* 228, 231–32 (2017) (concluding that subjects with major depressive disorder and social anxiety disorder showed similar gray matter volume reductions in a number of brain regions, along with changes in cortical thickness in a host of others).

²⁰⁸ *Sharp*, TC Memo 2013-290 at *3.

²⁰⁹ See *Allen v Bloomfield Hills School District*, 760 NW2d 811, 815–17 (Mich App 2008).

²¹⁰ 26 USC § 104(a) (flush language).

²¹¹ Compare *Mumy*, TC Summ Op 2005-129 at *3 (denying exclusion after noting that Mumy “did not seek medical care for her battery” and “[t]he incident was not reported to

2. A judge's guide to interpreting § 104(a)(2).

The case law likewise provides guidance for judges seeking to apply § 104(a)(2) more equitably.

First. Judges should recognize that exclusion is not an all-or-nothing proposition. When the plaintiff has suffered physical harms but the settlement is ambiguous about allocation, the best guess as to how much of the award should be tax-exempt is not zero. The Tax Court often cites *Taggi v United States*²¹² to hold that when “a settlement agreement is silent as to what portion, if any, of a settlement payment should be allocated towards damages excludable under 26 U.S.C. § 104(a)(2), the courts will not make that allocation for the parties.”²¹³ But the court occasionally diverges from this path. Going forward, judges should adopt the approach of cases like *Amos*,²¹⁴ *Parkinson*,²¹⁵ and *Simpson*:²¹⁶ when the “matter is not susceptible of any precisely accurate determination,” the court should “exercise . . . [its] best judgment based upon the entire record” to determine which portion of the settlement should be excludable.²¹⁷ Especially in harassment and discrimination cases, when payors are incentivized to craft vague settlements, courts should genuinely consider all “other facts that reveal the payor’s intent”—not just the words of the settlement.²¹⁸

Second. Feminist practical reasoning advocates for an interpretation of rules that “leave[s] room for the new insights and perspectives generated by new contexts.”²¹⁹ As such, judges should follow the lead of *Allen v Bloomfield Hills School District*,²²⁰ and take seriously the argument—provided plaintiffs raise it—that certain “emotional” harms may be just as physical as a broken arm.²²¹ As far back as 1890, judges have recognized that “the mind is no less a part of the person than the body, and the sufferings of the former are sometimes more acute and lasting

the police”), with *Amos*, TC Memo 2003-329 at *3–4 (allowing exclusion after setting out in detail the medical care Amos sought for his injuries related to Rodman’s kick).

²¹² 835 F Supp 744 (SDNY 1993).

²¹³ *Id* at 746.

²¹⁴ TC Memo 2003-329 at *15–16.

²¹⁵ TC Memo 2010-142 at *16.

²¹⁶ 141 TC at 347.

²¹⁷ *Eisler v Commissioner of Internal Revenue*, 59 TC 634, 641 (1973).

²¹⁸ *Parkinson*, TC Memo 2010-142 at *10.

²¹⁹ Bartlett, 103 Harv L Rev at 853 (cited in note 112).

²²⁰ 760 NW2d 811 (Mich App 2008).

²²¹ *Id* at 815–17.

than those of the latter.”²²² And as the court reasoned in *Allen*, the brain “is one of our major organs. It can be injured. It can be injured directly and indirectly. It can be injured by direct and indirect trauma. What matters for a legal analysis is the existence of a *manifest, objectively measured injury to the brain*.”²²³ The *Allen* court concluded that positron emission tomography (PET) scan results pointing to “decreases in frontal and subcortical activity consistent with depression and post traumatic stress disorder” and purporting to show “significant changes in brain chemistry, brain function and brain structure” were sufficient evidence of “bodily harm” to preclude summary judgment on whether the plaintiff’s claim (under a Michigan state statute) could proceed.²²⁴

To be sure, applying *Allen* here might be thought to contravene the clear intentions of § 104(a)(2)’s drafters. But today’s brain science is far beyond what was available in 1996, and courts should not deem verifiably physical injuries nonphysical just because they were *not known to be physical* by the provision’s drafters.²²⁵ And while proponents of interpreting statutes according to their original public meaning might argue that the definition of “physical” should be fixed according to its generally accepted meaning in 1996, there is evidence to suggest that at least some mental disorders, such as PTSD, would have been recognized as physical at the time.²²⁶ In any event, such a formalistic inquiry into original public meaning is at odds with the feminist perspective on legal reasoning, which emphasizes flexible, fact-bound inquiries and the incorporation of multiple perspectives when solving legal problems.²²⁷

Third. Judges should strive for clarity in their decisions and avoid using the intent of the payor as a crutch to escape decisions on the merits of the bruise rule. Was Murphy’s bruxism a

²²² *Young v Western Union Telegraph Co*, 11 SE 1044, 1048–49 (NC 1890).

²²³ *Allen*, 760 NW2d at 815 (emphasis added).

²²⁴ *Id* at 815–16.

²²⁵ For its part, the Supreme Court has interpreted the plain text of antidiscrimination statutes to cover cases surely not envisioned by their drafters. See, for example, *Oncale v Sundowner Offshore Services, Inc*, 523 US 75, 79 (1998) (holding that Title VII barred male-on-male sexual harassment even though it “was assuredly not the principal evil Congress was concerned with when it enacted Title VII”).

²²⁶ See, for example, *Maldonado v National Acme Co*, 73 F3d 642, 647 (6th Cir 1996) (holding that the plaintiff’s allegations of “post-traumatic stress disorder, asthma, high blood pressure, heart problems, and paranoia” were sufficient to state a claim for a physical injury under state tort law because they constituted “facts from which a jury could find or infer a compensable *physical injury*”) (emphasis added).

²²⁷ Bartlett, 103 Harv L Rev at 851–53 (cited in note 112).

physical injury? The *Murphy* court implies both that it might be and that it categorically was not²²⁸ but ultimately avoids deciding.²²⁹ A decision on the merits would not only have provided clarity to Murphy herself. It also would have reduced costs in the legal system going forward—costs that are disproportionately borne by women and minority taxpayers—by increasing the ability of taxpayers like Murphy to know *ex ante* whether their injuries are sufficiently physical to merit exclusion.

Fourth. Finally, following the teachings of feminist practical reasoning, judges should “offer their *actual* reasons” for denying exclusion and accept greater responsibility for their decisions.²³⁰ Harassment and discrimination § 104(a)(2) cases are replete with language noting that, while the court had “considerable sympathy” for the “unfortunate incidents,”²³¹ “great indignities,”²³² “significant distress,”²³³ or “grave harm”²³⁴ suffered by the plaintiff, formalistic application of the intent-of-the-payor principle precluded exclusion. Such language implies that the court’s hands are tied, thus evincing the sort of blind adherence to precedent and disregard for the judge’s role as “an active participant in the formulation of legal authority”²³⁵ that feminist theorists find so problematic. It is particularly troubling when the legal authority being formulated systemically disadvantages women and minorities.

Neither of these final two suggestions requires *overruling* the intent-of-the-payor or physical-manifestations doctrines—in fact, they simply require that judges apply these doctrines more faithfully. What I propose is that, in every case, courts genuinely consider whether, in view of “all the facts and circumstances of the case, including the complaint,”²³⁶ the payor intended to compensate for a physical injury. Deciding whether a physical injury in fact occurred is central to this endeavor.

²²⁸ Compare *Murphy*, 493 F3d at 176 (noting that Murphy’s “*physical injuries* themselves [her bruxism] were not the reason for the award”) (emphasis added), with *id* (referring to the bruxism as one of a number of nonexcludable “*physical manifestations* of emotional distress”) (emphasis added).

²²⁹ See *id* (denying exclusion on the grounds that, in any event, the settlement was not paid to compensate for the bruxism).

²³⁰ Bartlett, 103 Harv L Rev at 854 (cited in note 112).

²³¹ *Devine*, TC Memo 2017-111 at *13–14.

²³² *Stapp v Commissioner of Internal Revenue*, TC Memo 2017-191, *13.

²³³ *French*, TC Summ Op 2018-36 at *20.

²³⁴ *Burke*, 504 US at 238.

²³⁵ Bartlett, 103 Harv L Rev at 860 (cited in note 112).

²³⁶ *McMillan v Commissioner of Internal Revenue*, TC Memo 2019-108, *22.

B. The Cure: Congress Must Act to Amend § 104(a)(2)

The solutions suggested in Part III.A, if implemented successfully, would ameliorate many of the problems I highlight in this Comment. It should be possible, with proper framing and the introduction of relevant expert testimony, to convince judges that certain harms are sufficiently physical to merit exclusion. But this “band-aid” will not solve the provision’s largest problem—the fact that those who allege discrimination and harassment but suffer only more intangible psychic harms, will remain ineligible for § 104(a)(2) exclusion. To solve this more fundamental problem, Congress must act. This Section evaluates a number of possible solutions and concludes that a middle-ground option that allows exclusion of all compensatory personal injury damages except those awarded for lost wages offers the best path forward.

1. Option 1: Equalizing up.

Perhaps the most obvious solution would simply be to return § 104(a)(2) to its pre-SBJPA form by removing the word “physical” and the associated emotional-distress language.²³⁷ While this solution would surely alleviate § 104(a)(2)’s disparate impacts by “equalizing up,” rendering all damages from harassment and discrimination suits tax-exempt, it bears only brief mention here, for two reasons.

First, because Congress amended § 104(a)(2) expressly to prevent exclusion of damages for “claim[s] of employment discrimination or injury to reputation accompanied by a claim of emotional distress,”²³⁸ Congress is unlikely to reverse itself on learning that the amendment had the intended effect.

Second, and more importantly, even assuming Congress would consider this option, it is suboptimal from a tax-policy perspective. Justice O’Connor was right to note, dissenting in *Burke*, that traditional tort plaintiffs often receive damages for “income lost because of the injury”²³⁹ and that § 104(a)(2) renders this income tax-exempt when it would be taxable if earned in the ordinary course. Such income, however earned, is a taxable “accession[] to wealth.”²⁴⁰ Thus, while § 104(a)(2) wrongly confers a benefit to traditional tort plaintiffs that it denies to

²³⁷ See, for example, Leeper, Note, 55 Case W Res L Rev at 1071–72 (cited in note 32).

²³⁸ HR Rep No 104-737 at 301 (cited in note 20).

²³⁹ *Burke*, 504 US at 252 (O’Connor dissenting).

²⁴⁰ *Glenshaw Glass*, 348 US at 431.

discrimination plaintiffs, the best solution is not simply to place these latter plaintiffs “on an equal footing” with the former plaintiffs.²⁴¹ Instead, Congress should seek not merely to equalize, but to equalize and *optimize*. Returning § 104(a)(2) to its first iteration achieves only the first of these ends.

2. Option 2: Equalizing down.

Another straightforward solution to § 104(a)(2)’s disparate impacts would be to “equalize down” by removing the exclusion altogether.²⁴² Unlike the equalize-up solution, removing the exclusion entirely has the benefit of taxing all damages for lost income—whether from personal physical injury or discrimination claims—thus aligning more closely with *Glenshaw Glass*’s prescription that income constitute accessions to wealth.²⁴³ While this policy makes better sense from a tax perspective than equalizing up,²⁴⁴ practically, Congress is perhaps even less likely to equalize down than up because doing so would remove an exemption that has, in some form, been part of the tax code since its inception.

What is more, equalizing down fails to serve the expressive ends I advocate in this Comment. Psychological harms like those caused by discrimination and harassment have suffered second-class treatment for too long. The #MeToo movement sought to change that. The current version of § 104(a)(2) reinforces this status quo: emotional harms really *must* be less serious because the law says they are. Equalizing up would help change this—it would be an affirmative congressional statement that these harms really *are* just as real as a broken arm. Equalizing down, on the other hand, would be entirely unresponsive to the concerns of the moment. Simply eliminating the exclusion for physical harms would not imply congressional recognition of the severity of emotional harms, let alone express such a recognition. Such a change would merely suggest a new determination that *no* harms, not even physical harms, should be tax free; it does nothing to undo the status-quo subordination of psychological harms.

²⁴¹ *Burke*, 504 US at 252 (O’Connor dissenting).

²⁴² See, for example, Ronald H. Jensen, *When Are Damages Tax Free?: The Elusive Meaning of “Physical Injury”*, 10 Pitt Tax Rev 87, 134 (2013).

²⁴³ 348 US at 431.

²⁴⁴ See Morgan L. Holcomb, *Taxing Anxiety*, 14 Fla Tax Rev 77, 108–12 (2013) (touting the tax certainty and positive incentives this proposal would create).

Equalizing up is bad tax policy. Equalizing down is better policy, but it misses a critical opportunity to use law's expressive power to move society in the right direction. Neither will do.

3. Option 3: A middle ground.

A third option charts a middle ground—it equalizes *tactically*. In enacting the amended § 104(a)(2), Congress expressly sought to prevent exclusion of damages that “consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits.”²⁴⁵ As such, one possible way forward is to allow exclusion of all compensatory personal injury civil damages, but only to the extent that those damages do not compensate the plaintiff for lost wages or profits. Under this proposal, if a car-accident plaintiff and a sexual-harassment plaintiff both receive \$100,000 in damages—\$50,000 for lost wages and \$50,000, on the one hand, for pain and suffering and, on the other, for depression and PTSD—in each case only the \$50,000 for lost wages would be taxable. This change would bring § 104(a)(2)'s text more closely in line with Congress's purported intent, and it more closely tracks the human capital theory's focus on taxing only those sources of income that make taxpayers better off.

Under this solution, then, the plaintiffs in *Burke* still lose: their back-pay award remains taxable. But what the *Burke* plaintiffs win is a leveled playing field. Because now, *all* taxpayers—not just those alleging nonphysical harms—would be made to pay taxes on the portion of their damages that stem from lost wages. Critically, this solution thus equalizes the gender and race impacts of § 104(a)(2), removing a windfall enjoyed disproportionately by traditional tort plaintiffs at the expense of female and minority plaintiffs in discrimination and harassment suits. And as an expressive matter, this change serves the much-needed purpose of signaling that Congress takes the severity of discrimination and harassment claims at face value; it would bring our tax code into closer alignment with the values of the society that must abide by it.

This proposal has a number of additional benefits. First, the middle-ground solution aligns with the conception of mind-body “monism” that “nearly all brain researchers and philosophers” accept—the idea that “conscious experience is inseparable from the

²⁴⁵ HR Rep No 104-737 at 300 (cited in note 20).

physical brain.”²⁴⁶ As such, it places equal value on traditional tort harms and those more psychological and dignitary harms whose unfavorable tax treatment does not comport with modern understandings of their severity. Second, from a tax base perspective, this proposal will at least partially pay for itself because it reduces the per-plaintiff exclusion while increasing the number of plaintiffs who can claim *some* exclusion. And finally, moving to the middle-ground solution properly leaves to the jury (or the parties), rather than the judge, the task of determining the proper compensation for “nonphysical” harms. Adopting this solution removes the additional test of sincerity to which the current language of § 104(a)(2) improperly subjects certain plaintiffs, and takes claims brought primarily by female and minority plaintiffs at face value.

On this note, however, I must mention that this middle-ground solution creates a settlement incentive, likely resulting in fewer cases reaching juries to begin with. Under such a system, the allocation of settlement funds to lost wages would become a bargaining chip during settlement negotiations. Assume a 20 percent tax rate and suppose both parties expect a trial would find that a sexual harassment plaintiff’s true damages are \$200,000—\$100,000 for lost wages and \$100,000 for emotional distress. Under this regime, the plaintiff would owe \$20,000 in taxes on the lost wages. Her employer could instead offer to pay her \$180,001 allocated entirely to (nontaxable) emotional distress, thereby making both parties better-off—plaintiff by \$1, defendant by \$19,999.²⁴⁷

From an efficiency perspective, these cost savings might be viewed as beneficial. But feminist scholars have found such dispassionate focus on efficiency problematic because it disallows “incorporat[ion of] the victim’s perspective into [] legal analysis.”²⁴⁸ And while settlement is efficient insofar as it is cheaper, the cost savings do not factor in any social good that results from forcing courts to reckon with problems like sexual harassment directly.²⁴⁹ The ability of courts to create precedent matters:

²⁴⁶ Hilary Rosenthal, Note, *Scanning for Justice: Using Neuroscience to Create a More Inclusive Legal System*, 50 Colum Hum Rts L Rev 290, 308 (2019).

²⁴⁷ This example excludes consideration of legal fees for simplicity.

²⁴⁸ Martha Chamallas and Jennifer B. Wriggins, *The Measure of Injury: Race, Gender, and Tort Law* 22 (NYU 2010) (quotation marks and citation omitted).

²⁴⁹ Congress, too, may have expressed a preference for judgment in civil rights suits by creating an above-the-line deduction for “attorney fees and court costs . . . in connection with any action involving a claim of unlawful discrimination,” including “discrimination

judgment has an expressive value, and in ongoing social struggles like the fight against workplace harassment, “[t]he entry of judgment will [] not end the struggle, but rather change its terms and the balance of power.”²⁵⁰

That said, it is not obvious that the settlement incentive under this middle-ground solution is worse than the one that exists under § 104(a)(2) now. First, defendants today can in theory offer lower settlement awards in exchange for express allocation of funds to tax-free “personal physical injuries,” and they can do so while still denying all of the plaintiff’s allegations.²⁵¹ And second, to the extent that most harassment cases involve “a claim by a worker against a large corporation,” the resulting “disparities in resources between the parties” means that “the poorer party might be forced to settle because he does not have the resources to finance the litigation.”²⁵² Switching to the middle-ground solution would make this structural settlement incentive no worse. The data bears this out: since 2009, of the thirty-five Tax Court cases surveyed in this Comment involving some form of workplace harassment or discrimination, all but three (91 percent) settled.²⁵³ It would be hard to do worse.

* * *

The proposed middle-ground solution—treating as taxable any damages stemming from lost wages or back pay and as excludable all other compensatory personal injury civil damages—achieves equality while striking the best balance of tax and policy considerations. Congress should work to implement it.

against an employee.” 26 USC § 62(a)(20), (e)(18)(ii). But the deduction applies equally to the cost of procuring settlement of such claims, so any incentive to proceed to judgment is marginal at best. See, for example, *Stepp*, TC Memo 2017-191 at *2 n 3.

²⁵⁰ Fiss, Comment, 93 Yale L J at 1082 (cited in note 135).

²⁵¹ See *Amos*, TC Memo 2003-329 at *6, 13, 16 (noting that “it is the nature and character of the claim settled, and not its validity, that determines whether the settlement payment is excludable” under § 104(a)(2), and finding part of Amos’s award excludable even though the settlement was expressly “not to be construed as an admission of liability”).

²⁵² Fiss, Comment, 93 Yale L J at 1076 (cited in note 135).

²⁵³ See *Smith v Commissioner of Internal Revenue*, TC Memo 2018-127; *Barbato v Commissioner of Internal Revenue*, TC Memo 2016-23; *Neri v Commissioner of Internal Revenue*, TC Memo 2012-71.

CONCLUSION

Linda Sharp relied on the advice of her attorney in claiming her § 104(a)(2) exclusion.²⁵⁴ But after finding her settlement taxable, the court also assessed an accuracy-related penalty under 26 USC § 6662(b)(2). The court held that Sharp did not act with “reasonable cause and good faith” when she relied on her attorney’s advice that her damages would be excludable: “It is difficult to imagine how [Sharp], a professional, accomplished woman, could reasonably rely on an attorney whose tax advice was so contrary to such an established body of law.”²⁵⁵ But as this Comment has shown, the law of § 104(a)(2) is far from clearly established. It is rife with inconsistencies and obfuscation, the end effect of which is to impose a lopsided burden on women and minority plaintiffs bringing discrimination and harassment claims.

Courts—and Congress—should take these claims at face value. Congress should act to bring the words of § 104(a)(2) more in line with its stated purpose by taxing amounts that would be otherwise taxable as wages, regardless of the nature of the plaintiff’s injury. And until then, plaintiff’s lawyers and judges should work to litigate and interpret § 104(a)(2) in a more equitable and honest fashion. In recent years, the #MeToo movement forced society to grapple with and take more seriously the problems of women and minorities, particularly in the workplace. The tax code should follow suit.

²⁵⁴ *Sharp*, TC Memo 2013-290 at *16.

²⁵⁵ *Id.* at *16–17. It should be noted that the Tax Court regularly declines to impose § 6662’s penalty on plaintiffs claiming § 104(a)(2) exclusion in reliance on advice from an attorney. See, for example, *Prinster v Commissioner of Internal Revenue*, TC Summ Op 2009-99, *14 (“It is generally reasonable for the taxpayer to rely on an attorney’s tax advice as to a matter of tax law, and the taxpayer is ordinarily not required to challenge that advice.”).

APPENDIX: § 104(a)(2) TAX COURT CASES, 2009–2019

Case ²⁵⁶	Year	Plaintiff's Characteristics ²⁵⁷				Suspect Claim ²⁵⁸	§ 104(a)(2) Exclusion
		Sex	Race	Religion	Disability		
<i>Ghadiri-Asli v CIR</i> ²⁵⁹	2019	M	1	0	0	1	0
<i>McMillan v CIR</i> ²⁶⁰	2019	F	0	0	0	1	0
<i>Doyle v CIR</i> ²⁶¹	2019	M	0	0	0	1	0
<i>Smith v CIR</i> ²⁶²	2018	M	0	1	1	1	0
<i>French v CIR</i> ²⁶³	2018	F	0	0	0	1	0
<i>Zinger v CIR</i> ²⁶⁴	2018	F	0	0	0	1	0
<i>Stepp v CIR</i> ²⁶⁵	2017	F	0	0	0	1	0
<i>Collins v CIR</i> ²⁶⁶	2017	M	1	0	0	1	0

²⁵⁶ Cases not involving an underlying civil lawsuit were excluded from this analysis. See generally, for example, *Perez v Commissioner of Internal Revenue*, 144 TC 51 (2015) (contractual payment for pain and suffering related to egg donations); *O'Connor v Commissioner of Internal Revenue*, TC Memo 2012-317 (medical study participation payment); *Palsgaard v Commissioner of Internal Revenue*, TC Memo 2018-82 (Social Security disability benefits); *Zardo v Commissioner of Internal Revenue*, TC Memo 2011-7 (disability retirement benefits); *O'Neill v Commissioner of Internal Revenue*, TC Summ Op 2009-131 (pension fund).

²⁵⁷ For purposes of this analysis, gender, race, religion, and disability status were assigned based on those of the plaintiff in the lawsuit producing the disputed income. See generally, for example, *Bates v Commissioner of Internal Revenue*, TC Memo 2017-72 (married taxpayers filing jointly scored as “female” because at issue was the wife’s settlement of sex and pregnancy discrimination claims against her employer). “Race,” “Religion,” and “Disability” were scored as 1 if the plaintiff was a racial minority, religious or national origin minority, or disabled person, respectively.

²⁵⁸ For purposes of this Appendix, “Suspect Claim” was scored as 1 if the plaintiff’s claims involved some form of harassment, discrimination, negligent or intentional infliction of emotional distress, or some combination thereof.

²⁵⁹ TC Memo 2019-142. For purposes of this Appendix, respondent Commissioner of Internal Revenue in all cases is abbreviated “CIR.”

²⁶⁰ TC Memo 2019-108.

²⁶¹ TC Memo 2019-8.

²⁶² TC Memo 2018-127.

²⁶³ TC Summ Op 2018-36.

²⁶⁴ TC Summ Op 2018-33.

²⁶⁵ TC Memo 2017-191.

²⁶⁶ TC Summ Op 2017-74.

Case ²⁵⁶	Year	Plaintiff's Characteristics ²⁵⁷				Suspect Claim ²⁵⁸	§ 104(a)(2) Exclusion
		Sex	Race	Religion	Disability		
<i>Maciujec v</i> <i>CIR</i> ²⁶⁷	2017	F	0	0	1	1	0
<i>Rajcoomar v</i> <i>CIR</i> ²⁶⁸	2017	M	1	0	1	1	0
<i>Devine v</i> <i>CIR</i> ²⁶⁹	2017	F	0	0	0	1	0
<i>Bates v</i> <i>CIR</i> ²⁷⁰	2017	F	0	0	0	1	0
<i>McKinney v</i> <i>CIR</i> ²⁷¹	2017	F	0	0	1	1	0
<i>Arkow v</i> <i>CIR</i> ²⁷²	2016	M	0	0	0	0	0
<i>Tishkoff v</i> <i>CIR</i> ²⁷³	2016	F	0	0	0	1	0
<i>Braddock v</i> <i>CIR</i> ²⁷⁴	2016	M	0	0	1	0	0
<i>George v</i> <i>CIR</i> ²⁷⁵	2016	M	0	1	0	1	0
<i>Dulanto v</i> <i>CIR</i> ²⁷⁶	2016	F	1	0	0	1	0
<i>Barbato v</i> <i>CIR</i> ²⁷⁷	2016	F	0	0	1	1	0
<i>Lawson v</i> <i>CIR</i> ²⁷⁸	2015	M	0	0	0	0	0
<i>Smith v</i> <i>CIR</i> ²⁷⁹	2014	M	0	0	1	1	0

²⁶⁷ TC Summ Op 2017-49.

²⁶⁸ TC Memo 2017-129.

²⁶⁹ TC Memo 2017-111.

²⁷⁰ TC Memo 2017-72.

²⁷¹ TC Memo 2017-6.

²⁷² TC Summ Op 2016-87.

²⁷³ TC Summ Op 2016-65.

²⁷⁴ TC Summ Op 2016-46.

²⁷⁵ TC Memo 2016-156.

²⁷⁶ TC Memo 2016-34.

²⁷⁷ TC Memo 2016-23.

²⁷⁸ TC Memo 2015-211.

²⁷⁹ TC Summ Op 2014-93.

Case ²⁵⁶	Year	Plaintiff's Characteristics ²⁵⁷				Suspect Claim ²⁵⁸	§ 104(a)(2) Exclusion
		Sex	Race	Religion	Disability		
<i>Ktsanes v</i> <i>CIR</i> ²⁸⁰	2014	M	0	0	1	0	0
<i>Green v</i> <i>CIR</i> ²⁸¹	2014	F	0	0	1	1	0
<i>Simpson v</i> <i>CIR</i> ²⁸²	2013	F	0	0	0	1	1
<i>Sharp v</i> <i>CIR</i> ²⁸³	2013	F	0	0	0	1	0
<i>Molina v</i> <i>CIR</i> ²⁸⁴	2013	M	1	1	0	1	0
<i>Tirfe v</i> <i>CIR</i> ²⁸⁵	2013	F	0	0	0	1	0
<i>Carr v</i> <i>CIR</i> ²⁸⁶	2013	M	0	0	0	0	0
<i>Reesink v</i> <i>CIR</i> ²⁸⁷	2012	M	0	0	1	0	0
<i>Neri v</i> <i>CIR</i> ²⁸⁸	2012	M	0	0	1	1	0
<i>Blackwood v</i> <i>CIR</i> ²⁸⁹	2012	F	0	0	0	1	0
<i>Ahmed v</i> <i>CIR</i> ²⁹⁰	2011	M	1	0	0	1	0
<i>Ruffin v</i> <i>CIR</i> ²⁹¹	2011	F	0	0	0	1	0
<i>Dennis v</i> <i>CIR</i> ²⁹²	2011	F	1	0	0	1	0

²⁸⁰ TC Summ Op 2014-85.

²⁸¹ TC Memo 2014-23.

²⁸² 141 TC 331 (2013).

²⁸³ TC Memo 2013-290.

²⁸⁴ TC Memo 2013-226.

²⁸⁵ TC Summ Op 2013-42.

²⁸⁶ TC Summ Op 2013-3.

²⁸⁷ TC Memo 2012-118.

²⁸⁸ TC Memo 2012-71.

²⁸⁹ TC Memo 2012-190.

²⁹⁰ TC Memo 2011-295.

²⁹¹ TC Summ Op 2011-136.

²⁹² TC Summ Op 2011-134.

Case ²⁵⁶	Year	Plaintiff's Characteristics ²⁵⁷				Suspect Claim ²⁵⁸	§ 104(a)(2) Exclusion
		Sex	Race	Religion	Disability		
<i>Gutierrez v</i> <i>CIR</i> ²⁹³	2011	F	1	0	0	1	0
<i>McGowen v</i> <i>CIR</i> ²⁹⁴	2011	F	0	0	0	1	0
<i>Oliver v</i> <i>CIR</i> ²⁹⁵	2011	M	0	0	1	1	0
<i>Crane v</i> <i>CIR</i> ²⁹⁶	2011	F	0	0	0	1	0
<i>High v</i> <i>CIR</i> ²⁹⁷	2011	M	1	0	0	1	0
<i>Espinoza v</i> <i>CIR</i> ²⁹⁸	2010	F	1	0	0	1	0
<i>Parkinson v</i> <i>CIR</i> ²⁹⁹	2010	M	0	0	0	1	1
<i>Wells v</i> <i>CIR</i> ³⁰⁰	2010	F	0	0	0	1	0
<i>Domeny v</i> <i>CIR</i> ³⁰¹	2010	F	0	0	1	1	1
<i>MacGregor v</i> <i>CIR</i> ³⁰²	2010	F	0	0	0	0	0
<i>Save v</i> <i>CIR</i> ³⁰³	2009	F	0	0	0	1	0
<i>Taylor v</i> <i>CIR</i> ³⁰⁴	2009	M	0	0	0	0	0
<i>Longoria v</i> <i>CIR</i> ³⁰⁵	2009	M	1	0	0	1	0

²⁹³ TC Memo 2011-263.

²⁹⁴ TC Memo 2011-186.

²⁹⁵ TC Memo 2011-44.

²⁹⁶ TC Memo 2011-256.

²⁹⁷ TC Summ Op 2011-36.

²⁹⁸ TC Memo 2010-53.

²⁹⁹ TC Memo 2010-142.

³⁰⁰ TC Memo 2010-5.

³⁰¹ TC Memo 2010-9.

³⁰² TC Memo 2010-187.

³⁰³ TC Memo 2009-209.

³⁰⁴ TC Memo 2009-235.

³⁰⁵ TC Memo 2009-162.

Case ²⁵⁶	Year	Plaintiff's Characteristics ²⁵⁷				Suspect Claim ²⁵⁸	§ 104(a)(2) Exclusion
		Sex	Race	Religion	Disability		
<i>Prinster v</i> <i>CIR</i> ³⁰⁶	2009	M	0	0	0	1	0
<i>Johnson v</i> <i>CIR</i> ³⁰⁷	2009	M	0	0	0	0	0
<i>Hellesen v</i> <i>CIR</i> ³⁰⁸	2009	M	0	0	0	1	0
<i>Hennessey v</i> <i>CIR</i> ³⁰⁹	2009	M	0	0	0	1	0
<i>Shelton v</i> <i>CIR</i> ³¹⁰	2009	F	0	0	0	1	0
<i>Hansen v</i> <i>CIR</i> ³¹¹	2009	M	0	0	0	1	0

³⁰⁶ TC Summ Op 2009-99.

³⁰⁷ TC Memo 2009-156.

³⁰⁸ TC Memo 2009-143.

³⁰⁹ TC Memo 2009-132.

³¹⁰ TC Memo 2009-116.

³¹¹ TC Memo 2009-87.