TAking your lump sum or just taking your lumps? the negative tax consequences in employment dispute recoveries and congress's role in fashioning a remedy

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Any man of energy and initiative in this country can get what he wants out of life. But when initiative is crippled by legislation or by a tax system which denies him the right to receive a reasonable share of his earnings, then he will no longer exert himself and the country will be deprived of the energy on which its continued greatness depends.2

INTRODUCTION

A "society's choice of a system of taxation speaks volumes about what that society values and believes."3 While the United States should be applauded for having enacted anti-discrimination statutes, a hole in American tax law leaves the overarching goal of these statutes unfulfilled. Current

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3. Sharon C. Nantell, A Cultural Perspective on American Tax Policy, 2 CHAP. L. REV. 33, 35 (1999) (footnote omitted). This connection between tax law and a society's values repeats itself within scholarly circles:

   Every society makes choices as to the tax systems that not only raise the necessary revenues to support government expenditures, but within that choice are inherent reflections of societal values. Not only does a society choose a tax system but the tax system becomes one of the basic institutions that in itself shapes and molds the society.


   The design of a tax system . . . reflects the values of its designers. Tax systems, after all, do not follow the laws of nature. The design of a tax system is not ordained by anything even remotely analogous to the law of gravity. Unlike the falling of a pebble released from a hand, a particular tax system is not the inevitable result of forces which humans can understand, perhaps control and sometimes escape from, but cannot alter. Rather, tax systems are products of human creation. They exist because they serve human objectives, reflecting the values of their designers. A tax system's design can reveal much about those values.

   Id. at 84 (quoting recognized tax professor Alice G. Abreu).
law, most notably Title VII of the Civil Rights Act of 1964 (Title VII),\(^4\) the Age Discrimination in Employment Act (ADEA),\(^5\) and the Americans with Disabilities Act (ADA),\(^6\) confers courts with broad equitable powers to effectuate the desires of Congress.\(^7\) Although these provisions differ in origin, they nonetheless "share common substantive features and also . . . common purpose[s]:\(^8\) 'the elimination of discrimination in the workplace'"\(^9\) and the restoration of an employee to "'the economic status quo'" he would have enjoyed, absent the employer's illegal behavior.\(^10\) Unfortunately, this at-

4. 42 U.S.C. § 2000e-2 (2006) (prohibiting discrimination by employers "against any individual with respect to his compensation, terms, conditions, or privileges of employment" on the basis of race, color, religion, sex, or national citizenship in industries affecting interstate commerce).


7. See infra Section III.B (elaborating on the wide latitude Congress has vested in federal courts to eradicate discrimination in the United States). For a definition of "unlawful discrimination"—and appropriate synonyms—as this Note will use the term, see I.R.C. § 62(e) (2006) (including Title VII, the Congressional Accountability Act of 1995, the National Labor Relations Act, the Fair Labor Standards Act of 1938, the ADEA, the Rehabilitation Act of 1973, the Employee Retirement Income Security Act of 1974, Title IX of the Education Amendments of 1972, the Employee Polygraph Protection Act of 1988, the Worker Adjustment and Retraining Notification Act, the Family and Medical Leave Act of 1993, the ADA, and the Fair Housing Act). Title VII, the ADA, and the ADEA will be discussed exclusively. However, § 62(e)(18) makes the scope of employment dispute claims quite vast: Any provision of Federal, State, or local law, or common law claims permitted under Federal, State, or local law—(i) providing for the enforcement of civil rights, or (ii) regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law.

\(Id.\)

8. The differences between Title VII, the ADA, and the ADEA are inconsequential for purposes of this Note. See Dashnaw v. Peña, 12 F.3d 1112, 1115 (D.C. Cir. 1994) (per curiam) (substituting Title VII for ADEA case law in analyzing a constructive discharge suit).


tempt at justice falls blatantly short every year when the Internal Revenue Service (IRS) collects taxes from prevailing plaintiffs in employment disputes. In extreme cases, the employee may actually be left poorer, after taxes, than before the award.11 Thus, a plaintiff’s “adverse” tax consequences suggest, even if unintentionally, that Congress and federal courts do not “deem[] [the integrity of civil rights and employment law] worth protecting.”12

Damages in wrongful discharge suits can come in a variety of forms:13 lost wages,14 emotional distress damages,15 compensation for medical expenses and physical injuries,16 punitive damages,17 and attorneys’ fees.18 The first category, broken up into payment for wages already lost (back pay)19

11. See Kenseth v. Comm’r, 114 T.C. 399, 425-26 (2000) (Beghe, J., dissenting) (noting that if the ratio of attorneys’ fees to gross settlement amount is large enough, a pre-tax gain could be transmuted into an after-tax loss because the employee may be subject to a rate of tax in excess of 100%); Adam Liptak, Tax Bill Exceeds Award to Officer in Sex Bias Suit, N.Y. TIMES, Aug. 11, 2002, at A18 (telling the story of a plaintiff who ended up with a $99,000 loss, despite obtaining a $1,250,000 judgment in her favor); see also infra Subsections 1.8.2, II.C.2 (offering more hypothetical and real-life examples of how a plaintiff’s legal fees can transform a post-judgment recovery into a net loss). In 2004, Congress amended the Code to fix this problem, but a loophole for ancillary claims may still exist. See infra Subsection I.B.2 (emphasizing that the AMT trap, the name given to this predicament, continues to pose a problem, at least in demonstrating the reluctance of judges to provide gross ups).


15. See id. § 1981a(b)(2)-(3) (defining compensatory damages as “future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other nonpecuniary losses,” but not back pay).

16. See id.

17. See id. § 1981a(b)(1) (allowing for punitive damages when the employer acts “with malice or with reckless indifference to the federally protected rights of an aggrieved individual”); Kolstad v. Am. Dental Ass’n, 527 U.S. 526, 535 (1999) (“[Section 1981a] does not require a showing of egregious or outrageous discrimination independent of the employer’s state of mind.”).

18. See 42 U.S.C. § 2000e-5(k) (2006) (providing that a successful plaintiff can seek reasonable attorneys’ fees under Title VII); id. at § 12117(a) (adopting the remedies of Title VII for the ADA); 29 U.S.C. § 626(b) (2006) (recognizing attorneys’ fees in ADEA disputes). However, the attorney fee portion of an award must be included in gross income and, thus, could invoke the AMT trap. See discussion infra Subsection I.B.2 (introducing the alternative minimum tax and arguing that the AMT trap continues to cast a shadow over employment recoveries); Campbell v. Comm’r, 274 F.3d 1312, 1314 (10th Cir. 2001) (holding that a prevailing employee must account for attorneys’ fees in gross income); Young v. Comm’r, 240 F.3d 369, 377-78 (4th Cir. 2001) (same).

19. See Civil Rights Tax Relief Act of 2009, H.R. 3035, 111th Cong. § 3 (2009) (characterizing “back pay” as compensation for “services performed, or that would have
Negative Tax Consequences in Employment Dispute Recoveries

and payment for wages deprived of in the future (front pay), usually makes up the largest percentage of a successful plaintiff’s award. Because “compensation for services” falls within the definition of “gross income,” as provided by the Internal Revenue Code (Code), no one questions the federal government’s ability to tax these amounts. Therefore, unless the claim arises from a personal, physical injury, an employee’s entire judgment should generally be taxed as ordinary income. However, the timing of

been performed but for a claimed violation of law, as an employee, former employee, or prospective employee before such taxable year for the taxpayer’s employer, former employer, or prospective employer’); see also Albemarle Paper Co. v. Moody, 422 U.S. 405, 416-17 (1975) (finding that compensation for wages lost prior to judgment may be recovered, as long as the remedy is equitable). Due to the time value of money, courts typically include an interest component in the back-pay award; see, e.g., Skalka v. Fernald Envtl. Restoration Mgmt. Corp., 178 F.3d 414, 428-29 (6th Cir. 1999) (recognizing the interest plaintiff could have earned if he had the opportunity to invest the wages in due course); EEOC v. Ky. State Police Dep’t, 80 F.3d 1086, 1097-98 (6th Cir. 1996) (same, but limited to pre-judgment interest). For discussion on how a plaintiff’s pre-judgment interest can be analogized to his negative tax consequences, see infra Sections II.B, III.C.

20. Front pay compensates the plaintiff for future wage loss because of unemployment or under-employment. Susan K. Grebeldinger, The Role of Workplace Hostility in Determining Prospective Remedies for Employment Discrimination: A Call for Greater Judicial Discretion in Awarding Front Pay, 1996 U. ILL. L. REV. 319, 327-28; see also Rhodes v. Guiberson Oil Tools, 82 F.3d 615, 622 (5th Cir. 1996) (indicating that district courts may grant front pay, but the award should be reduced to present value).

21. See Mark J. Tindall, How Much Is an Illegal Immigrant’s Life Worth?, 89 TEX. L. REV. 729, 730 (stating that in wrongful-death suits, “[b]y far the largest percentage of damages comes from pecuniary losses, which mainly consist of the decedent’s lost earning capacity”) (footnote omitted).


23. See id. at § 61(a) (describing how “gross income” can come “from whatever source derived,” which includes wages). “Income” is any “accession[] to wealth, clearly realized, and over which a taxpayer has control. Comm’r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955); see also Comm’r v. Schleier, 515 U.S. 323, 327 (1995) (emphasizing that the Code’s definition of “gross income” has a “sweeping scope”).

24. See I.R.C. § 213 (2006) (stating medical bills do not get taxed either); id. at §104(a) (allowing a deduction for medical care expenses not compensated by insurance).

25. See id. at § 104(a)(2) (excluding from gross income damages other than punitive damages “on account of personal physical injuries or physical sickness”). Congress amended the Code in 1996 after two Supreme Court cases held that the personal injury exclusion could not be applied to back pay. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838-39; United States v. Burke, 504 U.S. 229, 233-37 (1992) (applying the exclusion only if the victim has suffered a tort-type personal injury); Schleier, 515 U.S. at 333-37 (ruling that the exclusion applies only if damages compensate for an injury to physical or mental health or bear a close nexus to the personal injury). With the Supreme Court in Burke “focusing on the remedial scheme of the underlying statutory cause of action,” Congress immediately stepped in to correct the Court and give Title VII a broader scope. BURKE & FRIEL, supra note 3, at 187. Presently, only damages “flowing from a non-physical personal injury,” which “include[] physical symptoms of [a] nonphysical injury, as well as any economic damages,” should be taxed. Laura Spitz, I Think, Therefore I Am; I Feel, Therefore I Am Taxed: Descartes, Tort Reform, and the Civil Rights Tax Relief Act, 35
any such payouts can directly affect the plaintiff’s tax burden and overall recovery. This phenomenon occurs because of the lump-sum nature of a jury verdict or settlement. One possible solution to this problem is “grossing up,” a process in which the court augments an award to account for the extra taxes that a recipient will owe. Normally, an employee will receive his wages over a span of years and, thus, spread out his tax liability. In an employment discrimination or wrongful termination suit, though, a victorious plaintiff will be responsible for paying taxes on the whole award—all at one time.

Transferring funds in this way often pushes the employee into a higher-than-normal tax bracket, which, reminiscent of causation in tort actions, would not have occurred but for the employer’s unlawful conduct. Despite this seemingly unfair and onerous result, modern courts have been reluctant to provide a “gross up,” and in so refusing, have forced plaintiffs to cover the additional costs that defendant’s breach itself caused. Although the resolution of this issue can have drastic effects on litigants, few judges, legal scholars, or practitioners have addressed the problem. Recently, the

N.M. L. REV. 429, 433 & n.30 (2005). This Note will assume that the initial injury is non-physical, making an origin-of-the-claim argument immaterial.

26 “Overall recovery,” as this Note defines it, refers to the plaintiff’s recovery after paying attorneys’ fees and taxes.


28 See Advocacy: Civil Rights Tax Relief Act, NELA, http://www.nela.org/NELA/index.cfm?event=showPage&pg=CRTRA (last visited Sept. 5, 2011) (“Under current law, employees who do not have to sue for lost wages pay taxes at the marginal rates applicable to their actual wages earned in each year; employees who do have to sue for lost wages pay taxes at the unduly high marginal rates applicable to the lump sum they receive all in one year, even though that sum substitutes for wages earned over a number of years.”)

29 A tax “bracket” is one of the rates (10%, 15%, 25%, 28%, 33%, 35%) found in I.R.C. § 1 that is applied to a given range of income. BURKE & FRIEL, supra note 3, at 17-18; see also BLACK’S LAW DICTIONARY 1187 (7th ed. 2000) (defining “tax bracket” as “[a] categorized level of income subject to a particular tax rate under federal or state law”).

30 See Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam) (denying a gross up because of “the complete lack of support in existing case law for” such relief); Fogg v. Gonzalez, 492 F.3d 447 (D.C. Cir. 2007) (refusing to overturn Dashnaw); see also infra Subsection II.C.2 (explaining Dashnaw and Fogg in more detail and listing other cases that reject a gross up).

31 While this Note focuses on the parties’ negative tax consequences, trial attorneys can also suffer “adverse consequences.” For information on the ethical and fiduciary duties the AMT trap may impose on lawyers (and the resulting sanctions and exposure to malpractice in the event of breach), see Gregg D. Polsky, The Contingent Attorney’s Fee Tax Trap: Ethical, Fiduciary Duty, and Malpractice Implications, 23 VA. TAX REV. 615 (2004); see also Jalali v. Root, 1 Cal. Rptr. 3d 689, 692 (Cal. Ct. App. 2003) (awarding plaintiff $310,000 in malpractice damages at the trial court level because attorney forgot about the AMT and thus, gave erroneous tax advice).

32 Gregg D. Polsky & Stephen F. Befort, Employment Discrimination Remedies and Tax Gross-Ups, 90 IOWA L. REV. 67, 69 (2004); Tim Canney, Comment, Tax Gross-ups:
Third Circuit deviated from this trend in *Eshelman v. Agere Systems, Inc.*, granting a plaintiff over $6,000 to neutralize "adverse" federal tax consequences.\(^{33}\)

As of the October 2011 Term, the United States Supreme Court has not ruled definitively on gross ups or offered any input on how lower courts should approach this conundrum.\(^{34}\) Based on the circuit split and wide disagreement among courts, the issue would seem ripe for adjudication.\(^{35}\) However, employers and employees cannot wait any longer for the "perfect" case. In the absence of Supreme Court guidance, Congress should step up now and pass an enhanced version of the Civil Rights Tax Relief Act, a bill that has been introduced several times in the Senate and House of Representatives.\(^{36}\) Looked at reasonably, a successful plaintiff's argument cannot be viewed as anything but logical: to subject him to higher tax rates than would have otherwise been applied only adds insult to injury—an injury already proven in a judicial proceeding beyond a preponderance of a doubt.\(^{37}\)

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33. 554 F.3d 426, 442-43 (3d Cir. 2009). See infra Sections II.A, II.B for a complete summary of *Eshelman*’s facts and holding.
34. Defendants did not file a writ of certiorari in *Eshelman*.
35. See infra Part II (citing cases from United States district courts and courts of appeals that diverge over the proper treatment of a plaintiff’s adverse tax consequences).
36. The bill first appeared during the 106th Congress in 1999 (entitled the Civil Rights Tax Fairness Act), and very similar provisions have been presented in subsequent sessions, including the years 2000, 2001, 2003, 2007, and 2009. *H.R. 3035: Civil Rights Tax Relief Act of 2009*, GOVTRACK.us, http://www.govtrack.us/congress/bill.xpd?bill=h111-3035 (last visited Feb. 11, 2011) (follow “Related Legislation” hyperlink) [hereinafter GOVTRACK H.R. 3035]. Sessions of Congress last two years. At the end of each session, all proposed bills and resolutions that have not passed are cleared from the books. Supporters, therefore, often re-introduce bills that do not become law under a new number in the next session. President George W. Bush signed the Civil Rights Tax Relief Act of 2004 into law in October 2004, but this particular bill was far less comprehensive than others. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004); see also Spitz, supra note 25, at 446 (“Although the Act [of 2004] bears the same name as earlier proposals, it is obviously nowhere near as extensive and should not be confused with earlier versions.”). For more history on the Civil Rights Tax Relief Act, see infra Section IV.B. Very late in the publication process, Representative John Lewis introduced the Civil Rights Tax Relief Act of 2011 to the 112th Congress. *H.R. 3195: Civil Rights Tax Relief Act of 2011*, GOVTRACK.us, http://www.govtrack.us/congress/bill.xpd?bill=h112-3195 (last visited Jan. 10, 2012). While still pending, the bill has little chance of even being reported by the Committee on Ways and Means, let alone voted on and signed.
37. This Note will avoid commenting on the merits of the plaintiff-employee’s case and, suffice it to say, will assume that the plaintiff has adequately convinced a trier of fact of the employer’s wrongdoing.
This Note considers whether a prevailing plaintiff in an employment discrimination or wrongful termination suit should receive an augmented award to balance out the extra taxes a lump sum creates. It also proposes a solution and urges Congress to respond accordingly. Part I defines pertinent terms, lays the groundwork for understanding how tax issues intersect with employment law, and describes the negative tax consequences that may impact plaintiffs. Part II presents a thorough analysis of the Eshelman decision and compares the Third Circuit's findings to the handful of other rulings on point. Part III argues that, in the spirit of anti-discrimination statutes, plaintiffs should be able to request payments that will offset increased tax liabilities. Moreover, Part III asserts that courts do have the authority to provide gross ups. Part IV details the uncertainty that pervades employment suits with regard to how taxes should be treated, as well as the great reluctance of many courts to resolve the matter adequately. Finally, this Note recommends that Congress breathe life back into the Civil Rights Tax Relief Act and, ultimately, pass Part IV's version of it. As courts struggle to reach a satisfactory approach to an employee's right to tax relief, Congress should guarantee that America's "national policy of encouraging the pursuit of meritorious civil rights claims" does not become diluted. 38

I. BACKGROUND

This section explores some basic elements of tax law and attempts to demonstrate the significant ramifications "adverse" tax consequences can have for a plaintiff-employee. It explains the alternative minimum tax (AMT), a system designed, in theory, to ensure that wealthy members of society "pay more than a minimal amount of income tax." 39 In addition, Part I juxtaposes the AMT with the regular tax regime and works through two numerical examples highlighting the monetary losses an average American worker may experience—depending on the availability of attorneys' fees and whether those fees cover a primary employment claim or an auxiliary one—in both situations. In this Note, the terms "adverse" and "negative" tax consequences will be used interchangeably and will refer to the amount by which (i) the after-tax dollars recovered by the plaintiff for pecuniary damages is less than (ii) the after-tax dollars the plaintiff would have received

39. Polsky & Befort, supra note 32, at 69 n.3; see also First Chi. Corp. v. Comm'r, 842 F.2d 180, 181 (7th Cir. 1988) ("Congress enacted the [alternative] minimum tax to prevent corporate and individual taxpayers from aggregating deductions to the point where they pay . . . no tax . . . .").
had no discrimination occurred and the plaintiff had earned his wages in due course.\textsuperscript{40}

A. Definitions Related to Income Taxation

In 1913, the United States ratified the Sixteenth Amendment, which allows Congress to levy income taxes: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."\textsuperscript{41} For decades, the IRS has utilized two constant features (or conventions). First, the government calculates a taxpayer's income based on any gains he actually or constructively receives during the calendar year in question.\textsuperscript{42} This concept is known as "annual accounting."\textsuperscript{43} Second, the United States employs a progressive income tax structure, which means that the marginal tax rate increases as the base amount of taxable income increases.\textsuperscript{44} The "tax rate" is the ratio—usually expressed as a percentage—at which the IRS taxes a business or individual.\textsuperscript{45} Tax rates are most commonly classified as either marginal or effective. The "marginal" tax rate signifies the change in one's tax obligation as income rises and is the tax rate that applies to the last dollar of the tax base.\textsuperscript{46} The "tax base" is the amount of taxable income.\textsuperscript{47} For instance, the marginal tax rate for an unmarried individual with taxable income of $100,000 would be 28% in

\begin{footnotes}
\footnote{40}{Polsky & Befort, supra note 32, at 73.}
\footnote{41}{U.S. CONST. amend. XVI.}
\footnote{42}{Treas. Reg. § 1.446-1(c)(1)(i) (2006); Rev. Rul. 78-336, 1978-2 C.B. 256 (ruling that dismissed federal employees must report income for back pay in the year paid); see also United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 219 (2001) (applying income taxes to back pay for the year the settlement was paid, not the years the wages should have been paid).}
\footnote{43}{Polsky & Befort, supra note 32, at 76-77.}
\footnote{44}{See Richard Schmalbeck, Income Averaging After Twenty Years: A Failed Experiment in Horizontal Equity, 1984 DUKE L.J. 509, 509-10 (differentiating a progressive income tax from a flat tax (e.g., Social Security tax) and a regressive tax (e.g., Medicare tax)). For sake of comparison, sales taxes usually have a flat, statutory rate.}
\footnote{45}{See BLACK'S LAW DICTIONARY, supra note 29, at 1189 (defining "tax rate" as "[a] mathematical figure for calculating tax, usu[ally] as a percentage"). For federal tax rates imposed on married individuals, heads of households, unmarried individuals, estates, and trusts, see I.R.C. § 1(a)-(e) (2006).}
\footnote{46}{BLACK'S LAW DICTIONARY, supra note 29, at 1189 (using "marginal tax rate" to mean the tax on an additional dollar of income). Let $m$ be the marginal tax rate, $\tau$ the tax liability, and $l$ the taxable income. Then, $m = \Delta \tau / \Delta l$.}
\footnote{47}{BLACK'S LAW DICTIONARY, supra note 29, at 1187 (defining "tax base" as "[t]he total property, income, or wealth subject to taxation in a given jurisdiction" or "the aggregate value of the property being taxed by a particular tax"). Spending would be the tax base if the Code called for a consumption tax instead of an income tax. In the hypothetical that follows, the tax base is $100,000.
}
2010. The first $8,375 is taxed at 10%, the next $25,625 at 15%, the next $48,400 at 25%, and the remaining $17,600 at 28%. In contrast to marginal tax rates, a taxpayer's "effective" tax rate is his average tax rate. Here, the total tax liability would be $21,709.25 giving an effective tax rate of 21.7%. Adverse tax consequences arise when a portion of a plaintiff's recovery will be taxed at a higher marginal rate than the rate that would have been applied for each individual year.

Controversy in tax law emerges most prominently whenever someone perceives the Code as being unfair or as taking advantage of the vulnerable. To gauge "the fairness, effectiveness, and desirability of [a particular] tax measure[,]" tax analysts use "two sorts of equities: vertical and horizontal." Vertical equity is the "premise that a person's greater ability to pay makes it "fair" to require that person to bear a larger portion of the country's overall revenue needs"—a sort of substantive or redistributive equality.

50. See BLACK'S LAW DICTIONARY, supra note 29, at 1189 (defining "average tax rate" as "[a] taxpayer's tax liability divided by the amount of taxable income"). Let \( e \) be the effective tax rate, \( r \) the tax liability, and \( i \) the taxable income. Then, \( e = \frac{r}{i} \).
51. Add \((8,375)(0.10) + (25,625)(0.15) + (48,400)(0.25) + (17,600)(0.28)\) to calculate the total tax liability. The effective tax rate is \( \frac{\text{total tax liability}}{\$100,000} \).
52. The plaintiff's effective tax rate and tax liability will also be higher.
53. Spitz, supra note 25, at 438.
54. Hale E. Sheppard, Perpetuation of the Foreign Earned Income Exclusion: U.S. International Tax Policy, Political Reality, and the Necessity of Understanding How the Two Intertwine, 37 VAND. J. TRANSNAT'L L. 727, 734 (2004). Modern progressive taxation can be traced back to Adam Smith, who wrote, "It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion." ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS V.2.71 (Edwin Cannan ed., Methuen & Co.) (1776), available at http://www.econlib.org/library/Smith/smWN21.html#B.V,%20Ch.2,%20Of%20the%20Sources%20of%20the%20General%20or%20Public%20Revenue%20of%20the%20Society. Politicians, economists, and political scientists continue to debate the rationality of a progressive tax system. See YABLON, supra note 3, at 140 (quoting Thomas Jefferson's belief that "[t]axes should be proportioned to what may be annually spared by the individual"); Franklin D. Roosevelt, President of the United States, Address at Worcester, Mass. (Oct. 21, 1936) (transcript available at Gerhard Peters & John T. Woolley, The American Presidency Project, UCSB.EDU, http://www.presidency.ucsb.edu/ws/index.php?pid=15201#axzz1WTf8fAbL (last visited Aug. 27, 2011) ("Here is my principle: Taxes shall be levied according to ability to pay. That is the only American principle."). But see J.R. McCulloch, A TREATISE ON THE PRINCIPLES AND PRACTICAL INFLUENCE OF TAXATION AND THE FUNDING SYSTEM 145 (1863) ("The moment you abandon . . . the cardinal principle of exacting from all individuals the same proportion of their income or their property, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit."); LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 807 (Found. for Econ. Educ., Inc. 4th ed. 1996) ("[A] system of discriminatory taxation [given] under the misleading name of progressive
Horizontal equity "seeks to tax similarly-situated taxpayers similarly." These two themes recur often in employment law claims because a plaintiff in a discrimination suit may pay higher taxes than his peers or co-workers, even though all persons should have earned the same amount of income.

B. How Adverse Tax Consequences Arise in Employment Law Cases

1. "Bunching": Damages Paid in a Lump Sum

By far, the most common type of negative tax consequence is "bunching," in which income earned over a period of time is received and taxed in a single year. The concept of bunching can be best exemplified with the sale of long-held property. Although the fair market value of certain property, such as land, may increase from year to year, the taxpayer does not report any gain until a realization event. Thus, a property owner will have more taxable income in the year he sells or exchanges the asset, which could lift him into a higher tax bracket for that year. Luckily, the Code has § 121 for excluding gain from the sale of principal residences and § 1(h) for capital gains. In all likelihood, one of Congress's major justifications for lowering taxes in these circumstances is to alleviate bunching on real property, stock, and other assets that may appreciate markedly. However, this tax benefit does not extend to pecuniary damages. Therefore, a problem could present itself if an employee receives a three-year bonus in just one year, or, more importantly to this Note, is deprived of wages because of a wrongful discharge.

To grasp the potential magnitude of adverse tax consequences on an average American taxpayer in the twenty-first century, the following hypothetical will be discussed. This example is not meant to compute the precise amount of tax that will be owed in every case. Rather, the fact pattern contains fairly simple numbers that serve to illustrate how negative tax consequences come up and the impact they may have on an everyday person. The taxation" is "a mode of disguised expropriation of the successful capitalists and entrepreneurs.").

55. Spitz, supra note 25, at 438.
56. Polsky & Befort, supra note 32, at 73.
57. BURKE & FRIEL, supra note 3, at 28-30.
58. See I.R.C. § 121(a) (2006) ("Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer’s principal residence for periods aggregating 2 years or more.").
59. See id. at § 1(h) (providing preferential tax rates for capital assets).
61. See I.R.C. § 1222(3) (2006) (requiring a capital asset for long-term capital gains); id. at § 1221(a) (defining a capital asset as "property").
actual computation can be somewhat time-consuming, and this may be one reason why courts tend to avoid the issue. In spite of the mathematics involved, another goal of this exercise is to demonstrate that the calculations are not that hard and thus, courts should be able to handle a plaintiff's tax demands. Nevertheless, judges, Congress, and the public must remember that although the Code may seem daunting at times, "[w]e [still] cannot lose sight of the fact that complexity [in tax law] is the result of our struggle for fairness." Convenience should not replace accuracy. For ease in this Note only, many details will be omitted and considerations, such as inflation, raises, and deductions, ignored.

Suppose a single-filing worker had an annual salary of $35,452 before being wrongfully terminated five years ago. Based on 2005 to 2009 tax brackets, the employee would have paid $5,528 in income taxes for 2005, $5,420.50 for 2006, $5,286.75 for 2007, $5,206.75 for 2008, and $5,050.50 for 2009. Therefore, the employee's total tax liability would have been

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62. See Burke & Friel, supra note 3, at v ("[T]he complexities [in tax law] are manageable."); see also infra Section III.A (arguing that computing taxes is neither an arduous nor an out-of-the-ordinary exercise for courts to undertake).

63. Over the years, many observers have criticized or poked fun at the Code for being too perplexing, including Judge Learned Hand:

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession; cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time.

Yablonskiy, supra note 3, at 46; see also Dave Barry, April’s Been Cruel Again, CHI. TRIB., Apr. 30, 2000, http://articles.chicagotribune.com/2000-04-30/features/0004300284_1_tax-forms-tax-guide-united-states-tax-code (“As a taxpayer, you are required to be fully in compliance with the United States Tax Code, which is currently the size and weight of the Budweiser Clydesdales.”).

64. Yablonskiy, supra note 3, at 144; see also C. Eugene Steuerle, Contemporary U.S. Tax Policy 266 (2d ed. 2008) ("No matter how much badly designed tax policies stand as evidence that getting it 'right' is difficult, when good policies are enacted and revisions well-timed, they remind us that political honesty . . . and integrity can help create a . . . more . . . equitable system."); Yablonskiy, supra note 3, at 29 (quoting tax professor Edward McCaffery: Tax law “has unavoidable moral . . . dimensions.”).

65. “Simplicity is not a goal per se, and it is definitely undesirable when it conflicts with the major objectives of a good tax system.” Robert B. Eichholz, Should the Federal Income Tax Be Simplified?, 48 YALE L.J. 1200, 1220 (1939); see also Dobson v. Comm'r., 320 U.S. 489, 495 (1943) ("[T]ax law can never be made simple.").


67. IRS tax-rate schedules for each year in question should be used.

$26,492.50.\textsuperscript{69} If the worker initiates an unlawful discrimination suit in 2009 against his former employer and wins, then the court will probably award $177,260 as a lump sum.\textsuperscript{70} Without taking into account any other income sources,\textsuperscript{71} this amount will move the employee up two levels—from the 25% tax bracket to the 33% tax bracket for 2009.\textsuperscript{72} Assume further that the defendant-employer pays the entire lump sum in 2009 and that the employee’s taxable year ends on December 31, 2009. Then, the plaintiff must report $177,260 as income for that year. Under this scenario, the worker will pay $43,638.30 in income taxes on the lump sum,\textsuperscript{73} not $26,492.50. The difference is $17,145.80, which comprises 48% of the employee’s yearly salary\textsuperscript{74} and more than 56% of what would have been his net income in 2009.\textsuperscript{75} In other words, Mr. Taxpayer will lose approximately six months worth of compensation, even though his employer, not he, committed the wrong. His effective tax rate jumps from 14.9% to 24.6%.

Obviously, averaging one’s income over a set number of years could reduce the problem. From 1964 to 1986, the Code contained these types of provisions, enabling a taxpayer to apply a lower tax rate for years when his taxable income exceeded his average taxable income over the previous four years by more than 40%.\textsuperscript{76} Had Congress not repealed these statutes,\textsuperscript{77} a
wrongly discharged employee would not suffer as harshly today. However, the Tax Reform Act of 1986 did eliminate the “income-averaging” provisions. As a result, a plaintiff in an employment suit incurs a higher level of tax liability than he would have had the payments been spaced out appropriately. Furthermore, a variety of circumstances, in practice, could actually exacerbate the worker’s negative tax consequences—even more than the hypothetical plaintiff experienced. For example, a married plaintiff who would have earned wages while single may, because of his changed marital status, have a higher marginal tax rate at the time of recovery. Congress may also raise marginal tax rates in the interim, requiring a successful plaintiff to pay taxes based on the elevated, present-day rate.

2. The AMT “Trap”: Disallowing a Deduction for Attorneys’ Fees

Since passing the AMT in 1969, Congress has maintained two separate, but parallel tax schemes: a regular tax and an alternative tax. When a taxpayer’s AMT liability exceeds his regular tax liability, he must pay the higher amount. The AMT serves to limit or modify the credits, deductions, and exclusions a taxpayer may use to prevent high-income individuals from completely “escap[ing] their fair share of taxation”—a form of vertical equity. Specifically, the AMT withholds a deduction for miscellaneous itemized deductions, such as attorneys’ fees, and may even impose a marginal

78. Income averaging will not always reduce a plaintiff’s negative tax consequences. See Sears v. Atchison, Topeka & Santa Fe Ry., 749 F.2d 1451, 1456 (10th Cir. 1984) (realizing that plaintiffs would still be in the highest tax bracket even with income averaging). For a debate on the effectiveness of income averaging and its influence on different social classes, compare Lily L. Batchelder, Taxing the Poor: Income Averaging Reconsidered, 40 HARV. J. ON LEGIS. 395, 404-06 (2003) (contending that the poor will normally benefit from income averaging), with Schmalbeck, supra note 44, at 578 (arguing that because income averaging helps the rich, the Code should not contain income-averaging provisions).


83. I.R.C. § 55(a) (2006). Determining which liability is greater “depends on the complex interaction of many variables,” but it is safe to say that a taxpayer’s AMT liability will generally exceed his regular liability whenever he has expenses that are not deductible under the regular tax. Sager & Cohen, supra note 38, at 1077 n.9.

84. Polsky & Befort, supra note 32, at 79. See also supra Section I.A (defining vertical and horizontal equity).
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The IRS ordinarily subjects miscellaneous itemized deductions to a 2% floor, meaning a taxpayer can only receive a deduction on amounts over 2% of adjusted gross income. However, these items cannot be deducted at all whenever the AMT controls.

In the employment law context, a successful plaintiff will undoubtedly incur substantial lawyering fees, yet if the AMT is triggered, the employee will be forced to pay out-of-pocket expenses to cover taxes incident to the recovery. The AMT trap has been partially resolved in unlawful discrimination suits, detailed below, but in peculiar circumstances could still rear its ugly head and "turn[] an apparent pre-tax 'winner' into an after-tax 'loser.'"

Therefore, the AMT has been, not surprisingly, widely criticized for expanding beyond its intended scope and contradicting fundamental tax

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85. The Code defines "miscellaneous itemized deductions" in the negative and, by not mentioning legal fees, characterizes attorneys' fees as such. I.R.C. § 56(b)(1)(A)(i) (2006); see also id. at § 67(b) (not referring to attorneys' fees).

86. Id. § 67(a) ("In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income.").

87. Courts and commentators have used the discharge of indebtedness doctrine, made famous in Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929), as the rationale behind including legal fees in gross income. See id. at 726, 729 (holding that a taxpayer must realize gross income in the amount of the discharged obligation whenever a third party discharges some or all of the taxpayer's obligation); see also Sinyard v. Comm'r, 268 F.3d 756, 757 (9th Cir. 2001) (labeling the defendant's payment of attorneys' fees as merely a discharge in income on behalf of the plaintiff).

88. See supra note 18 and accompanying text (explaining that a plaintiff may petition the court for attorneys' fees, but must report this award as gross income). Cases involving the AMT usually concern settlements, in which "the plaintiff has paid his attorney the relevant amount of fees out of [his] total recovery, or where the defendant, pursuant to the terms of the settlement, wrote two different checks—one to the plaintiff representing his net recovery and one to the plaintiff's attorney representing his fee." Polsky & Befort, supra note 32, at 88 (footnote omitted). However, the situation where the defendant pays the plaintiff's attorney through a court order after a victory by plaintiff should be analyzed similarly. Id. at 88 & n.124; see also Civil Rights Tax Relief Act of 2009, H.R. 3035, 111th Cong. (2009) (failing to distinguish between damages from suit or agreement, or from a lump sum or periodic payments). Thus, no distinction will be made between fees paid pursuant to a judgment or through a settlement.

89. Polsky & Befort, supra note 32, at 79.

90. The AMT has evolved to not only encompass upper-class taxpayers, but middle-class ones too. See Shakin, supra note 82 (predicting that in 2010, "one in six taxpayers will be affected by the AMT"); Leonard E. Burman et al., The AMT: Projections and Problems, 100 TAX NOTES 105 (2003) (projecting that by 2010, 92% of households with income between $100,000 and $500,000 will pay the AMT). Although 2010 has passed, the AMT has been controversial for more than just the last few years. Scott Bernard Nelson, Escape the AMT Trap, U.S. NEWS AND WORLD REP. (MAR. 18, 2008), http://money.usnews.com/money/business-economy/small-business/articles/2008/03/18/escape-the-amt-trap.
policy, especially since a plaintiff may be required to pay taxes on money that goes directly to his lawyer as part of a contingency agreement. In general, Congress has not been averse to allowing deductions for trade or business expenses, but the AMT prevents an employee from deducting any legal costs spent to recover compensation for lost wages. At least two law professors have put forward the notion that all attorneys' fees should be classified as employee business expenses to avoid the AMT trap in any context, yet judges have not been convinced. A "very cornerstone of [American tax law] rests on the idea that [taxes should only apply to] economic benefit[s]" that are controlled and enjoyed. However, the attorney fee portion still gets double taxed—both to the client and his lawyer—even though the plaintiff-employee has little more than temporary control over his attor-

91. See Polsky & Befort, supra note 32, at 70, 81 (calling the AMT "simply awful" and "absurd" policy).

92. Contingent agreements usually provide "that the attorney will receive the greater of (a) some percentage of the overall recovery . . . or (b) the amount of court-awarded attorneys' fees." Polsky, supra note 31, at 625. In situations where (b) is higher than (a), "it may actually be in the [employee's] best interests not to petition for attorney[s'] fees." Id. For discussion on how the AMT trap may infringe upon a lawyer's undivided loyalty to his client, see supra note 31 and accompanying text. Most likely, an employee will not be anticipating any adverse tax consequences. Thus, attorneys' fees will almost always be granted and sometimes are mandatory.

93. I.R.C. § 162(a) (2006) (enabling a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business").

94. See Sager & Cohen, supra note 38, at 1096-97 (arguing that attorneys' fees should be deducted as business expenses, not as miscellaneous itemized deductions, because an individual should not pay tax on the cost of producing taxable income); Gregg D. Polsky, A Correct Analysis of the Tax Treatment of Contingent Attorney's Fee Arrangements: Enough with the Fruits and the Trees, 37 GA. L. REV. 57, 73 (2002) (attorneys' fees "bear a clear and direct relationship to taxable income").

95. See Biehl v. Comm'r, 351 F.3d 982, 987-88 (9th Cir. 2003) (believing that legal fees in an employment-related case should only be considered a business expense if the fees would be paid while the plaintiff was still employed by the payor and in the interests of the payor); Alexander v. IRS, 72 F.3d 938, 944-47 (1st Cir. 1995) (attorneys' fees do not qualify as reimbursed business expenses). For discussion on why this doctrine should have no relevance to the AMT trap, see Polsky, supra note 94, at 88-92 (plaintiff and his lawyer have an "arm's length" relationship). The assignment of income doctrine was developed "to prevent the subversion of the progressive rate structure of the tax system through the use of artificial income-splitting between related parties." Id. at 79; see also Helvering v. Horst, 311 U.S. 112, 114 (1940) (holding that a father cannot assign interest rights to his underage son); Comm'r v. Earl, 281 U.S. 111, 113-15 (1930) (same with high-earning husband vis-à-vis his unemployed wife). Numerous law review articles play the semantics game to either justify or refute grossing up. This Note simply lobbies for a sensible judicial interpretation.

ney's fees and hardly exercises the dominion over them that the Supreme Court requires.97

The American Jobs Creation Act of 2004 responded to disapproval98 over the AMT trap and ameliorated the problem to a significant degree.99 The Act provides that "[a]ny deduction . . . for attorney fees and court costs paid by . . . the taxpayer in connection with any action . . . [for] unlawful discrimination" will be an above-the-line deduction.100 However, § 62 does not specifically grant relief from the AMT trap for ancillary claims of discrimination, such as negligent and intentional infliction of emotional distress or loss of consortium.101 Since it is unclear whether attorneys' fees related to such ancillary claims would be entitled to relief,102 the AMT problem may persist and, therefore, will not be completely ignored in this Note. Furthermore, the unwillingness of judges to gross up under extreme circumstances—when the AMT trap is implemented—reveals a strong opposition toward gross ups and suggests that courts will not address the plaintiff's adverse tax consequences due to bunching on their own. Without congressional action, the Supreme Court, in Commissioner v. Banks,103 would have continued the tradition of including attorneys' fees as miscellaneous itemized deductions, even though plaintiffs might have recovered nothing or actually lost money. If courts did not correct an employee's negative tax consequences when the injustice was so blatant, how can one expect judges to do so under less obvious, but still meaningful, circumstances?104

To appreciate the enormous burden the AMT can inflict, return to the hypothetical from Subsection I.B.1 and assume the trial court ordered the defendant-employer to reimburse the worker $400,000 in legal fees for an

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98. See James Serven, Oral Argument in Hukkanen-Campbell: Taxpayers' Last Stand?, 93 TAX NOTES 854, 859 (2001) (asserting before the addition of § 62(a)(20) that "[t]here is . . . no public policy or conceptual theory by which the denial of a deduction under the AMT for . . . attorney's fees . . . can be plausibly defended").
99. It is important to remember that law review articles and scholarly criticism do not always fall on deaf ears and can actually result in positive change, as evidenced by § 62(a)(20).
102. Id. (citing Robert W. Wood, Tax Aspects of Settlements and Judgments, in BNA U.S. INCOME PORTFOLIOS: INCOME, DEDUCTIONS, CREDITS AND COMPUTATION OF TAX 522 § V.G.2 (3d ed. 2005)) ("The IRS may argue that the attorneys' fees should be allocated between the discrimination and nondiscrimination claims.").
103. 543 U.S. 426 (2005) (providing that if a litigant's recovery constitutes gross income, the litigant must include in gross income the portion of the recovery paid to the attorney as a contingent fee).
104. Therefore, Congress might again have to intervene if courts do not address a plaintiff's adverse tax consequences in the bunching context.
auxiliary claim resulting in the same monetary award. The size of this allowance relative to the amount in wages will almost always implicate the AMT. The employee would then have to include $577,260 in his 2009 taxable income, but could deduct the attorneys’ fees only when computing his regular tax.105 From before, the worker would have $43,638.30 in income tax using the usual method. Under the AMT regime though, the first $46,700 is taxed at the ordinary rate, the next $175,000 is taxed at 26%, and the remaining $355,560 at 28%, yielding a total tax liability of $152,919.30.106 In sum, the worker, at an effective tax rate of 26.5%, will net $24,340.70—barely 14% of his overall judgment, 18% of his lump sum after taxes minus attorneys’ fees, and 16% of the after-tax wages he would have earned in due course—all because of fees he never possessed and a wrongful termination he did not ask for.107 The tax consequences become “even more dramatic as the ratio of attorney’s fees to the gross settlement [or verdict] amount increases.”108 If the worker’s lawyers charged more than just $400,000, the plaintiff could quickly end up in the red, as happened to a female police officer in Spina v. Forest Preserve District of Cook County.109 Again, § 62 of the Code solves the AMT problem to a large extent. However, as noted by one prominent tax attorney, this potential solution is not “foolproof”110 and highlights how reluctant courts are to gross up, begging the question: why did Congress not address negative tax consequences under all circumstances in the American Jobs Creation Act of 2004?111

105. The plaintiff’s taxable income overstates his true economic income by the price of his attorneys’ fees.


107. In paying the alternative tax, the worker keeps $24,340.70 compared to $133,621.70 after tax on the lump sum and $150,767.50 if no illegal conduct had taken place. Stated another way, the plaintiff will owe $126,426.80 more in taxes if no discrimination had occurred and $109,281 more in taxes if he had not taken advantage of the fee-shifting statutes.


109. 207 F. Supp. 2d 764, 777 (N.D. Ill. 2002) (reducing a jury’s award from $3 million to $200,000 and, therefore, requiring the plaintiff to pay back “her entire award, plus $154,322 of her own money (money which she does not have) to the IRS”).


111. See infra note 153 and accompanying text (discussing Polsky & Befort who conclude that the AMT trap and bunching both cause adverse tax consequences regardless of the source). Therefore, Congress should also fix the bunching problem and any remnants of the AMT trap. See infra Section IV.B (advocating for an enhanced bill).
II. ESHELMAN V. AGERE SYSTEMS AND THE GROWING DIVIDE OVER HOW TO HANDLE TAX ISSUES

On January 30, 2009, the Third Circuit added to a split among federal courts by publishing an opinion approving of "gross ups." With very little persuasive—and no binding—case law on point, the Eshelman court relied on Title VII Supreme Court cases. That Court has repeatedly held that the "chief remedial purpose of employment discrimination statutes . . . is 'to make persons whole'" and emphasized that "Congress armed [judges] with broad equitable powers to effectuate this 'make whole' remedy." In opposition to Eshelman, a trial court in Illinois declined "to [travel] down [this] slippery slope and wade into [the] legal morass [of gross ups]," for as one circuit said, "[w]e know of no authority for such relief." This section familiarizes the reader with the facts and procedural history of Eshelman and puts the Third Circuit's decision in perspective, especially as it relates to how other courts have dealt with adverse tax consequences. Prior to Eshelman, only two circuit courts had addressed the issue and each came to a different conclusion, yet Congress still provided the tools—even if not directly—for awarding gross ups.

113. Id. at 440 n.7.
114. Id. at 440 (citing Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975); McKennon v. Nashville Banner Publ'g Co., 513 U.S. 352, 358 (1995)).
117. Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam). ("Absent an arrangement by voluntary settlement of the parties, the general rule that victims of discrimination should be made whole does not support 'gross-ups' of backpay to cover tax liability.").
118. In Hukkanen v. International Union of Operating Engineers, Hoisting & Portable Local No. 101, the Eighth Circuit ignored the plaintiff's adverse tax consequences associated with receiving multiple years of pay and retirement benefits in a single year because "she failed to present evidence of the . . . amount or a convenient way for the [lower] court to calculate the amount." 3 F.3d 281, 287 (8th Cir. 1993). Therefore, the Hukkanen case stands for the proposition that a plaintiff-employee must introduce some statistical or financial evidence in the record to have a chance at a gross up, not necessarily that a gross up is always inappropriate. Plenty of other courts have also been able to skirt the issue on evidentiary grounds. See, e.g., Shovlin v. Timemed Labeling Sys., Inc., No. 95-CV-4808, 1997 U.S. Dist. LEXIS 2350, at *6 (E.D. Pa. Feb. 27, 1997) (denying a gross up because the plaintiff did not produce an expert witness); infra note 149 (explaining EEOC v. Joe's Stone Crab, Inc., 15 F. Supp. 2d 1364, (S.D. Fla. 1998)). Thus, one should be careful when determining why a court declined to award a gross up. Was the decision based on the plaintiff's factual showing or the equitable relief itself? Hukkanen "suggests that if a district court has . . . proof of negative tax liability . . . , the power to grant such an award would be within its discretion." Canney, supra note 32, at 1126. Another Eighth Circuit case disallowed a gross up solely
A. The Story Behind the Lawsuit

In *Eshelman*, the Third Circuit explored how far courts should venture when protecting an employee’s right, in the face of wrongful termination, to become “whole” again—at least in the economic sense. Western Electric, the predecessor to Agere Systems, hired Joan Eshelman (Eshelman or Plaintiff), in 1981. Over a twenty-year period, Plaintiff advanced steadily through the company, eventually becoming a supervisor and then a manager. In 1998, doctors diagnosed Eshelman with breast cancer and soon thereafter, she took a medical leave of absence to receive treatment. Almost immediately, Plaintiff started suffering from short-term memory loss, a side effect of chemotherapy. Despite the affliction, Eshelman kept her supervisors informed about her condition and continued to receive excellent performance reviews. Unfortunately, Agere Systems began experiencing financial troubles in October 2001; management proceeded to lay off employees and even threatened to close the facility where Eshelman worked.
The company responded to the downturn by ranking employees on a wide assessment of skills to determine who “would be needed following [some] corporate restructuring.”\(^\text{127}\) Eshelman was initially rated very highly and her bosses even took steps “to shield [her] from termination.”\(^\text{128}\) However, the company soon altered her scores after learning that she would not travel to a new facility.\(^\text{129}\) In refusing to relocate, Plaintiff lost her job and brought suit under the ADA.\(^\text{130}\) Eshelman cited her memory deficiencies as the reason behind her dismissal.\(^\text{131}\)

**B. Both the Trial and Appellate Courts Accept Eshelman’s Pleas for Relief**

Eshelman ultimately obtained a jury verdict in her favor for $200,000.\(^\text{132}\) Following entry of judgment, she filed a post-trial motion, asking the district court to enhance her recovery for the adverse tax consequences she would incur.\(^\text{133}\) Plaintiff submitted an affidavit from a financial expert who calculated this tax “penalty” based on the amount of back pay, applicable tax rates, and her income tax liabilities for the affected years.\(^\text{134}\) The trial court agreed with Eshelman in principle and granted her partial relief—an extra $6,893.\(^\text{135}\) Agere Systems did not rebut the testimony of Eshelman’s witness nor did it dispute the accuracy of the figure derived.\(^\text{136}\) On appeal, the Third Circuit affirmed the district court’s findings: “Without this type of equitable relief in appropriate cases, it would not be possible”\(^\text{137}\) to “locate ‘[the] just result’”\(^\text{138}\) that the American public demands. Congress gave courts wide discretion “to assure ‘the most complete relief.’”\(^\text{139}\) While

127. *Id.* Employees who scored above a certain level retained their jobs. *Id.*
128. *Id.*
129. *Id. at 432.*
130. *Id.* Agere Systems laid off Eshelman effective December 30, 2001, believing that Plaintiff lacked the ability to commute to new sites in Breiningsville and Allentown, “a limitation . . . attributed to [her] chemotherapy.” *Id.*
131. *Id. at 430.* Plaintiff argued that Agere Systems “unlawfully discharged her because of her record of cancer-related disability, or because it regarded her as disabled.” *Id.*
132. *Id. at 432.* The jury returned a special verdict, giving Plaintiff $170,000 in back pay and $30,000 in compensatory damages. *Id.*
133. *Id. at 432.* Agere Systems moved for judgment as a matter of law and alternatively for a new trial, alleging insufficient evidence and improper instruction. *Id. at 432-33.*
134. *Id. at 442.*
135. *Id. at 442-43.* On October 20, 2005, the trial court granted Eshelman’s motion and denied Defendant’s motions. *Id. at 432-33.*
136. *Id. at 443.*
137. *Id. at 442.*
138. *Id. at 443* (quoting Langnes v. Green, 282 U.S. 531, 541 (1931)).
engaging in this task, Judge Michael Chagares compared grossing up to the well-accepted practice of including pre-judgment interest in a back pay award, which recognizes that a plaintiff’s grievances may be more extensive than wages themselves. Thus, the Third Circuit merely complied with the “make-whole” objective of the ADA and took advantage of the liberties and flexibility that Congress supplied.

C. Federal and State Cases That Previously Contemplated a “Gross Up”

1. Cases Supporting Plaintiff-Employee’s Tax Raise

Historically, the leading case advocating for the propriety of gross ups is Sears v. Atchison, Topeka & Santa Fe Railway Co., in which the Tenth Circuit held a labor union and railroad company liable for seventeen years’ worth of back pay, plus a tax component, stemming from a Title VII race violation. Plaintiff, Joe Vernon Sears, filed a class action on behalf of the railroad’s train porters, alleging that the defendant favored the company’s white brakemen over its black porters. The Tenth Circuit ruled that the district court did not abuse its discretion when “[reimbursing] class members for their additional tax liability.” Sears, however, did not create a blanket presumption of a gross up, but stressed that only under “special [or extraordinary] circumstances” should a court augment an award for tax purposes: compensation for negative tax consequences may not be fitting in every case, or even the “typical” case. Here, the payment of a lump sum after more than a decade and a half would have placed most of the plaintiffs in the highest income tax bracket for the year of receipt. With “the

140. Eshelman, 554 F.3d at 442 (drawing on “the now-universal acceptance of ... prej udgment interest on back pay awards”). Pre-judgment interest is the interest accruing on a back pay award. Courts employ various tables and methods to calculate pre-judgment interest. See, e.g., Taxman v. Bd. of Educ., 91 F.3d 1547, 1566 (3d Cir. 1996) (IRS-adjusted prime rate); Conway v. Electro Switch Corp., 825 F.2d 593, 602 (1st Cir. 1987) (federal judgment rate); Gelof v. Papineau, 829 F.2d 452, 456 (3d Cir. 1987) (state judgment rate).

141. See Eshelman, 554 F.3d at 442 (stating that tax gross ups, along with pre-judgment interest, acknowledge “that the harm to a prevailing employee’s pecuniary interest may be broader in scope than just a loss of back pay”).


143. Sears, 749 F.2d at 1453.

144. Id. at 1456. According to the Tenth Circuit, the Supreme Court provided courts with a wide array of damages for Title VII violations. See id. (citing Ford Motor Co. v. EEOC, 458 U.S. 219, 230 (1982)).

145. Id.

146. Id.
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prolonged nature of the litigation," the Tenth Circuit felt obligated to gross up. District courts, outside the Tenth Circuit, in Missouri, Florida, and Pennsylvania went on to adopt Sears' line of reasoning, distinguishing between pecuniary awards and ones "solely a product of the lawsuit," such as punitive and liquidated damages.

The goal of [anti-discrimination and wrongful termination statutes] is to allow plaintiff to keep the same amount of money as if he had not been unlawfully terminated. [Adhering to] this goal requires reimbursement for the reduced amount of front pay money that the plaintiff has to invest as a result of higher taxes, as well as reimbursement for the higher taxes he must pay on his back wages caused by getting this money in a lump sum. . . . [While Mr. O’Neill] is entitled to receive the value of front pay and backpay that he would have received over his work life . . . [, he] would not have received [the compensatory and liquidated damages] but for the defendant’s discriminatory action. Hence, allowing the plaintiff to recover the increased tax he will have to pay on these sums does more than make him whole. It gives the plaintiff a windfall.

When faced with an AMT problem, a trial judge in Washington D.C. suggested that courts do have the power to enforce gross ups: "If [plaintiff’s]
liability to pay tax on the attorneys' fee award... were established as a matter of law, and if that tax could be calculated with precision, I believe I could enter a gross-up order in the exercise of the 'full equitable powers' I have [at my disposal]." 154 Remarkably, one defendant even found the compensation for negative tax consequences so reasonable that presumably he did not contest liability. 155 State courts interpreting laws modeled after federal anti-discrimination statutes have followed this thinking also. 156

2. Cases Denying Plaintiff-Employee's Tax Raise

In contrast to the Tenth Circuit, the District of Columbia Circuit has taken a strong stance against gross ups. 157 In Dashnaw v. Peña, the court did "not linger long" in rejecting an engineer's request for tax relief in an ADEA lawsuit, dismissing his claim in fewer than two sentences. 158 Although the Tenth Circuit decided Sears nine years earlier, it appears the D.C. Circuit simply disregarded the plaintiff's argument without analyzing any existing case law. 159 In 2007, the same court chose not to overturn Dashnaw when again confronted with an employee's adverse tax consequences because of Dashnaw's "binding circuit precedent." 160 A perceived absence of authority—or possibly an ulterior motive (a "wariness [to tread] on sover-

155. See Gelof v. Papineau, 829 F.2d 452, 455-56 (3d Cir. 1987) (remanding back to the district court for a redetermination of the tax element of damages because a Delaware state official conceded liability on that front).
157. One could say that the D.C. Circuit has never gotten too "charged up" over a plaintiff's adverse tax consequences.
158. 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam) ("Absent an arrangement by voluntary settlement of the parties, the general rule that victims of discrimination should be made whole does not support 'gross-ups' of backpay to cover tax liability."). However, while not following the general rule, the court in Dashnaw does concede the make-whole objective of discrimination statutes. Id. The plaintiff claimed that the Federal Maritime Administration forced him to retire by promoting younger candidates over him. Id. at 1114-15. The district court reinstated Dashnaw and granted back pay, but did not gross up. Id.
159. Dashnaw's lawyers may have been partially responsible for this result since the opinion does state that "appellee points to [no authority for such relief]." Id. at 1116. Clearly, however, the D.C. Circuit did not spend much time debating grossing up and its potential merits.
negative tax consequences in employment dispute recoveries

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foreign immunity)—prevented the D.C. Circuit from ever considering the pros and cons of grossing up, even with more and more courts warming up to the idea and Congress mulling over the Civil Rights Tax Relief Act on multiple occasions. One district court gave the topic even less thought, seemingly acknowledging that a party “is responsible for his own taxes just as if he had remained a[n] . . . employee” of the defendant. Of course, a victorious plaintiff cannot possibly pay his taxes in the same fashion without a gross up.

One particular case captures the injustice of not relieving a plaintiff of his negative tax consequences most shockingly. In 2001, Cynthia Spina accused a city of sexual discrimination, harassment, and retaliation. At the end of her trial, she received a “huge,” but short-lived award. The district judge ordered a remittitur of the damages from $3 million to $300,000, causing plaintiff to lose $154,322 of her own money when she had to pay income taxes on $1 million in attorneys’ fees and costs. The Spina court admitted that its “application of the current tax law . . . [would] produce an ‘anomalous . . . result’” and sympathized with the plaintiff’s plight: “Plaintiff waged a courageous fight for what she believed was just, even though other female officers, who felt similarly victimized, lacked the fortitude to do so.”

161. Canney, supra note 32, at 1131. At least one writer believes that both the Dashnaw and Fogg cases “represent an unwillingness to apply tax gross-ups against the government [without] an express waiver of sovereign immunity.” Id. (footnote omitted). See also supra note 118 and accompanying text (describing how the Eighth Circuit denied a gross up because of governmental immunity). The Dashnaw decision can also be attacked as a per curiam opinion.

162. Polsky & Befort, supra note 32, at 82-83, 91-93.


164. The Spina case does not squarely address the legality of adverse tax consequences for bunching because the plaintiff “used the AMT trap as a defense to the claim that her award was excessive,” not necessarily that she should be entitled to a gross up. Polsky & Befort, supra note 32, at 99. Yet, the court leaves no doubt that “plaintiff’s tax [predicament is] strictly a matter between her and Congress.” Id. For more on Congress’s duty to fix the tax problems inherent in employment suits, see discussion infra Section IV.B (advocating for Congress to pass a renewed version of the Civil Rights Tax Relief Act).


166. Id. at 769. The “award made headlines in both of Chicago’s major newspapers, and was featured on several morning television and radio shows.” Id.

167. Id. Plaintiff could have either taken the $300,000 remittitur as compensation for emotional distress and damage to her reputation or retried the issue of damages. Id. at 778-79.

168. Id. at 776-77.

169. Id. at 777 (quoting Hukkanen Campbell v. Comm’r, 274 F.3d 1312, 1314 (10th Cir. 2001)).

170. Id.
leaving her to hold the bag, the court cannot be described as anything but hypocritical:

Cynthia Spina dreamt of being a police officer since she was a child; she worked hard and sacrificed to realize that dream. By all accounts, Officer Spina is an excellent officer, which makes the District’s conduct all the more astounding. Its willingness to sacrifice a good officer instead of addressing serious sexual harassment and internal grievance problems reveals an anachronistic attitude that has no place in today’s law enforcement community.

Officer Spina presented overwhelming evidence at trial that the District [harassed and abused] her...

... Nevertheless, the Court must conclude that [a gross up should be denied].

One of the major justifications for the permissibility of gross ups is to meet “sound [public] policy ends.” A void in the Code should not “threaten[] to thwart meritorious suits because a highly successful plaintiff runs the risk of having [some or] the entire benefit of a judgment eliminated plus incurring a substantial tax liability to the [IRS].”

People count on the legal system to protect them and when their civil rights are violated the system needs to function properly. It is disheartening... that, in actuality,... [he] is going to be taken to the cleaners by the government tax system, and as a result, he ends up owing [money out of his wages] to the government for the ‘privilege’ of having won his... case.

...[T]here is something fundamentally wrong with the law when it hurts the people it is supposed to protect.

However, the AMT trap and bunching do just this: discourage aggrieved plaintiffs from ever bringing suit. Thus, the Code penalizes citizens for “do[ing] the [right] thing” and maybe even hurts the country.

171. Id. at 778.
172. Polsky & Befort, supra note 32, at 96 n.173.
173. Blaney v. Int’l Ass’n of Machinists & Aerospace Workers, District No. 160, 55 P.3d 1208, 1217 (Wash. Ct. App. 2002) (concerning the Washington Law Against Discrimination, which is very similar to Title VII). From a tax perspective, the meaning is the same for federal anti-discrimination statutes, as plaintiff had to pay $244,753 out of his own savings. See Blaney v. Int’l Ass’n of Machinists & Aerospace Workers, District No. 160, 87 P.3d 757, 760 n.2 (Wash. 2004) (the Washington Supreme Court affirming the lower state court); Polsky & Befort, supra note 32, at 97 (“[T]he underlying state laws share the same [objectives] as federal... law.”).
175. Id.
176. See supra note 2 and accompanying text (containing an epigraph from Andrew Mellon).
III. TO "GROSS UP" OR NOT TO "GROSS UP": THE ARGUMENTS ON BOTH SIDES

If Congress takes no further action, then courts’ approaches to gross ups will vary across the country and depend exclusively on statutory interpretation.\(^\text{177}\) On the one hand, Congress imposes a civil obligation on citizens, including plaintiffs who recover lost wages and other pecuniary damages in employment disputes, to pay specified amounts in income tax.\(^\text{178}\) On the other hand, Congress grants judges broad equitable power to put victorious plaintiffs in the same economic position the employee would have occupied had no discrimination occurred.\(^\text{179}\) Trial and circuit courts will have to decide individually “which congressional directive (for the plaintiff to pay his own taxes or for the defendant to make the plaintiff economically whole)” should take precedence over the other.\(^\text{180}\) This section reexamines federal anti-discrimination statutes, legislative history, and judicial construction in an effort to declare once and for all that courts \textit{do} have the legal authority to gross up a settlement or jury award.

A. Justice Trumps Efficiency: Tax Computations Are Not Overly Cumbersome

Since as early as 1939, albeit in a contract case, employers and judges have complained that gross ups involve too much guessing and conjecture.\(^\text{181}\) To compute a plaintiff’s negative tax consequences in the employment context, one needs only to determine his gross income and two separate tax rates: (1) the tax rates that would have been applied to the wages had the employee earned them normally and (2) the present tax rates.\(^\text{182}\) Without a doubt, this process will entail some speculation, as a multitude of unknown factors could affect the plaintiff’s tax situation. For example, try-

\(^\text{177}\) A common adage in statutory interpretation is, "‘[w]here there is no clear intention, . . . a specific statute will not be controlled or nullified by a general one.’" Crawford Fitting Co. v. J.T. Gibbons, Inc., 482 U.S. 437, 445 (1987) (quoting Radzanower v. Touche Ross & Co., 426 U.S. 148, 153 (1976)). But this begs the question: which provision is “specific”? A legitimate case could be made for either set of statutes being “specific.” Furthermore, the tax and employment statutes do not make any reference to each other.

\(^\text{178}\) Polsky & Befort, \textit{supra} note 32, at 107.

\(^\text{179}\) \textit{Id}.

\(^\text{180}\) \textit{Id}. Different courts will take different approaches, leading to unpredictable outcomes.

\(^\text{181}\) See Paris v. Remington Rand, Inc., 101 F.2d 64, 68 (2d Cir. 1939) (holding that augmenting damages for adverse tax consequences caused by bunching could be too speculative); DePalma v. Westland Software House, 225 Cal. App. 3d 1534, 1544 (Cal. Ct. App. 1990) (ignoring defendant’s argument that plaintiff’s damages should be reduced by tax benefits because of “the necessarily complex . . . nature of inquiring into tax [matters]”).

\(^\text{182}\) Polsky & Befort, \textit{supra} note 32, at 113.
ing to calculate an employee’s adverse tax consequences may raise several questions with impossible-to-know answers. 183 Will the plaintiff marry? 184 Will he be eligible for a dependency deduction 185 or other write-offs? Will he report income from stock dividends or wages from another job? When will he retire? Will tax rates or the Code change? Will inflation rise? Will the AMT be triggered?

These concerns do not extend to back pay, as calculating a plaintiff’s adverse tax consequences on back pay is fairly straightforward; one only has to consult old editions of the Code. Front pay, however, will inevitably pose more headaches.

In light of the damages courts assess every day, though, especially in tort actions, 187 this chore does not seem to be too out of the ordinary. Courts routinely consider variables, such as life expectancy, predicted costs, and anticipated needs, when estimating damages for future physical and mental pain, medical expenses, and earning capacity. 188 A gross up, like pre-judgment interest and the remedies listed above, are necessary “‘element[s] of complete compensation.’” 189 Even in the employment context, judges do not shy away from speculative matters: courts presume an award for back pay even though it “encompasses far more than just [an employee’s] previous salar[y],” such as “expected tips, lost bonuses, and overtime pay.” 190 Most importantly, tax fairness “[f]rom the Boston Tea

183. “There is no way of telling what the tax rates will be in the future, nor what exemptions, deductions and other income the plaintiff would have, so as to determine what tax bracket he would have been in.” VICTOR E. SCHWARTZ, ET AL., PROSSER, WADE AND SCHWARTZ’S TORTS: CASES AND MATERIALS 534 (11th ed. 2005).
184. See I.R.C. § 1(a)-(d) (2006) (listing different tax rates depending on whether taxpayer is married).
185. See id. § 152 (defining a “qualifying child” and a “qualifying relative”).
186. Note that a trial court has already determined a plaintiff’s back pay award when calculating negative consequences. Thus, computing a gross up on this amount should not be too demanding since all events that would affect plaintiff’s income and deductions have occurred.
187. See Anderson v. Sears, Roebuck & Co., 377 F. Supp. 136, 139 (E.D. La. 1974) (assuming that a young burn victim “will be deprived of a normal social life” and “will never find a husband and raise a family” because of her deformities). The Anderson court also approved a large award for the girl’s medical expenses because presumably, she will “need the guidance, treatment and counseling of a team of doctors, including plastic surgeons, psychiatrists, and sociologists, throughout her lifetime.” Id. On this occasion, the district court in Louisiana speculated far into the future.
188. SCHWARTZ, supra note 168, at 547-54.
189. Loeffler v. Frank, 486 U.S. 549, 558 (1988) (quoting West Virginia v. United States, 479 U.S. 305, 310 (1987)); see also Losch v. City of Philadelphia, No. 05-CV-0578, 2008 WL 2557429, at *10 (E.D. Pa. June 25, 2008) (“[T]he mere fact that there is an element of speculation involved in calculating the taxes that would have been paid on lost wages does not provide a sound reason for denying the award.” (footnote omitted)).
190. Canney, supra note 32, at 1117 (footnote omitted). “[B]ackpay compensation includes all economic benefits that the plaintiff would have received from the employer, whether directly or indirectly, but for the employer’s discriminatory conduct.” Id. Courts use
Party to now... [has been] firmly parked in the American psyche,” and so, efficient tax administration should not be made a priority over considerations of fairness.

To overcome any difficulties, plaintiffs should be required to retain their own accountants and if necessary, provide prior tax returns. Thus, in order to recover for his negative tax consequences, the employee, not the court, should bear the burden of proving the specific damage amount. This expectation seems entirely fair since judges are not in the business of computing a person’s taxes. However, ignoring a plaintiff’s adverse tax consequences altogether calls into question the main purpose of the American court system: to administer justice.

B. Anti-Discrimination Statutes Seek To Compensate and Deter

Title VII, the ADA, and the ADEA all serve to deter discrimination in the workplace, achieve “equality of employment opportunities,” and compensate plaintiffs for any financial and emotional losses caused by the employer’s illegal behavior. To accomplish these honorable goals, Congress vested courts with plenty of leeway. As the Supreme Court said in Bell v. Hood, “[W]here federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies a four-step process for calculating a plaintiff’s back pay: (1) determine the plaintiff’s probable employment history absent discrimination, (2) fix the period of time where back pay should apply, (3) determine additional pecuniary interests other than lost wages, and (4) reduce the award if the plaintiff fails to mitigate the damages. CHARLES A. SULLIVAN & LAUREN M. WALTER, EMPLOYMENT DISCRIMINATION LAW AND PRACTICE § 13.09[B][1] (4th ed. 2009).

191. YABLON, supra note 3, at 134 (quoting Congressman Richard Neal).

192. Eshelman did (predictably) put the burden of proof on the plaintiff. Eshelman v. Agere Sys., Inc., 554 F.3d 426, 443 (3d Cir. 2009); see also supra note 118 and accompanying text (implying that the Eighth Circuit would allow gross ups if the plaintiff-employee introduced evidence on how the district court should calculate his adverse tax consequences). District courts in the Third Circuit also require a level of proof. See Argue v. David Davis Enters, Inc., No. 02-9521, 2009 WL 750197, at *26-27 (E.D. Pa. Mar. 20, 2009) (declining a gross up because the plaintiff did not provide “a reliable estimate of the negative income tax consequences of his lump sum”); Loesch, 2008 WL 2557429, at *11. Mistakes could occur, so courts should require the testimony of an expert on the subject matter, or at least detailed accounting computations arriving at the precise figure. However, the burden should not be too high. See Canney, supra note 32, at 1137 (“The burden of proof should rest on the plaintiff, not crush her.”). This Note assumes that an award for back pay or front pay has already been calculated. Thus, evidence regarding the plaintiff’s finances will already be in the record and accounting principles will have already been applied. In all, only the District of Columbia Circuit’s decision in Dashnaw justified excluding a gross up for bunching, among federal circuit courts, on Title VII grounds. Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam).

so as to grant the necessary relief.” 194 Judges “may use any available remedy to make good the wrong done.” 195 Title VII’s section on damages, which the ADA later incorporated, 196 reflects this sentiment: courts should redress discrimination “as may be appropriate.” 197 In 1972, Congress expanded Title VII’s scope to any “equitable relief as the court deems appropriate.” 198 A committee report from the Senate explained the thinking behind the amendment:

[This] Act is intended to make the victims of unlawful discrimination whole, and . . . the attainment of this objective rests not only upon [ending] the particular unlawful employment practice . . . , but also requires that [plaintiffs] . . . be, so far as possible, restored to a position where they would have been were it not for the unlawful discrimination.199

The ADEA uses almost identical language.200 In addition to compensating plaintiffs, Title VII also incentivizes employees to expose and “root out” employment discrimination.201 However, a plaintiff’s adverse tax consequences may “inhibit[] the prosecution of some cases or . . . forc[e] [him] into a[] . . . lowball settlement.”202 Only with meaningful and financially consequential remedies can the desire to eliminate such discretions be carried out. Thus, all three statutes offer an “arsenal of remedies” to ensure the most complete relief possible.203 The only measures not condoned are those

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194. 327 U.S. 678, 684 (1946) (granting subject matter jurisdiction in a Fourth Amendment search and seizure case); see also Pennsylvania v. Del. Valley Citizens’ Council for Clean Air, 483 U.S. 711, 716 (1987) (holding that attorneys’ fees and other payments should be adjusted according to the economic effects litigation has on monetary awards).

195. Bell, 327 U.S. at 684.

196. The ADA has adopted Title VII’s remedies. See 42 U.S.C. § 12117(a) (2006) (“The powers, remedies, and procedures set forth in [the Civil Rights Act of 1964] shall be the powers, remedies, and procedures this subchapter provides to the Commission, to the Attorney General, or to any person alleging discrimination on the basis of disability in violation of any provision of this [Act] . . . .”).


200. Federal “courts shall have jurisdiction to grant such legal or equitable relief as may be appropriate.” 29 U.S.C. § 626(b) (2006). The Civil Rights Act of 1991 sought to “align the ADEA with Title VII.” SULLIVAN & WALTER, supra note 190, at § 13.09[C].

201. Polsky & Befort, supra note 32, at 106. Tax law can also achieve this purpose. See YABLON, supra note 3, at 20 (quoting former Associate Justice Felix Frankfurter, who described the Code as not only “a means for raising revenue,” but also “a device for regulating conduct”).

202. Polsky, supra note 31, at 617 n.12. Obviously, only plaintiffs aware of adverse tax consequences will be discouraged from filing or continuing lawsuits against their employer: “[U]nknowing victim[s] will still prosecute . . . claims[s] only to realize later, . . . the pernicious effects . . . .” Id. at 616 n.8.

that "frustrate the central statutory purposes of eradicating discrimination . . . and making persons whole for injuries" flowing from that unlawful conduct.204

In response, federal courts have taken large strides in actually implementing Congress's wishes, as awards regularly compensate plaintiffs for pre-judgment interest and other costs caused by delays in litigation.205 Bearing in mind that Title VII and the ADEA are meant "to restore the employee to the [exact same economic] position he or she would have been in," no more and no less, adjustments to a plaintiff's award do not always work in his favor—and this is how it should be.206 In this vein, liquidated, punitive, and other types of damages that arise only out of litigation should not receive a gross up. The objective is to make the employee whole, not to give him a windfall. For instance, courts have increasingly become aware of the time value of money, a basic premise in financial accounting that one would rather have money now than later. Essentially, pre-judgment interest takes care of "the [reality] that the plaintiff [could] not enjoy the use of [his wages] at the time when [he] would have earned them."207 The flip side is front pay: judges must discount awards that look ahead.208

Title VII law has evolved so far that pre-judgment interest can almost be presumed,209 despite the same evidentiary hurdles that adverse tax conse-
quences present. Although Title VII does not explicitly mention pre-judgment interest, courts have taken it upon themselves to fit it into the statute's "make-whole" scheme. In fact, many appellate courts will find an abuse of discretion if a trial judge does not include pre-judgment interest. In other words, pre-judgment interest does not require the unusual or limited circumstances that Sears calls for with adverse tax consequences and since both concepts more accurately return a plaintiff to the economic status quo, time-value-of-money reasoning can easily be analogized to that of adverse tax consequences. "Restorative justice" demands, then, that "interest-informed" courts also become "tax-informed courts." After reading Eshelman, Sears, and the hypotheticals in Part I as proof, grossing up is definitely possible—both from a mathematical standpoint and a common sense one. Without acknowledging a plaintiff's negative tax consequences, courts may leave an employee not only incomplete, but empty (emotionally) as well: "The tax system touches more people . . . than any other part of the government" and "[t]he loss of confidence in its integrity is the loss of confidence in the government itself."
C. Pre-Tax Dollars Versus After-Tax Dollars: Does It Matter?

To justify not grossing up, courts sometimes liken a plaintiff’s adverse tax consequences to his attorneys’ fees under the classic “American Rule”:\textsuperscript{216} Just as a litigant arranges a private agreement with his lawyers, a plaintiff-employee’s taxes are purely a matter between him and the IRS.\textsuperscript{217} The Second Restatement of Torts supports this “tax-blind” position, namely that courts should not concern themselves with after-tax dollars.\textsuperscript{218} However, the Supreme Court has highlighted how detrimental to a plaintiff this technique can be:

The amount of money that a wage earner is able to contribute to . . . [himself and] his family is unquestionably affected by the amount of . . . tax he must pay to the Federal Government. It is his after-tax income, rather than his gross income before taxes, that provides the only realistic measure of his . . . [net income]. It follows inexorably that the wage earner’s income tax is a relevant factor . . . .\textsuperscript{219}

Moreover, Congress has not been afraid to ignore the American rule when appropriate, as the fee-shifting provisions that entitle prevailing plaintiffs in civil rights cases to attorneys’ fees are “a deliberate departure from the usual American [rule] that each party must bear [his] own legal costs.”\textsuperscript{220} This notion—that “income tax consequences . . . [should be] of no relevance in personal injury litigation”\textsuperscript{221}—is therefore, inherently flawed, especially in cases where attorneys’ fees are already waived.

IV. A LACK OF CONSISTENCY IN FEDERAL CASE LAW LEAVES EMPLOYERS AND EMPLOYEES UNSURE WHEN TO EXPECT A “GROSS UP”

Unlike the widespread acceptance that pre-judgment interest has gained among courts, tax gross ups still have a long way to go. This Note takes the position that appellate courts should not only show deference to a trial judge’s decision to gross up, but should also pressure lower courts to

democratic country to lose faith in their government. A plaintiff may feel like the court did not vindicate him or truly appreciate his plight.

\textsuperscript{216} See Alyeska Pipeline Serv. Co. v. Wilderness Soc’y, 421 U.S. 240, 247 (1975) (explaining that, unless a statute has a fee-shifting provision, each party must pay for his own legal representation).

\textsuperscript{217} Polsky & Befort, \textit{supra} note 32, at 110.

\textsuperscript{218} “The amount of an award of tort damages is not augmented or diminished because of the fact that the award is or is not subject to taxation.” \textit{Restatement (Second) of Torts} § 914A (1979).


\textsuperscript{220} Sager & Cohen, \textit{supra} note 38, at 1076.

make grossing up the rule, not the exception.\textsuperscript{222} Congress has consistently expressed its intention that courts broadly interpret discrimination statutes in all employment disputes:\textsuperscript{223} "Title VII authorizes the award of interest or other compensation for delay in payment of back pay and attorneys' fees in actions against private employers as well as state and local governments."\textsuperscript{224} However, judges have not taken the hint, leaving uncertainty over a court's ability to gross up, over the application of governmental immunity, and over the magnitude of adverse tax consequences to fester. With the goal of eliminating negative tax consequences in mind, the Third Circuit fell short: \textit{Eshelman} is merely a "jumping-off" point in achieving the full equality that Congress reserved for mistreated employees. To accelerate the process, Congress has to reiterate one more time that anti-discrimination statutes should make the plaintiff-employee \textit{completely} whole and not just "whole" to the satisfaction of the court.\textsuperscript{225}

A. Despite the Praise \textit{Eshelman} May Receive, the Third Circuit Left Numerous Questions Unanswered

Even with \textit{Eshelman} and \textit{Sears}, employers and employees in the Third and Tenth Circuits, not to mention circuits that have not spoken on the issue of adverse tax consequences, will still wonder whether a particular district judge in his or her own case will allow for a gross up.\textsuperscript{226} Although most plaintiffs bringing employment discrimination claims suffer negative tax consequences, \textit{Eshelman}, like earlier courts, limited its holding, resisting the urge to establish a presumption of a tax gross up.\textsuperscript{227} Rather, according to \textit{Eshelman}, courts have the option to increase a judgment, based on a case-by-case analysis,\textsuperscript{228} and most troubling, the Third Circuit's gross up only addressed a fraction of Eshelman's adverse tax consequences.\textsuperscript{229} Clearly, the

\begin{itemize}
\item \textsuperscript{222} Even advocates of gross ups only feel that courts should consider a plaintiff's adverse tax consequences when the employee's unique situation demands grossing up.
\item \textsuperscript{223} \textit{See supra} Section III.B (showing how Congress did not intend to tie the hands of federal courts); H.R. REP. NO. 101-644, pt., at 1, 84-85 (1990) ("Departure from the established rules of statutory construction, such as the rule favoring broad construction of civil rights laws, interferes with the ability of Congress to express its will through legislation.").
\item \textsuperscript{224} H.R. REP. NO. 101-644, pt. 1, at 48-49 (1990) (emphasis added).
\item \textsuperscript{225} The legislature has no obligation "to the courts, but to the people by whom its members are elected." Veazie Bank v. Fenno, 75 U.S. 533, 548 (1869).
\item \textsuperscript{226} Ironically, only cases in the D.C. Circuit are cut-and-dry, yet hopefully, this Note highlights the unfairness and bare reasoning in the \textit{Dashnaw} precedent.
\item \textsuperscript{227} \textit{Eshelman} v. \textit{Agere Sys., Inc.}, 554 F.3d 426, 443 (3d Cir. 2009).
\item \textsuperscript{228} \textit{Id. Compare id.}, with \textit{Albemarle Paper Co. v. Moody}, 422 U.S. 405, 421-22 (1975) (presuming an award for back pay whenever a plaintiff-employee is successful on the merits).
\item \textsuperscript{229} The $6,893 upgrade did not cover all of Eshelman's adverse tax consequences. \textit{Eshelman}, 554 F.3d at 442-43.
\end{itemize}
argument for grossing up is strongest when litigation has been protracted and the size of the lump sum significant. But should an innocent plaintiff with a less than titanic tax burden still have to foot the bill?

Without a guaranteed gross up, litigants will hesitate before settling. No one disputes that when employees face discrimination and other violations of their civil rights, it is best if they can avoid litigation by coming to amicable agreements with their employers. Settling will ensure that courts are more efficient and do not get flooded with cases that could have been resolved months before. However, ambiguity over the IRS’s treatment of discrimination awards makes settlement agreements with employers extremely difficult. Both employers and employees take tax liability into account when exchanging settlement figures and thus, the difference between including or not including tax damages can act as a serious impediment to resolving cases early on or at all.\(^\text{230}\) Moreover, a plaintiff’s adverse tax consequences may contribute, along with the stress and distraction of litigation, to a valid claim being dropped altogether.

Procedural problems also present themselves. The Third Circuit did not address the tax implications of front pay, nor did it decide whether an employee can recover from a government-employer.\(^\text{231}\) Furthermore, \textit{Eshelman} ignored the impact of adverse tax consequences on jury instructions. Should juries be told to disregard tax issues?\(^\text{232}\) If not, could plaintiff enjoy a double recovery?\(^\text{233}\) Finally, do tax gross ups violate the Seventh Amendment’s prohibition on additur?\(^\text{234}\) The flaws in the \textit{Eshelman} decision

\begin{footnotesize}

231. \textit{See Library of Cong. v. Shaw}, 478 U.S. 310, 314-15 (holding that unless the United States expressly and unequivocally waives its sovereign immunity, it is not liable for pre-judgment interest or other awards authorized by discrimination statutes).


234. \textit{See} Dimick v. Schiedt, 393 U.S. 474, 482 (1935) (forbidding federal courts from increasing the amount of damages awarded by a jury in personal injury actions). The Seventh Amendment reads:

\begin{verbatim}
In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.
\end{verbatim}
\end{footnotesize}

U.S. CONST. amend. VII.
should not take away from its merits. However, the case, while serving as a step in the right direction, demonstrates that courts are slow, unpredictable, and extremely reticent to attack issues not directly in front of them. In the meantime, as courts either overlook the negative tax consequences or reach inconsistent results, hundreds of plaintiffs will suffer a two-fold injury: one for improper behavior on the part of the employer and another for judicial and congressional negligence.

B. Congressional Action Is Needed To Reinforce the “Make-Whole” Objective of Title VII and Other Statutes

Determining after-tax income can be a somewhat painstaking and lackluster endeavor.\textsuperscript{235} Therefore, courts are typically “reluctant to get their hands dirty with tax law if they can avoid it.”\textsuperscript{236} Former Associate Justice Harry Blackmun once joked that “[i]f [a United States Supreme Court Justice is] in the doghouse with the Chief [Justice], he gets the crud[,] . . . the tax cases . . . .”\textsuperscript{237} This unwillingness to delve into federal tax matters can usually be blamed on a lack of explicit legislative authorization: “If Congress wanted to impose an extra tax on defendants [liable] for unlawful discrimination, then Congress would have . . . made clear its intention . . . [to] shift[] part of plaintiff’s tax [liability] to the defendant.”\textsuperscript{238} As the argument goes, “Congress, not [federal or state courts], must correct any shortcomings” or inequities in the Code.\textsuperscript{239} Other courts have shared their same viewpoint\textsuperscript{240} putting the impetus on Congress to take charge and show that this

\textsuperscript{235} See Spitz, supra note 25, at 447 (“I realize that the ‘tax implications of nonphysical personal injury loss for plaintiff’s’ is not a sexy topic . . . .”); Polsky, supra note 31, at 637 (“[Adverse tax consequences have become] a pervasive nuisance for tax practitioners and federal judges . . . .”).

\textsuperscript{236} Polsky & Befort, supra note 32, at 70; see also Shott v. Rush-Presbyterian-St. Luke’s Med. Ctr., 338 F.3d 736, 744 (7th Cir. 2003) ([L]itigation already places a ‘heavy burden’ on the federal courts; adding a requirement to calculate the tax status of the parties would only increase that burden.”).

\textsuperscript{237} Stuart Taylor, Jr., Supreme Court, N.Y. TIMES, Dec. 22, 1986, at B14 (quoting Justice Blackmun). Other Justices on the Supreme Court have made similar remarks. When a reporter asked former Associate Justice David Souter why he sang along with the Chief Justice at the Court’s annual Christmas party, Justice Souter replied, “I have to. Otherwise I get all the tax cases.” BERNARD SCHWARTZ, THE UNPUBLISHED OPINIONS OF THE REHNQUIST COURT 8 (1996).

\textsuperscript{238} Polsky & Befort, supra note 32, at 108.

\textsuperscript{239} Campbell v. Comm’r, 274 F.3d 1312, 1315 (10th Cir. 2001). For a humorous reiteration of this belief, see YABLON, supra note 3, at 62 (quoting Dave Barry: “The question is: What can we, as citizens, do to reform our tax system? As you know, under our three-branch system of government the tax laws are created by: Satan. But he works through the Congress, so that’s where we must focus our efforts.”).

\textsuperscript{240} See McLaughlin v. Union-Leader Corp., 127 A.2d 269, 273 (N.H. 1956) (claiming that gross ups “should be sought at the source—in federal legislation”).
country is “committed to horizontal and vertical equity” in tax law—\(^{242}\)—and equality in society at large:

[America’s] tax system suffers from delay in getting the final word in judicial review, from retroactivity of the decision when it is obtained, and from the lack of a roundly tax-informed viewpoint of judges. . . .

... Judicial efforts to mold tax policy by isolated decisions make a national tax system difficult to develop, administer, or observe.\(^{243}\)

Beginning in 2000, Congressmen and Senators have made repeated attempts to help a plaintiff-employee cope with any adverse tax consequences he may experience with bunching.\(^{244}\) However, all the bills have failed because the Committee on Ways and Means, one of the oldest House committees charged with the duty of writing tax legislation and bills affecting Social Security, Medicare, and other entitlement programs, has quickly dropped them from the agenda.\(^{245}\) On June 25, 2009, John Lewis (D-GA) and James Sensenbrenner (R-WI) re-introduced the Civil Rights Tax Relief Act (CRTRA) to the House of Representatives.\(^{246}\) H.R. 3035 sought “to exclude from gross income amounts received on account of claims based on certain unlawful discrimination and to allow income averaging for backpay and frontpay awards received on account of such claims.”\(^{247}\)

This bill too did not pass.\(^{248}\) Law review articles, the Internet, and other sources offer little insight into why these bills have been overlooked.\(^{249}\)

241. Congress has “to act responsibly and finally fix this mess.” Polsky, supra note 31, at 618 (footnote omitted).


243. YABLON, supra note 3, at 191, 198 (quoting former Associate Justice Robert H. Jackson).


248. On October 13, 2012, the same two congressmen presented the newest version of the CRTRA to the 112th Congress. Civil Rights Tax Relief Act of 2011, H.R. 3195, 112th
This Note thus proposes an enhanced CRTRA that would (1) make non-economic damages in civil rights cases non-taxable,\(^{250}\) (2) tax lump-sum awards at the correct marginal tax rates or actually force the defendant to gross up,\(^{251}\) and (3) repeal double taxation of attorneys’ fees. Most of the bills previously presented would have averaged the back pay or front pay awards.\(^{252}\) However, as the Sears case revealed, income-averaging provisions will not always alleviate a plaintiff of his negative tax consequences.\(^{253}\) Since no rational reason can be given why an employee should not be fully reimbursed, this “new-and-improved CRTRA” would always eliminate a plaintiff’s adverse tax consequences.

**CONCLUSION**

The United States holds itself out as a beacon of freedom, striving to put every person (male/female, white/black, Catholic/Protestant, etc.) before the law equally. In pursuing this goal, Congress passed a number of anti-discrimination statutes, preventing employers from firing workers based on sex, race, and disabilities. Discrimination is “an invidious practice that causes grave harm to its victims”\(^{254}\) and the law, especially the Code, is a “government’s most effective device for modifying behavior”\(^{255}\). “Taxes

\(^{249}\) All of the CRTRA-related bills have had some bi-partisan support. See GovTrack H.R. 3035, supra note 36 (listing nine Republican and twenty-eight Democrat Congressmen who co-sponsored the bill with Rep. Lewis). Also, tens of associations and organizations have shown support for the bill. See Advocacy: Civil Rights Tax Relief Act, NELA, http://www.nela.org/temp/ts_610E300E-BDB9-50CE-F493B784BDA564C6710E301E-BDB9-50CE-F1FF8D50F4C68591/EndorsersSTATEMENTOFSUPPORTofCRTRA3408.pdf (last visited Nov. 1, 2011) (listing the American Bar Association, NAACP Legal Defense and Education Fund, and American Civil Liberties Union, among others, as signing a statement of support for the CRTRA of 2007).

\(^{250}\) Thus, back pay, front pay, and punitive damages should still be taxed.

\(^{251}\) The latter part of (2) would actually provide a disincentive for employers to engage in unlawful discharge or employment discrimination.

\(^{252}\) See supra note 244 and accompanying text (finding that the Civil Rights Tax Fairness Act of 2000 and its progeny would all average income for plaintiffs in successful discrimination claims).

\(^{253}\) See supra note 78 and accompanying text (bringing attention to the fact that income averaging would not have helped the plaintiffs in Sears and also citing to authority calling for an end to income averaging).


send messages," “mak[ing] statements about the relative desirability of different types of activity and patterns of conduct.”

The Supreme Court, in its seminal decision on a district court’s equitable judgment, Albemarle Paper Co. v. Moody, argued that Title VII and other anti-discrimination statutes serve to “mak[e] persons whole for injuries suffered through past discrimination” and abrogate “discrimination throughout the economy.” At the heart of congressional intent was to give Title VII liberal construction to do just this. However, the Code, as presently written, undermines Title VII’s and the ADA’s very objective: to put a victim in the exact same financial position he would have enjoyed had no wrongdoing occurred. Only by shifting the burden of adverse tax consequences to the more politically savvy and deep-pocketed defendants can tax gross ups finally produce the long awaited legislative solution.

In the words of one district court, “'[i]t's not how much you make, it is how much you keep.’” With the law as it is, courts can deprive prevailing plaintiffs, who have already suffered humiliation and economic loss at the hands of their employer, of funds they deserve. Too often judges refuse to shift a portion, let alone the entirety, of plaintiff’s elevated tax liability to defendants, whose unlawful conduct—it must be emphasized—necessitated the lawsuit in the first place. Ironically, statutes meant to protect citizens frequently penalize them. With courts tending to treat tax issues in non-tax cases like the bubonic plague—and the few that have dared to compute gross ups have been at odds—the onus should be on Congress to fix the problem.

256. YABLON, supra note 3, at 51 (quoting Edward J. McCaffery and Richard E. Wagner).
257. 422 U.S. 405, 421 (1973). Albemarle Paper granted back pay and pre-judgment interest awards to African Americans who alleged discrimination. Id. at 409, 436.
258. Canney, supra note 32, at 1115.
259. Polsky & Befort, supra note 32, at 70. Employees bringing discrimination suits “lack sufficient political coordination and muscle to stimulate Congress to act.” Id. at 120. Therefore, Polsky encourages “politically adept trial lawyers” to put pressure on Congress to pass the CRTRA or a derivative of it. Polsky, supra note 31, at 618. A federal judge in Georgia underscores the helplessness of plaintiff-employees:

Nowhere is the federal government’s mighty hand felt more directly than when the Internal Revenue Service comes calling with a demand for unpaid taxes. Taxation, admittedly a necessary element of any form of civilized government, places unparalleled power in the hand of the sovereign. When that power is unleashed in an inconsistent, threatening, and arrogant manner, the powerless taxpayer, who for all practical purposes is at the mercy of the government, has little recourse to remedy such abuses.

YABLON, supra note 3, at 217.
261. See Reece, supra note 96, at 342 (“[L]egislative response to this issue is overdue.”).
The solution is simple: amend the Code.\textsuperscript{262} Congress has repeatedly reformed Title VII and other discrimination statutes\textsuperscript{263} ""to provide more effective deterrence and adequate compensation.""\textsuperscript{264} One step remains. The chronic decisions not to pass the CRTRA have left (and continue to leave) gaping holes in the United States' anti-discrimination statutes. Only enactment can preserve the dignity of federal civil rights law, ""restore [employees]—as best as possible—to their rightful place in society,""\textsuperscript{265} and fill this void.

\textsuperscript{262} To fix the adverse tax consequence problem, the legislature, as usual, does not need to make drastic changes to the Code:

Legislative changes in tax policy usually begin as marginal adjustments to the existing tax structure. . . . The tax code offers a variety of easily grasped levers. In this sense, it is an incrementalist paradise, susceptible and seductive to political tinkerers. As a result, most changes in tax bills consist of simple adjustments in existing tax provisions.


\textsuperscript{265} Canney, \textit{supra} note 32, at 1137.