TAXING DISCRIMINATION VICTIMS: HOW THE CURRENT TAX REGIME IS UNJUST AND WHY A HYBRID INCOME AVERAGING AND GROSS UP REMEDY PROVIDES THE MOST EQUITABLE SOLUTION

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INTRODUCTION

The United States Congress has utilized its constitutionally enumerated powers under the Commerce Clause[1] and the Fourteenth Amendment[2] to enact laws with the goal of ending harmful workplace discrimination.[3] The seminal federal employment discrimination laws that were passed to

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[1] "The Congress shall have the Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ." U.S. CONST. art. I, § 8, cl. 3.

[2]

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws. . . . The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

U.S. CONST. amend. XIV, §§ 1, 5.

[3] *See, e.g.*, Bd. of Trs. of Univ. of Ala. v. Garrett, 531 U.S. 356, 363-64 (2001) (holding that the ADA was enacted under Congress's power to regulate commerce and states therefore have Eleventh Amendment immunity); Fitzpatrick v. Bitzer, 427 U.S. 445, 456 (1976) (holding that Congress is empowered under section five of the Fourteenth Amendment to enact "appropriate legislation," such as Title VII, which enforces the substantive provisions of the other sections of the Fourteenth Amendment).

achieve this noble end include Title VII of the Civil Rights Act of 1964,[4] the Age Discrimination in Employment Act (ADEA) of 1967,[5] and the Americans with Disabilities Act (ADA) of 1990.[6] Employment discrimination laws embody the principle that "[d]istinctions must be made on the basis of merit, rather than skin color, age, sex or gender, or any other measure that obscures a person's individual humanity and worth."[7]

Dawn Loesch was unlawfully discriminated against because of her gender, and she filed suit under Title VII after her former employer, the Philadelphia Fire Department, fired her because she is a woman.[8] Ms. Loesch prevailed against her former employer after years of proceedings, culminating in a five day jury trial in which Ms. Loesch was awarded $464,037 in back and front pay damages.[9] Although the damages Ms. Loesch received provided compensation for the years she was unlawfully denied employment, she was victimized again by the tax code.[10]

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[4] Civil Rights Act of 1964, Pub. L. No. 88-352, Title VII, 78 Stat. 241 (codified as amended at 42 U.S.C.A. §§ 2000e to e-17 (West, Westlaw through P.L. 112-3)).

[5] Age Discrimination in Employment Act of 1967, Pub. L. No. 90-202, 81 Stat. 602 (codified as amended at 29 U.S.C.A. §§ 621-634 (West, Westlaw through P.L. 112-3)).

[6] Americans with Disabilities Act, Pub. L. No. 101-336, 104 Stat. 327 (1990) (codified as amended at 42 U.S.C. §§ 12101-12213 (West, Westlaw through P.L. 112-3)).

[7] Enriquez v. W. Jersey Health Sys., 777 A.2d 365, 380 (N.J. Super. Ct. App. Div. 2001) (discussing the purpose behind New Jersey's Law Against Discrimination, which is comparable to Title VII).

[8] *See* Loesch v. City of Phila., No. 05-0578, 2008 U.S. Dist. LEXIS 48757, at *1-2 (E.D. Pa. June 25, 2008). Loesch claimed that she was terminated from her medical command for violating protocol, while similarly situated male paramedics received lesser punishments. *Id.* at *2.

[9] *Id.* at *1-2.

[10] *Id.* at *27-36. *See* I.R.C. § 104(a)(2) (West, Westlaw through P.L. 112-3).

Under the court's calculations, Ms. Loesch was liable for $82,863 in income taxes on her lump sum award—an effective tax rate of 26.67% after deductions for attorney's fees were taken into account.[11] This effective tax rate is more than double the effective tax rate of 12.45% Ms. Loesch would have paid in income taxes on her normal salary of $51,925.[12] Due to the fact that Ms. Loesch was a victim of employment discrimination, she was subjected to $46,746 in additional taxes compared to what her tax liability would have been had no discrimination occurred.[13]

Federal circuit courts are divided on the issue of whether anti-discrimination laws grant courts the power to redress a plaintiff's negative tax consequences.[14] Luckily for Ms. Loesch, the district court hearing her case followed the "gross up" method—awarding an additional sum to offset the negative tax consequences.[15] Another remedy Congress considered is whether victims of unlawful discrimination should be liable for their "normal" tax burden, calculated by averaging the plaintiff's award over the number of years that the award is designed to cover.[16]

This note discusses the tax dilemma victims of employment discrimination face and weighs which remedy, income averaging or the judicial "gross up," provides the best solution. Part II surveys federal discrimination laws and the equitable remedies provided under them. Part III examines the

[11] *Loesch*, 2008 U.S. Dist. LEXIS 48757, at *33-35.

[12] *Id.* at *35.

[13] *Id.*

[14] *Compare* Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456 (10th Cir. 1984) (holding that courts have equitable power to grant a gross up), *and* Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441-42 (3d Cir. 2009) (same), *with* Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (holding that tax offsets are not within courts' equitable powers to make victims of discrimination whole).

[15] *Loesch*, 2008 U.S. Dist. LEXIS 48757, at *28-29 (citing O'Neill v. Sears, Roebuck & Co., 108 F. Supp. 2d 443, 447 (E.D. Pa. 2000)).

[16] *See* Civil Rights Tax Relief Act of 2009, S. 1360, 111th Cong. (2009); Civil Rights Tax Relief Act of 2009, H.R. 3035, 111th Cong. (2009).

changes in the tax code that have subjected employment discrimination victims' damages to higher federal income taxes. Parts IV and V respectively survey the judicial and legislative reactions to this dilemma. Part VI analyzes possible remedies, and proposes a hybrid scheme that involves income averaging and allows courts to retain the power to gross up awards. A hybrid scheme is the most effective solution in balancing the rights of discrimination victims with the need to raise federal revenue because it allows for the flexibility needed to address the unforeseeable and extreme circumstances that arise when the federal employment discrimination and tax regimes intersect.

FEDERAL EMPLOYMENT DISCRIMINATION LAWS AND EQUITABLE REMEDIES

In the context of the employer-employee relationship, anti-discrimination laws seek to balance the rights of the employee with the duties of the employer by requiring employers to hire, evaluate, and compensate employees based on intrinsic qualities rather than extrinsic characteristics.[17] The federal government and most states have laws that seek to aid in creating a fair workplace. Before analyzing how federal tax laws have impacted front and back pay damages, it will be helpful to survey the most important federal employment discrimination statutes under which those remedies are sought.

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[17] *See* Laura Grenfell, *Embracing Law's Categories: Anti-Discrimination Laws and Transgenderism*, 15 YALE J.L. & FEMINISM 51, 84-85 (2003). *See also* Geoffrey D. Mueller, *The Federal Income Tax Consequences of States' Laws Against Discrimination: Why* Blaney *was Right and Why New Jersey's Law Against Discrimination Should be Amended*, 29 SETON HALL LEGIS. J. 603, 605 (2005) ("The general aim of most anti-discrimination laws is to 'protect individuals from the stereotypical ascription of presumed group characteristics.'") (quoting Sujit Choudhry, *Distribution vs. Recognition: The Case of Anti-Discrimination Laws*, 9 GEO. MASON L. REV. 145, 177 (2000)).

TITLE VII OF THE CIVIL RIGHTS ACT OF 1964

Although it was not Congress's first attempt at preventing employment discrimination,[18] Title VII of the Civil Rights Act of 1964 (Title VII) is a seminal piece of legislation that was enacted to prevent and remedy discrimination in employment.[19] Title VII provides that it is unlawful for employers to discriminate against an employee in any manner if that discrimination is based on the employee's "race, color, religion, sex, or national origin."[20] Justice Brennan best summarized Title VII's importance as well as its boundaries when he wrote:

> In passing Title VII, Congress made the simple but momentous announcement that sex, race, religion, and national origin are not relevant to the selection, evaluation, or compensation of employees. Yet, the statute does not purport to limit the other qualities and characteristics that

[18] Prior to Title VII, the Equal Pay Act (EPA) of 1963 helped to eliminate the wage disparity between men and women by providing that "[n]o employer . . . shall discriminate . . . between employees on the basis of sex by paying wages to employees in such establishment at a rate less than the rate at which he pays wages to employees of the opposite sex . . . for equal work . . . ." Equal Pay Act of 1963, Pub. L. No. 88-38, § 3, 77 Stat. 56, 56-57 (codified as amended at 29 U.S.C.A. § 206(d)(1) (West, Westlaw through P.L. 112-3)). Title VII incorporates the four exceptions under which the EPA exempts employers from paying all employees equally for the same work. *See* Cnty. of Wash. v. Gunther, 452 U.S. 161, 171 (1981). It is worth noting that a prima facie case of sex discrimination under the EPA is different from Title VII. *See* Peter Avery, *The Diluted Equal Pay Act: How Was it Broken? How Can it Be Fixed?*, 56 RUTGERS L. REV. 849, 857-60 (2004).

[19] *See* Griggs v. Duke Power Co., 401 U.S. 424, 429-30 (1971).

[20] *See* Civil Rights Act of 1964, Pub. L. No. 88-352, Title VII, § 703, 78 Stat. 241, 255 (codified as amended at 42 U.S.C.A. § 2000e-2 (West, Westlaw through P.L. 112-3)). Since Title VII was passed, Congress has enacted the Civil Rights Act of 1991, which serves to amend some of the basic procedural and substantive rights provided by federal employment discrimination law. *See* Civil Rights Act of 1991, Pub. L. No. 102-166, § 3, 105 Stat. 1071.

> employers *may* take into account in making employment decisions.[21]

Although Congress cast a wide net with Title VII, the Act does leave a narrow exception where discrimination would be tolerable under the law.[22] However, there are some bases of employment discrimination not covered by Title VII, including discrimination predicated on age, disability, and family circumstance, which, as will be seen below, were prohibited in subsequent legislation.

AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967

The Age Discrimination in Employment Act of 1967 (ADEA) was enacted by Congress "to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment; to help employers and workers find ways of meeting problems arising from the impact of age on employment."[23] Although the ADEA includes broad bans and protects against age discrimination in the workplace,[24] it also includes an exception that allows businesses to discriminate when "age is a bona fide occupational

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[21] Price Waterhouse v. Hopkins, 490 U.S. 228, 239 (1989) (footnote omitted).

[22] *See* Title VII § 703(h):

> [I]t shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system, or a system which measures earnings by quantity or quality of production or to employees who work in different locations . . . .

Id.

[23] Age Discrimination in Employment Act of 1967, Pub. L. No. 90-202, § 2(b), 81 Stat. 602 (codified as amended at 29 U.S.C.A. § 621 (West, Westlaw through P.L. 112-3)).

[24] *See id.* at § 4(a)-(e).

qualification reasonably necessary" for the business.[25] The ADEA intends to stop employers from having a discriminatory preference for the young over the old, but this sense of discriminatory age preference only runs one way because the ADEA "does not mean to stop an employer from favoring an older employee over a younger one."[26]

AMERICANS WITH DISABILITIES ACT OF 1990

The Americans with Disabilities Act (ADA) offers protections similar to those provided by Title VII,[27] and generally prohibits employers from discriminating "against a qualified individual on the basis of disability in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment."[28] The ADA provides employers with an affirmative defense to an accusation of discrimination based on a person's disability if such discrimination is demonstrated to be "job-related and consistent with business necessity, and such performance cannot be accomplished by reasonable accommodation."[29]

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[25] *Id.* at § 4(f)(1).

[26] Gen. Dynamics Land Sys., Inc. v. Cline, 540 U.S. 581, 600 (2004).

[27] *See* Americans with Disabilities Act, Pub. L. No. 101-336, 104 Stat. 327 (1990) (codified as amended at 42 U.S.C.A. §§ 12101-12213 (West, Westlaw through P.L. 113-2)). Another anti-discrimination law providing similar protections to disabled workers is the Rehabilitation Act of 1973, which "prohibits discrimination on the basis of disability in programs conducted by Federal agencies, in programs receiving Federal financial assistance, in Federal employment, and in the employment practices of Federal contractors." Disability Rights Section, Civil Rights Div., U.S. Dep't of Justice, *A Guide to Disability Rights Laws*, ADA HOME PAGE, 16 (Sept. 2005), http://www.ada.gov/cguide.pdf; *see also* Rehabilitation Act of 1973, Pub. L. No. 93-112, 87 Stat. 355 (codified as amended at 29 U.S.C.A.§§ 701-796*l* (West, Westlaw through P.L. 112-3)). The ADA incorporated the Rehabilitation Act's standards for determining employment discrimination. *See* 42 U.S.C.A. § 12117(b) (West, Westlaw through P.L. 112-3).

[28] 42 U.S.C.A. § 12112(a) (West, Westlaw through P.L. 112-3).

[29] 42 U.S.C.A. § 12113(a) (West, Westlaw through P.L. 112-3).

FAMILY MEDICAL LEAVE ACT

The Family Medical Leave Act (FMLA) was designed by Congress "to balance the demands of the workplace with the needs of families, to promote the stability and economic security of families, and to promote national interests in preserving family integrity."[30] Under FMLA, eligible employees are entitled to twelve workweeks of leave during any twelve month period.[31] Employers are prohibited from retaliating against an employee for exercising his or her entitlement to take leave.[32] To be eligible under the FMLA, the affected employee has to work for a specified period of time and for an employer company meeting certain size requirements; these threshold requirements are more difficult to satisfy with respect to the FMLA than compared to other federal employment discrimination statutes.[33]

REMEDIES AVAILABLE

As the survey above shows, federal employment discrimination laws have developed to protect employees from unlawful discrimination. One of the primary purposes of employment discrimination laws is to make discrimination victims whole.[34] The United States Supreme Court found that

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[30] Family Medical Leave Act of 1993, Pub. L. No. 103-3, § 2(b)(1), 107 Stat. 6, 7 (codified as amendment at 29 U.S.C.A. § 2601(b)(1) (West, Westlaw through P.L. 112-3)).

[31] *See* 29 U.S.C.A. § 2612(a)(1) (West, Westlaw through P.L. 112-3).

[32] *See* Bryant v. Dollar Gen. Corp., 538 F.3d 394, 401 (6th Cir. 2008) (citing § 2615(a)(2)).

[33] *Compare* 29 U.S.C.A. § 2611(2) (West, Westlaw through P.L. 112-3) (protecting employees who have worked for the employer for the previous twelve months or for 1,250 hours; and exempting employers with fewer than fifty employees), *with* 42 U.S.C.A. § 12111(5)(a) (West, Westlaw through P.L. 112-3) (exempting employers with fewer than twenty five employees from the requirements of the ADA), *and* 29 U.S.C.A. § 630(b) (West, Westlaw through P. L. 112-3) (exempting employers with fewer than twenty employees from the requirements of the ADEA).

[34] *See* 42 U.S.C.A. § 12117 (West, Westlaw through P.L. 112-3) (providing victims of ADA violations the same remedies as victims of Title VII violations);

courts have broad power to help victims of discrimination because "Congress took care to arm the courts with full equitable powers."[35]

Aside from compensatory damages, the most obvious tool courts can utilize to achieve the goals of employment discrimination laws is to reinstate the employee and/or order the discriminatory practice stopped.[36] As stated above, federal legislation, such as Title VII, empowers courts with the ability to craft equitable remedies needed to make the victim of employment discrimination whole.[37] If an employee lost seniority as a result of the unlawful discrimination, courts can order the employee's seniority remediated.[38] Courts are also empowered with a limited ability to punish liable employers with punitive damages.[39]

Front pay is available as a remedy when it is not possible or equitable for a court to reinstate a victim with his former

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Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975) (noting the ability of courts to make victims whole in Title VII cases); Palasota v. Haggar Clothing Co., 499 F.3d 474, 488 (5th Cir. 2007) (quoting Julian v. City of Houston, 314 F.3d 721, 728 (5th Cir. 2002)) ("The central purpose of the ADEA is 'making the individual victim of discrimination whole.'"); Moran v. Gtech Corp., 989 F. Supp. 84, 88 (D.R.I. 1997) (discussing how the victim of a FMLA violation may be made whole). The other primary purposes of anti-discrimination employment laws are simply to prevent discrimination in the workplace and achieve equal employment opportunity in the future. *See* Kilgo v. Bowman Transp., Inc., 789 F.2d 859, 876 (11th Cir. 1986) (noting the primary purposes of Title VII).

[35] *Albemarle Paper Co.*, 422 U.S. at 418.

[36] *See, e.g.*, 42 U.S.C.A. § 2000e-5(g)(1) (West, Westlaw through P.L. 112-3) ("[T]he court may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees . . . .").

[37] *See Albemarle Paper Co.*, 422 U.S. at 418.

[38] *See, e.g.*, Franks v. Bowman Transp. Co., 424 U.S. 747, 771 (1976).

[39] *See, e.g.*, Kolstad v. Am. Dental Ass'n, 527 U.S. 526, 529-30 (1999) ("Punitive damages are limited, however, to cases in which the employer has engaged in intentional discrimination and has done so with malice or with reckless indifference to the federally protected rights of an aggrieved individual.") (citation and internal quotations omitted).

employer.[40] Courts are also empowered by statute to compensate victims of discrimination with awards of back pay.[41] In *Albemarle Paper Co. v. Moody*, the Supreme Court found that back pay damages were integral to the national system of employment discrimination laws, and that there is a strong presumption that victims of discrimination are entitled to back pay damages.[42] The United States Supreme Court also stated that, in the context of Title VII claims, there was no "legal bar to raising backpay claims after the complaint for injunctive relief has been filed, or indeed after a trial on that complaint has been had."[43]

With the right to back pay damages firmly entrenched in federal employment discrimination statutory and case law, legal professionals have recognized the important role back pay damages play in employment discrimination suits.[44] This is especially true when one considers the incentives that back pay damages provide in prompting class action suits for employment discrimination, which was described by one legal professional as "[p]erhaps the most significant development in the law of labor relations."[45] Since the passage of Title VII, large employment discrimination class action settlements have continued to engender headlines.[46] Recently, Wal-Mart, the

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[40] *See, e.g.*, Pollard v. E.I. du Pont de Nemours & Co., 532 U.S. 843, 846 (2001) ("[F]ront pay is simply money awarded for lost compensation during the period between judgment and reinstatement or in lieu of reinstatement.").

[41] *See* 42 U.S.C.A. § 2000e-5(g)(1).

[42] *Albemarle Paper Co.*, 422 U.S. at 420-21.

[43] *Id.* at 424.

[44] *See* George A. Davidson, *"Back Pay" Awards Under Title VII of the Civil Rights Act of 1964*, 26 RUTGERS L. REV. 741, 773 (1972-73) (noting that back pay awards will continue to grow in importance and frequency, and courts should approach the back pay remedy as to develop uniformity in the law).

[45] *See* Charles A. Edwards, *The Back Pay Remedy in Title VII Class Actions: Problems of Procedure*, 8 GA. L. REV. 781, 781 (1973-74).

[46] It was front page news in 1973 when AT&T settled a Title VII and EPA suit brought by the EEOC for fifteen million dollars. *See* Eileen Shanahan, *A.T.&T. to Grant 15,000 Back Pay in Job Inequities*, N.Y. TIMES, Jan. 19, 1973,

world's largest retailer, has been the target of a class action employment discrimination suit, and it is estimated that the payment for back pay damages could total as much as one billion dollars if this suit settles.[47]

In addition to constituting a dynamic component of class action suits, back pay damages often represent a significant portion of the damages a discrimination victim receives.[48] To receive back pay damages, the plaintiff must demonstrate the amount of compensation he was unjustly denied as a result of the discrimination.[49] In making this calculation, the plaintiff measures the time going back two years from the filing of the

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at 1. The New York Times also covered a large employment discrimination settlement in 1992 when State Farm Insurance providers paid roughly $250 million to female employees in California. *Insurance Company Pays $157 Million to Settle Bias Case*, N.Y. TIMES, Apr. 29, 1992, at A22, *available at* http://www.nytimes.com/1992/04/29/us/insurance-company-pays-157-million-to-settle-bias-case.html. Front page treatment was also provided when the largest employment discrimination settlement to-date ($508 million) was struck in 2000 between the US government and 1,100 women who claimed to have been denied jobs and promotions by the federal agency in charge of producing the "Voice of America." *See* Irvin Molotsky, *U.S. is Offering Record Amount in Sex-Bias Suit*, N.Y. TIMES, Mar. 23, 2000, at A1, *available at* http://www.nytimes.com/2000/03/23/us/us-is-offering-record-amount-in-sex-bias-suit.html.

[47] *See* Steven Greenhouse & Constance L. Hays, *Wal-Mart Sex-Bias Suit Given Class-Action Status*, N.Y. TIMES, June 23, 2004, at A1, *available at* http://www.nytimes.com/2004/06/23/business/wal-mart-sex-bias-suit-given-class-action-status.html; Andrew Dunn & Margaret Cronin Fisk, *Wal-Mart Sex-Bias Suit Can Move Forward, Judge Says*, BLOOMBERG, June 22, 2004, http://quote.bloomberg.com/apps/news?pid=10000103&sid=aOBaag6PvxfQ&refer=news_index.

[48] *See, e.g.*, Ellis v. Ethicon, Inc., No. 05-726, 2009 U.S. Dist. LEXIS 106620, at *7 (D.N.J. Nov. 13, 2009) (noting that the jury awarded from $311,200 to $486,250 in back pay damages as compared to $734,000 in front pay); Tomasso v. Boeing Co., No. 03-4220, 2007 U.S. Dist. LEXIS 70001, at *2 (E.D. Pa. Sept. 21, 2007) (noting that the total jury award was $636,278, $261,539 of which was allocated to back pay damages); McKenna v. City of Phila., Nos. 98-2535, 99-1163, 2009 U.S. Dist. LEXIS 57955, at *4-5 (E.D. Pa. July 7, 2009) (finding the plaintiff entitled to $208,781 for back pay accumulating from the period of March 12, 1999 to August 30, 2005).

[49] *See* Edward P. O'Keefe, *The Effect of the Continuing Violations Theory on Title VII Back Pay Calculations*, 13 SETON HALL L. REV. 262, 265-69 (1983).

suit and extending to the date of reinstatement.[50] In certain cases, courts have augmented back pay damage awards with prejudgment interest, determining that such an augmentation is needed to make the victim whole.[51]

As the remainder of this article will explore, a few courts have extended their discretion to craft an equitable back pay remedy to compensate discrimination victims who also become victims of the tax code. Other courts (notably the D.C. Circuit) have held the position that it is not the job of trial courts to assist discrimination victims who face tax liability from receiving a lump sum back pay award. Aside from the courts, there is a legislative solution. Members of Congress have proposed a third way to solve the problem of taxing back pay damages. Before an examination of these respective policies is possible, it is first necessary to observe why tax discrimination victims are taxed and why this is inequitable.

TAXING DISCRIMINATION BACK PAY AWARDS

ARE BACK PAY DAMAGE AWARDS SUBJECT TO THE FEDERAL INCOME TAX?

The inclusion of pecuniary damages, such as back pay, in gross income was not always a foregone conclusion. The Revenue Act of 1918 excluded from gross income "[a]mounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or by agreement on account of such injuries or sickness."[52] Under this statute, courts determined whether the pecuniary damages added to the taxpayer's wealth (taxable), or

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[50] *See id.* at 265-66. *See also* 42 U.S.C.A. § 2000e-5(g) (West, Westlaw through P.L. 112-3).

[51] *See* Loeffler v. Frank, 486 U.S. 549, 557 (1988) ("[A]ll of the United States Courts of Appeals that have considered the question agree, that Title VII authorizes prejudgment interest as a part of the backpay remedy.") (footnote omitted).

[52] Revenue Act of 1918, Pub. L. No. 65-254, § 213(b)(6), 40 Stat. 1057, 1066 (1919).

whether the damages served as a return to that taxpayer's capital (nontaxable compensation for a physical injury).[53] The return-to-capital theory of exempting damages from taxes was expanded by courts to include damages for personal injuries with no physical manifestations, such as libel and slander.[54]

After the advent of anti-discrimination laws, it was not clear whether pecuniary damages awarded in accordance with such statutes were subject to income tax liability or exempt under the return-to-capital theory.[55] In *United States v. Burke*, the Supreme Court settled the issue of the taxability of pecuniary damages in discrimination actions by holding that Title VII damages were subject to the federal income tax.[56] The Supreme Court followed this decision in 1995 with *Commissioner v. Schieier*, which held that in the context of an ADEA suit, back wages are different from compensation for a physical injury, and therefore subject to taxes.[57] Congress removed any doubt that discrimination damages were subject to the federal income tax in 1996 with the passage of the Small Business Job Protection Act (SBJPA), which changed the language of the IRC to exclude from gross income only those

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[53] *See* Kevin C. Jones, *Taxation of Personal Injury Damages Award: A Call for a Definition of the Scope of the Section 104(a)(2) Exclusion*, 66 TEMP. L. REV. 919, 922-23 (1993).

[54] *See, e.g.,* Farmers' & Merchs.' Bank v. Comm'r, 59 F.2d 912, 913 (6th Cir. 1932) (finding that damages for injury to a business's goodwill are exempted from taxes because they represent a return to capital); Hawkins v. Comm'r, 6 B.T.A. 1023, 1024-25 (1927) (holding that similar to damages for loss of a life, damages for libel and slander were excluded from federal income tax liability because they represented "compensation for injury to his personal reputation for integrity and fair dealing").

[55] *Compare* Sparrow v. Comm'r, 949 F.2d 434, 438 (D.C. Cir. 1991) (concluding that Title VII back pay damages are subject to federal income tax) *and* Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456 (10th Cir. 1984) , (same), *with* Rickel v. Comm'r, 900 F.2d 655, 667 (3d Cir. 1990) (concluding that all damages caused by age discrimination are excludable under § 104(a)(2) because they are similar to tort damages), *and* Downey v. Comm'r, 97 T.C. 150, 173 (1991) (holding that liquidated damages under the ADEA are not subject to the federal income tax).

[56] United States v. Burke, 504 U.S. 229, 242 (1992).

[57] Comm'r v. Schleier, 515 U.S. 323, 336 (1995).

damages paid "on account of personal *physical* injuries or *physical* sickness."[58] Therefore, under the current tax code, back pay damages in employment discrimination actions are subject to the federal income tax because they are in compensation for non-physical injuries.[59]

NEGATIVE EFFECTS OF PROGRESSIVE INCOME TAX SYSTEM ON BACK PAY DAMAGES

The uniform taxation of all pecuniary, nonphysical damages under the SBJPA of 1996 was not welcome news for victims of discrimination. Under the SBJPA, employment discrimination victims became liable for federal income taxes on the amounts received in compensation for attorney's fees, front pay, and back pay.[60] The taxation of attorney's fees awards—a remedy devised in anti-discrimination laws as a mechanism to encourage plaintiffs to file suits[61]—was quickly criticized as an unjust double tax by legal scholars and organizations including the American Bar Association and American Civil Liberties Union.[62] Congress reacted to this criticism by passing the Civil

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[58] Small Business Job Protection Act, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838 (1996) (codified as amended at I.R.C. § 104(a)(2) (2006)) (emphasis added).

[59] *See* I.R.C. § 104(a)(2). The distinction in the tax code between *physical* and *non-physical* injuries has been criticized by tax scholars. *See, e.g.*, J. Martin Burke & Michael K. Friel, *Getting Physical: Excluding Personal Injury Awards Under the New Section 104(A)(2)*, 58 MONT. L. REV. 167, 168 (1997) ("[T]he remedy chosen to limit an overbroad statute, the drawing of a line between physical and nonphysical injuries, has introduced its own difficulties and is not supportable from a tax policy standpoint.").

[60] *See* Comm'r v. Banks, 543 U.S. 426, 433 (2005) (holding that damages received for attorney's fees under civil rights fee shifting provision is taxable income); Julia K. Braxelton, *The Income Tax Treatment of Damage Awards*, 75 TAXES 562, 571 (1997) (discussing the changes contained in the SBJPA have on back and front pay damages in employment discrimination actions).

[61] *See* Newman v. Piggie Park Enters., Inc., 390 U.S. 400, 402 (1968) (mentioning Congress' motive in allowing victorious civil rights plaintiffs to recover damages for attorney's fees).

[62] *See* Noah Burton, *The Taxation of Contingent Attorneys' Fees: How the Court Got Lost in the Forest*, 36 RUTGERS L.J. 953, 954, 984-85 (2005)

Rights Tax Relief Act of 2004, which amended tax laws to provide discrimination victims an above the line, Alternate Minimum Tax ("AMT") exempt income tax deduction for litigation expenses.[63]

While the Civil Rights Tax Relief Act of 2004 reformed one of the tax inequalities imposed on discrimination plaintiffs by the SBJPA, it did not address another major tax inequality discrimination plaintiffs face: the taxation of multiple years of back pay in one tax year.[64] As a matter of tax policy, it is reasonable to tax back pay damages;[65] however, legal scholars have pointed out the burden imposed on discrimination plaintiffs by taxing multiple years of back and front pay damages

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(criticizing the Supreme Court's holding in *Commissioner v. Banks* and arguing that such a result is contrary to tax policy); Rhonda McMillion, *Focusing the ABA's Efforts*, A.B.A.J., July 2004, at 63, *available at* http://www.abajournal.com/magazine/article/focusing_the_abas_efforts/print/ (noting the ABA's support for a bill that exempts attorney fees from a civil rights plaintiff's income taxes); Letter from Laura W. Murphy, Dir., & Christopher E. Anders, Legislative Counsel, ACLU, to U.S. Senators (Dec. 9, 2003), *available at* http://www.aclu.org/racial-justice_womens-rights/aclu-letter-senate-urging-support-s-557-civil-rights-tax-relief-act (urging Senators to create a legislative solution to the double taxation of damages for discrimination victim's attorney's fees).

[63] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-47 (codified as amended at I.R.C. § 62(a)(20) (West, Westlaw through P.L. 112-12)) (allowing for a deduction from gross income all expenses paid by or on behalf of the tax payer in connection to a discrimination lawsuit).

[64] *See* Jon Hyman, *3rd Circuit Decision Illustrates Need for the Civil Rights Tax Relief Act*, OHIO EMPLOYER'S LAW BLOG (Feb. 4, 2009), http://ohioemploymentlaw.blogspot.com/2009/02/3rd-circuit-decision-illustrates-need.html ("Because back pay and front pay represents lost wages, no one disputes whether the government should receive its fair share via income tax on those amounts.").

[65] It is reasonable to tax back and front pay damages because such damages are calculated by measuring wages lost as a result of the unlawful discrimination, and had the discrimination not occurred, the wages would have been subject to the federal income tax. *But see* Michael J. Minihan, Note, United States v. Burke*: the Taxation of Damages Recovered in Title VII Discrimination Actions*, 13 PACE L. REV. 1043, 1100 (1994) (contending that recoveries under Title VII should be wholly excludable because of the special nature of Title VII actions).

in one tax year.[66] Specifically, plaintiffs who receive back pay awards are taxed at a higher, if not the highest, marginal tax rate, and pay higher net income taxes than they would if their wages were earned in an ordinary fashion and the discrimination never occurred.[67]

As the result of the interaction between the annual tax accounting system and the progressive system of marginal rates, discrimination plaintiffs who receive pecuniary damages for lost wages suffer a tax penalty.[68] The federal income tax places discrimination plaintiffs in a worse position than if the discrimination never occurred, and from a policy perspective, this result is perverse because it prohibits the goal of employment discrimination laws, to make the victim whole, from being achieved. Both the courts and Congress have proposed solutions to this inequality, and these proposals will be discussed respectively in the following two sections.

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[66] *See, e.g.*, Gregg D. Polsky & Stephen F. Befort, *Employment Discrimination Remedies and Tax Gross Ups*, 90 IOWA L. REV. 67, 74-78 (2004) (describing how lump sum back pay damages are taxed at a higher rate than they would be otherwise because of the interaction between the annual accounting system and progressive tax rates); Mark J. Wolff, *Sex, Race, and Age: Double Discrimination in Torts and Taxes*, 78 WASH. U. L.Q. 1341, 1403 (2000) ("[I]njured taxpayer must declare the lump sum award in the taxable year he receives it, and this bunching of back pay or lost profits will normally send the plaintiff into a higher marginal tax bracket given the progressive rate of the federal income tax.").

[67] *See* Polsky & Befort, *supra* note 66, at 74-78. Polsky and Befort construct an illustrative model to demonstrate how employment discrimination plaintiffs who receive pecuniary damages are harmed by current tax laws. *See id.* The plaintiff in the example is assumed to be an unmarried taxpayer who earns $40,000 a year from 1993-2003. *Id.* at 74. In 2003, the plaintiff receives a favorable judgment from a court, which finds that but for unlawful discrimination, the plaintiff should have made $65,000 a year. *Id.* The plaintiff receives back pay of $250,000 and front pay for the next four years totaling $100,000. *Id.* Under current tax laws, the plaintiff would be liable for $111,022 in income taxes on the pecuniary damages, an effective tax rate of 31.72%. *Id.* at 75. If the plaintiff did not suffer unlawful discrimination, and earned $65,000 from 1993-2006 as the court determined he would have, then he would have been taxed $87,500 or an effective tax rate of 25%. *Id.* at 76. Therefore, Polsky and Befort determined, under a number of assumptions, that the tax penalty the plaintiff would have suffered as a result of being a victim of discrimination was $23,522. *Id.*

[68] *See id.* at 76-77.

HOW COURTS HAVE HANDLED THE TAXING OF PECUNIARY DISCRIMINATION AWARDS

The next step requires an examination of how federal courts have reconciled the inclusion of discrimination damages in gross income with the requirement of anti-discrimination law to place the victim in as good a position as if the discrimination never occurred. Courts have responded to this dilemma by either 1) adjusting the award to account for the increase in the marginal tax rate, or 2) ignoring the increased marginal tax rate. The Tenth Circuit was the first to definitively rule on the matter and it adopted the former approach.[69] The Circuit Court of Appeals for the District of Columbia ruled roughly a decade later that employment discrimination laws do not allow courts the discretion to adjust awards for negative tax consequences.[70] Nearly fifteen years after the D.C. Circuit ruling, the Third Circuit issued an opinion, which adopted the approach of the Tenth Circuit, thus deepening the circuit split.[71] The opinions of the three Circuit Courts must be analyzed in order to determine which approach is best.

THE 10TH CIRCUIT

The first federal circuit to squarely address the issue of including a tax component in back pay discrimination damage awards was the Tenth Circuit in *Sears v. Atchison, Topeka & Santa Fe Railway, Co*.[72] In *Sears*, a group of African American males filed a Title VII class action lawsuit against the Atchison, Topeka, and Santa Fe Railway (Santa Fe) and the United Transportation Union (UTU).[73] The plaintiffs were employed in

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[69] *See* Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456-57 (10th Cir. 1984).

[70] *See* Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994).

[71] *See* Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441-42 (3d Cir. 2009).

[72] *See Sears*, 749 F.2d at 1456-57.

[73] Sears v. Atchison, Topeka & Santa Fe Ry., Co., 454 F. Supp. 158, 159-60 (D. Kan. 1978), *aff'd*, 749 F.2d 1451 (10th Cir. 1984).

one capacity or another as train porters for the Santa Fe any time from July 2, 1965 to June 14, 1978.[74]

The train porter's Title VII claims arose from their contention that the Santa Fe and the UTU "engaged in a systematic campaign and practice of excluding blacks, and more particularly, black train porters, from employment as brakemen, conductors, and supervisory or management personnel."[75] The African American porters performed the same duties as non-minority brakemen; however, the brakemen were paid an overall higher wage than the porters.[76] The District Court found that both the Santa Fe and the UTU violated Title VII in their treatment of the train porter subclass.[77] When considering the issue of damages, the District Court provided for additional compensation to account for the negative tax effect of receiving a lump sum back pay award in one tax year.[78]

Among other issues, the UTU contested the tax component of the back pay award in its appeal to the Tenth Circuit.[79] The Tenth Circuit held that the lower court did not abuse its discretion because Title VII vested trial courts with "wide discretion in fashioning remedies to make victims of

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[74] *Id.* at 160.

[75] *Id.* at 161. In addition to claiming that they were denied advancement opportunities, the plaintiffs also contended that the Santa Fe and UTU designed the seniority system to have a disparate impact on African Americans. *Id.*

[76] *Id.* at 163-66.

[77] *Id.* at 182. The District Court bifurcated the proceedings into a liability and damages phase. *Id.* at 174, 182. Santa Fe had previously settled all of its claims with the plaintiffs; therefore, the damages awarded would be paid by UTU and offset by the settlement amount paid by Santa Fe. *Id.* at 182.

[78] *See* Sears v. Atchison, Topeka & Santa Fe Ry., Co., Nos. W-4963, W-4946, 1982 U.S. Dist. LEXIS 16862, at *19 (D. Kan. Dec. 1, 1982), *rev'd on other grounds by* 749 F.2d 1450, 1456 (10th Cir. 1985) (reversing and remanding the district court on the issue of attorney's fees). Although the Supreme Court had yet to issue the definitive rule on the taxation of Title VII back pay damages, *see* United States v. Burke, 504 U.S. 229, 242 (1992), the District Court in *Sears* correctly ruled that such damages are subject to the federal income tax. *Sears*, 1982 U.S. Dist. LEXIS 16862, at *22-23.

[79] *See Sears*, 749 F.2d at 1453.

discrimination whole."[80] The Court of Appeals noted that tax remedies "may not be appropriate in a typical Title VII case," but that "this case presents special circumstances in view of the protracted nature of the litigation" that make a tax component necessary to make the victims of the discrimination whole.[81] The UTU argued that income averaging could mitigate or eliminate the need for a tax component to back pay damages; however, the Tenth Circuit viewed income averaging as an insufficient solution.[82]

The principle of *Sears*, that the IRS should not commit a second injustice on the victims of employment discrimination by taxing their back pay award at the highest tax rate, has only been bolstered with time because of the disappearance of income averaging as a tax tool for individual taxpayers.[83]

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[80] *Id.* at 1456 (citing Sears v. Atchison, Topeka & Santa Fe Ry., Co., 645 F.2d 1365, 1378 (10th Cir. 1981) (citation omitted); Ford Motor Co. v. EEOC, 458 U.S. 219, 230 (1982) (noting that one of the purposes of Title VII is to place victims of unlawful discrimination in "a position where they would have been were it not for the unlawful discrimination") (citation and internal quotations omitted); Int'l Bhd. of Teamsters v. United States, 431 U.S. 324, 364 (1977) (noting that Congress' purpose in vesting broad equitable powers to the courts under Title VII was to make possible "the most complete relief possible") (citation and internal quotations omitted).

[81] *Sears*, 749 F.2d at 1456.

[82] *Id.* The *Sears* Court noted the differences between their decision to allow an enhancement for negative tax effects and their decision to not allow such an enhancement in Blim v. Western Electric Co., 731 F.2d 1473, 1480 (10th Cir. 1984). *Sears*, 749 F.2d at 1456-57. In *Blim*, the plaintiff received liquidated damages (the tax effect of which was unknown) and averaging the income over five years would have eliminated any negative tax effects from the award. *Blim,* 731 F.2d at 1480. The *Sears* Court also recognized that many of the plaintiffs had died and their estates would not be able to take advantage of income averaging provisions. *Sears*, 749 F.2d at 1456-57.

[83] Congress repealed income averaging in the Tax Reform Act of 1986. Pub. L. No. 99-514, § 141, 100 Stat. 2085, 2117 (1986). Prior to repealing income averaging, recipients of lump sum back pay awards could have elected to average their income over a period of several years to be taxed at a lower marginal rate in the outlier year. *See* Richard Schmalbeck, *Income Averaging After Twenty Years: A Failed Experiment in Horizontal Equity*, 1984 DUKE L.J. 509, 512-14 (1984). Therefore, the repeal of income averaging intensifies the negative tax effect of discrimination victims who receive a large lump sum back pay award.

Despite appearing to further Title VII's mandate to make victims of discrimination whole, this principle of accounting for the adverse tax effect of back pay damages has not been universally accepted.[84] As the next section explores, at least one federal circuit has rejected the principle of grossing up discrimination awards embodied in *Sears*.

THE D.C. CIRCUIT

One such case in which a court denied a plaintiff the opportunity to collect additional compensation for the adverse tax consequences of a lump sum back pay award is *Dashnaw v. Pena*.[85] In *Dashnaw*, the Court of Appeals for the District of Columbia heard an appeal from the defendant, the Department of Transportation, and a cross appeal from the plaintiff, Francis Dashnaw.[86] Dashnaw had been employed at the Federal Maritime Administration (MARAD), a division of the Department of Transportation, since 1967.[87] In the suit filed under the ADEA in 1977, the plaintiff alleged age discrimination arising from four incidents in which he was denied advancement.[88] The District Court found MARAD liable for unlawful age discrimination, but the proceedings were protracted for several reasons, including Dashnaw's retirement from MARAD.[89]

In his cross appeal, Dashnaw contended he should have been awarded "additional compensation to help cover the higher taxes he will have to pay because he will receive his backpay in a

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[84] *See e.g.*, Fogg v. Gonzales, 492 F.3d 447, 455-56 (D.C. Cir. 2007); Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994); Pollard v. E.I. du Pont de Nemours, Inc., 338 F. Supp. 2d 865, 883 (W.D. Tenn. 2003); Best v. Shell Oil Co., 4 F. Supp. 2d 770, 776 (N.D. Ill. 1998).

[85] *Dashnaw*, 12 F.3d at 1116.

[86] *Id.* at 1113.

[87] *Id.* at 1114.

[88] *See* Dashnaw v. Verity, No. 77-1342, 1988 U.S. Dist. LEXIS 15341, at *3 (D.D.C. Apr. 4, 1988), *aff'd in part, rev'd in part*, 12 F.3d 1112 (D.C. Cir. 1994).

[89] *See Dashnaw*, 12 F.3d at 1114-15.

lump sum."[90] Citing a lack of authority on the subject, the D.C. Circuit refused the plaintiff's request for additional compensation for an added tax liability.[91] Without citing to any other authority, the D.C. Circuit announced the often quoted phrase that, "[a]bsent 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."[92]

In announcing this general principle of barring consideration of the victim's tax implications in determining damages, the *Dashnaw* Court appears to be directly at odds with the holding in *Sears*.[93] There are some notable differences between *Sears* and *Dashnaw* that could lead to the conclusion that the two opinions can coexist;[94] however, any notion that the *Sears* and *Dashnaw* holdings were not contradictory was eviscerated by the D.C. Circuit's decision in *Fogg v. Gonzales*, which explicitly rejected the principle announced in *Sears*.[95]

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[90] *Id.* at 1113.

[91] *Id.* at 1116.

[92] *Id.* Other courts have cited this portion of the *Dashnaw* decision in denying plaintiffs a tax component to discrimination damages. *See* Fogg v. Gonzales, 492 F.3d 447, 455-56 (D.C. Cir. 2007) (holding that the district court erred in increasing the plaintiff's Title VII back pay award to account for his higher tax liability); Pollard v. E.I. du Pont de Nemours, Inc., 338 F. Supp. 2d 865, 883 (W.D. Tenn. 2003) (holding, without citing any authority other than *Dashnaw*, that "the literature and case law" prevent awarding a Title VII plaintiff compensation for adverse tax consequences).

[93] *Compare Dashnaw*, 12 F.3d at 1116, *with* Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456-57 (10th Cir. 1984).

[94] In *Sears*, the plaintiffs, almost 40% of whom were deceased, were members of a class. *See Sears*, 749 F.2d at 1156. Whereas in *Dashnaw*, the plaintiff was an individual employee. *See Dashnaw*, 12 F.3d at 1114. Additionally, both *Sears* and *Dashnaw* similarly held that the lower court's ruling with regard to an enhancement for tax liability was correct, and one could infer from such a ruling that the decision to enhance a plaintiff's damages is at the discretion of the trial court. *See Sears*, 749 F.2d at 1456-57; *Dashnaw*, 12 F.3d at 1116.

[95] *See Fogg*, 492 F.3d at 455 (rejecting the "directly contrary decision in *Sears*" in light of the D.C. Circuit's decision in *Dashnaw*) (internal citation omitted).

Announcing blanket bars to a plaintiff's recovery without public policy or case law support is, in this author's opinion, an unjust way to interpret discrimination laws like Title VII. The *Dashnaw* Court spends little time discussing the cross appeal for a tax enhancement and it implicitly assumes that no case law on the issue exists.[96] However, a search of federal jurisprudence would have revealed *Sears v. Atchison, Topeka & Santa Fe Railway Co.*, an authority the *Dashnaw* Court ignored. Although at least one other court has attempted to link the D.C. Circuit's general principle against tax enhancements to the decision of another federal circuit court,[97] the D.C. Circuit stands alone in finding this general principle of law.[98]

THE THIRD CIRCUIT

The most recent federal circuit to weigh in on the issue of "grossing up" back pay damages to adjust for tax liabilities has been the Third Circuit in *Eshelman v. Agere Systems, Inc.*[99] Joan Eshelman, the plaintiff, worked for Agere Systems and its predecessors from 1981 to 2001, and alleged her former employer of engaging in employment discrimination in violation

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[96] *See Dashnaw*, 12 F.3d at 1116.

[97] *See* Best v. Shell Oil Co., 4 F. Supp. 2d 770, 776 (N.D. Ill. 1998). In *Best*, the District Court for the Northern District of Illinois cites the Eighth Circuit's decision in *Hukkanen v. International Union of Operating Engineers* to support their denial of the plaintiff's request for a tax enhancement for his lump-sum judgment. *Id.* However, *Hukkanen* only indirectly supports this conclusion, and *Hukkanen* actually supports the *Sears* Court's principle that Title VII allows for a tax enhancement. Hukkanen v. Int'l Union of Operating Eng'rs, Hoisting & Portable Local No. 101, 3 F.3d 281, 287 (8th Cir. 1993) (holding that the plaintiff was not entitled to a tax enhancement because of a failure to present evidence in support of such an enhancement). Although it was not overtly adopted, a subsequent Eighth Circuit decision has also lent support to the principle announced in *Sears*. *See* Arneson v. Callahan, 128 F.3d 1243, 1247 (8th Cir. 1997) (finding that tax enhancements are "analogous to the prejudgment interest remedy").

[98] *See generally* Tim Canney, Comment, *Tax Gross-Ups: A Practical Guide to Arguing and Calculating Awards for Adverse Tax Consequences in Discrimination Suits*, 59 CATH. U.L. REV. 1111 (2010).

[99] Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441-42 (3d Cir. 2009).

of the ADA.[100] Eshelman specifically contended she was terminated from Agere because of a disability related to her breast cancer.[101] A jury sitting in the Eastern District of Pennsylvania agreed and awarded Eshelman $170,000 in back pay and $30,000 in compensatory damages.[102] After the verdict was rendered, the District Court granted Eshelman's request to offset the negative tax consequences of receiving the jury's back pay award in a lump sum.[103] Agere appealed this decision to shift the burden of the added tax liability.[104]

The Third Circuit rejected Agere's appeal and held that it was within the trial court's "broad equitable powers" to grant "a prevailing employee an additional sum of money to compensate for the increased tax burden a back pay award may create."[105] In reaching this decision, the Third Circuit recognized the broad power to craft an equitable remedy that the ADA, like Title VII, conferred on trial courts.[106] The *Eshelman* Court reiterated the principle that discrimination remedies should restore the plaintiff "to the economic status quo that would exist but for the employer's conduct."[107]

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[100] *Id.* at 430-31. The plaintiff in *Eshelman* also contended that her employer violated the ADEA and the Pennsylvania Human Relations Act (PHRA). *Id.* at 432. The jury only found Agere in violation of the ADA and PHRA claim. *Id.* The Third Circuit only discussed the ADA claim because it is coterminous with the PHRA claim. *Id.* at 433 n.3. Therefore, for simplicity's sake, this note will only concentrate on the plaintiff's ADA claim.

[101] *Id.* at 432.

[102] *Id.*

[103] *Id.*

[104] *Id.* at 433.

[105] Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441-42 (3d Cir. 2009).

[106] *Id.* at 440 (citing 42 U.S.C. § 2000e-5(g)(1) (2006); Franks v. Bowman Transp. Co., Inc., 424 U.S. 747, 764 (1976); Albemarle Paper Co. v. Moody, 442 U.S. 405, 418 (1975).

[107] *Id.* (quoting *In re* Cont'l Airlines, 125 F.3d 120, 135 (3d Cir. 1997) (internal quotations omitted).

The *Eshelman* case was the first time that the Third Circuit squarely addressed the need for trial courts to craft tax considerations into equitable solutions for victims of discrimination.[108] The Third Circuit recognized the need for accuracy in determining the amount of the tax effect damages, and in affirming the additional $6,893 the District Court awarded Eshelman, the Third Circuit noted the presence of an uncontested affidavit from an economic expert calculating the negative tax amount.[109] The goal, that victims of discrimination should be placed in the same economic situation as if the discrimination never occurred, is reinforced by requiring precision in calculating tax effect damages. The Third Circuit also supported its holding by illustrating that like the universally accepted remedy of prejudgment interest, tax effect damages are necessary under Title VII to make the victim economically whole.[110]

The Third Circuit reasoned that it would be impossible to restore Eshelman to her original condition if the tax effect damages were not provided because Eshelman would have been taxed at a much higher rate than she would have been if the discrimination never occurred.[111] In coming to this decision, the Third Circuit relied heavily on the Tenth Circuit's ruling in *Sears* as well as a few district court opinions that directly addressed the issue and allowed for tax effect damages.[112]

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[108] *Id.* at 441. Despite being the first to address this precise issue, the Third Circuit recognized that other cases have come close to addressing this issue. *Id.* In particular, the *Eshelman* Court cites *Gelof v. Papineau*. *Id.* (citation omitted). In *Gelof*, the Third Circuit did not need to reach the decision of whether an additional award for the added tax burden was valid under the ADEA because the defendant conceded liability for the tax damages and only contested their calculation. Gelof v. Papineau, 829 F.2d 452, 455 (3d Cir. 1987).

[109] *Eshelman*, 554 F.3d at 442-43.

[110] *See id.* at 442 (citing Loeffler v. Frank, 486 U.S. 549, 557 (1988) (noting that all of the federal circuits authorize prejudgment interest under Title VII); Booker v. Taylor Milk Co., 64 F.3d 860, 868 (3d Cir. 1995) ("As with the back pay award, prejudgment interest helps to make victims of discrimination whole.")).

[111] *Id.* at 441-42.

[112] *Id.* at 441(citing Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456 (10th Cir. 1984); O'Neill v. Sears, Roebuck & Co., 108 F. Supp. 2d

Like the Tenth Circuit in *Sears*,[113] the Third Circuit added a very important caveat to their ruling by stating: "[W]e do not suggest that a prevailing plaintiff in discrimination cases is presumptively entitled to an additional award to offset tax consequences . . . . The nature and amount of relief needed to make an aggrieved party whole necessarily varies from case to case."[114] The Third Circuit wanted to provide lower courts with "wide discretion to locate 'a just result.'"[115] In adopting this principle, the *Eshelman* Court decidedly rejected the D.C. Circuit's one-size-fits-all tax prohibition on allowing award enhancements for negative tax consequences as announced in *Dashnaw*.[116]

LEGISLATIVE SOLUTIONS TO THE TAX PENALTY IMPOSED ON DISCRIMINATION VICTIMS

The push for a legislative solution to the tax penalty imposed on discrimination plaintiffs began shortly after the SBPJA of 1996 was enacted. The first version of a legislative solution, the Civil Rights Tax Fairness Act of 1999, was introduced in the House of Representatives on May 27, 1999.[117] The Civil Rights Tax Fairness Act of 1999 was not enacted into law, and a renamed version of the bill, the Civil Rights Tax Relief

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443, 446 (E.D. Pa. 2000) ("[T]he Plaintiff is entitled to an award for negative tax consequences . . . on the award of front and backpay, only."); E.E.O.C. v. Joe's Stone Crab, Inc., 15 F. Supp. 2d 1364, 1380 (S.D. Fla. 1998) (recognizing that a tax component is appropriate to compensate plaintiffs in Title VII suits who receive large lump sum awards)).

[113] *See Sears*, 749 F.2d at 1456.

[114] *Eshelman*, 554 F.3d at 443.

[115] *Id.* at 443 (citation omitted).

[116] *Id.* at 441 n.8. The *Eshelman* Court noted the brevity of the portion of the opinion in which the *Dashnaw* Court "considered and summarily rejected the argument that a court could issue an award to compensate an employee for additional tax liability." *Id.*

[117] *See* H.R. 1997, 106th Cong. (1st Sess. 1999).

Act (CRTRA) of 2001,[118] was later reintroduced in the House of Representatives on March 1, 2001[119] and introduced in the Senate on May 21, 2001.[120] The CRTRA of 2001 was likewise not enacted into law, and the bill was reintroduced to both the House of Representatives and the Senate as the CRTRA of 2003 in the next Congress.[121] Portions of the CRTRA of 2003 were included in the American Jobs Creation Act of 2004; however, the parts of the CRTRA which address the tax penalty imposed on pecuniary damages awarded to discrimination victims was omitted.[122]

A revised version of the CRTRA of 2003, containing the provisions not included in the American Jobs Creation Act of 2004, was introduced to both houses of Congress in 2007, but this bill, like its 1999 and 2001 predecessors, was never passed into law.[123] The most recent incarnation of this legislation—the CRTRA of 2009—was introduced in both the House of Representatives and the Senate on June 25, 2009.[124] This

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[118] *See* Debra Pickett, *Only Winner in Woman's Bias Suit may be the IRS*, CHI. SUN-TIMES, Aug. 16, 2002, at 2 (discussing how members of the House of Representatives may have been reluctant to vote on the Civil Rights Tax Fairness Act of 1999 because they "were reluctant to make a change to the giant, complicated mess that is the U.S. tax code, especially a change that reversed another change they'd made only a few years before.").

[119] *See* H.R. 840, 107th Cong. (1st Sess. 2001).

[120] *See* S. 917, 107th Cong. (1st Sess. 2001).

[121] *See* S. 557, 108th Cong. (1st Sess. 2003); H.R. 1155, 108th Cong. (1st Sess. 2003).

[122] *See supra* note 63.

[123] *See* S. 1689, 110th Cong. (1st Sess. 2007); H.R. 1540, 110th Cong. (1st Sess. 2007). *See also* Jeremy J. Gray, Eshelman v. Agere Systems: *Grossing-up of Back Pay Award for ADA Claim*, LAWUPDATES.COM (May 5, 2009), http://www.lawupdates.com/commentary/ieshelman_v_agere_systems_i_grossing_up_of_back_pay_award_for_ada_claim (noting how the CRTRA of 2007 has been introduced in both houses of Congress but has "gone no where" [sic]).

[124] *See* S. 1360, 111th Cong. (1st Sess. 2009); H.R. 3035, 111th Cong. (1st Sess. 2009). S. 1360 and H.R. 3035 are identical and closely resemble the CRTRA of 2007 in all aspects except for the effective date.

proposed legislation allows victims of unlawful discrimination to average their front and back pay damage awards over the years used in their calculation.[125] At the time of writing, the CRTRA of 2009 has remained in Committee in both the House of Representatives and Senate.[126]

To illustrate how the CRTA of 2009 would impact a discrimination plaintiff, refer to Polsky and Befort's illustration discussed in Section III.[127] In their example, the plaintiff received $350,000 for pecuniary damages and paid $111,022 in income taxes at an effective rate of 31.72%.[128] Under the proposal contained in the CRTRA of 2009, the plaintiff would pay only $87,500 in income taxes, or an effective rate of 25%; the same effective rate the plaintiff would have paid had the plaintiff not experienced discrimination and earned $65,000 a year.[129] The income averaging approach proposed in the CRTRA of 2009 is attractive at first glance for its ability to place the discrimination victim in the same tax bracket as if the discrimination never occurred.

Given the attractive nature of the income averaging approach, it is not surprising that such a broach spectrum of political interests have publicly supported this proposal.[130] The

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[125] The CRTRA of 2009 also exempts non-pecuniary damages awarded from discrimination victims' taxable income. *See* S. 1360, 111th Cong. (1st Sess. 2009); H.R. 3035, 111th Cong. (1st Sess. 2009).

[126] *See S. 1360: Civil Rights Tax Relief Act of 2009*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=s111-1360 (last visited Apr. 23, 2011); *H.R. 3035: Civil Rights Tax Relief Act of 2009*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=h111-3035 (last visited Apr. 23, 2011).

[127] *See supra* note 67.

[128] *See supra* note 67.

[129] Under the CRTRA of 2009, the maximum tax rate is determined by the following formula: regular tax that would have been imposed had there been no back or front pay damages + [the number of years covered by the back and front pay x the amount the plaintiff's tax would increase if the plaintiff's income were increased by the average annual front and back pay awards].

[130] Advocacy groups for lawyers (ABA and National Employment Lawyers Association), discrimination victims (ACLU and NAACP), and employers (Society for Human Resource Management) all publicly supported the 2007

following section will analyze whether this approach of income averaging or the judicial gross up option are the most equitable in fixing the inequity the tax code places on discrimination victims.

IN SEARCH OF AN OPTIMAL SOLUTION: INCOME AVERAGING V. GROSS UPS

Lump sum front and back pay damages, common remedies under federal employment discrimination statutes,[131] were at one time tax free; however, pecuniary damages such as these are currently subject to federal income taxes.[132] This change in the way pecuniary damages are taxed resulted in the imposition of higher marginal tax rates on employment discrimination plaintiffs compared to similarly situated employees who were not victims of discrimination.[133] The negative tax treatment of discrimination victims' lump sum damages is recognized as an inequitable dilemma by some academics, legislatures, and courts.

Two possible solutions to this equitable dilemma have been debated by academics, legislatures, and courts. The first solution is the income averaging approach as embodied by the CRTRA,[134] and the second solution is the damages gross up approach as embodied by the court holdings in *Sears*[135] and *Eshelman*.[136] There are virtues and deficiencies associated with both the income averaging and gross up approaches. As a result,

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version of the CRTRA, which is identical to the 2009 version of the bill. *H.R. 1540: Civil Rights Tax Relief Act of 2007*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=h110-1540 (last visited Apr. 23, 2011).

[131] *See supra* notes 40-43 and accompanying text.

[132] *See supra* note 59.

[133] *See supra* note 66.

[134] *See* discussion *supra* Part V.

[135] *See* discussion *supra* Part IV (a).

[136] *See* discussion *supra* Part IV (b).

the optimal approach should be to implement a hybrid system of income averaging and (in extreme circumstances) court ordered gross ups.

ASSESSING THE DILEMMA

To devise an optimal solution, it is helpful to first classify this problem as either a part of the victims' "actual damages" or as a negative consequence of changes in the tax code. The former classification is traditionally left for the courts to address, while Congress has the power to remedy the latter.

The first step in determining whether negative tax consequences are a part of the actual damages caused by the defendant is to see if such a cost to the plaintiff fits within the definition of compensatory damages. The Supreme Court of Ohio defined compensatory damages as those monies need to compensate victims "for all of the injuries sustained."[137] Liability for a higher marginal tax rate can be considered injurious to the plaintiff under the broad definition of actual compensatory damages articulated above, and it can be construed that the defendant's discriminatory conduct is the but for cause of this tax injury.[138]

Although it is conceptually possible to view negative tax consequences as a part of the victim's actual damages, it is more logical to identify the changes made in the Internal Revenue Code as the actual cause of the discrimination victims' tax

[137] Fantozzi v. Sandusky Cement Prod. Co., 597 N.E.2d 474, 482 (1992) (discussing damages in the context of a personal injuries case). Justice Holmes of the Supreme Court of Ohio went on to explain that "[c]ompensatory damages are intended to make whole the plaintiff for the wrong done to him or her by the defendant . . . . Compensatory damages are defined as those which measure the actual loss, and are allowed as amends therefor [sic]." *Id.* (citations omitted).

[138] At least one court has classified the negative tax consequences an employment discrimination plaintiff endures as a result of receiving lump sum payments as a part of that plaintiff's actual damages. *See* Ferrante v. Sciaretta, 839 A.2d 993, 996 (N.J. Super. Ct. Law Div. 2003) (holding that the "make whole" provision of the New Jersey Law Against Discrimination requires defendants to compensate plaintiffs for the negative tax consequences of receiving a lump sum award).

woes.[139] After all, if it were not for *United States v. Burke* and the changes made by the SBJPA of 1996, then some federal circuits would probably continue to exempt victims of discrimination from tax liability brought about by employment discrimination damages.[140]

Additional support for the proposition that negative tax consequences are not a part of a victim's actual damages can be found in federal employment discrimination statutes, which provide courts with many remedies in assessing actual damages, and gross ups to offset tax consequences is not among these remedies.[141] Courts in the DC Circuit, 8th Circuit, and elsewhere have interpreted the absence of the explicit remedy of tax offsets from employment discrimination laws as evidence that negative tax consequences are not part of the victim's actual damages, and therefore outside of the court's power to provide a remedy.[142]

When the nature of the negative tax consequences imposed on discrimination plaintiffs who receive lump sum payments is assessed, it is best classified as an ancillary issue to receiving the damages, and not as a part of the injury caused by the defendant. The dilemma of imposing a higher marginal rate on pecuniary damages is comparable to the double taxation of

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[139] *See supra* note 58. *See also* Mueller, *supra* note 17 at 636-38 (criticizing the *Ferrante* decision classifying tax implications as actual damages, and stating that negative tax consequences are created by the Internal Revenue Code); Blaney v. Int'l Ass'n of Machinists & Aerospace Workers, 87 P.3d 757, 764 (Wash. 2004) ("[T]he proximate cause of the additional tax consequences is not the unlawful discrimination, but rather the additional tax liability is a direct result of the tax laws.").

[140] *See* discussion *supra* Part III.

[141] *See* discussion *supra* Part II (f).

[142] *See* Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (holding that the "make whole" rule of anti-discrimination laws does not support a gross up); Pollard v. E.I. du Pont de Nemours, Inc., 338 F. Supp. 2d 865, 883 (W.D. Tenn. 2003) (same); Best v. Shell Oil Co., 4 F. Supp. 2d 770, 776 (N.D. Ill. 1998) (finding that, as a matter of law, the plaintiff was responsible for her increased tax liability, and that the defendant bore no burden in offsetting negative tax consequences).

attorney's fees awarded to discrimination plaintiffs.[143] Both lump sum pecuniary damages and awards for attorney's fees were remedies offered to discrimination plaintiffs under federal law,[144] and both of these remedies were subjected to federal income taxes under the SBJPA of 1996.[145] Congress ended the double taxation of attorney's fees in the Civil Rights Tax Relief Act of 2004 because it recognized that a legislative solution was the best cure for tax laws which conflict with public policy.[146] The next section will discuss why such a legislative solution is the most effective way to prevent the inequity of taxing discrimination victims at a higher rate.

THE CIVIL RIGHTS TAX RELIEF ACT OF 2009: A STARTING POINT FOR THE OPTIMAL SOLUTION

The income averaging approach provided in the CRTRA places employment discrimination victims in the same after tax position as if the discrimination never occurred. The current tax regime is inequitable because back and front pay lump sum damages are taxed at a higher marginal rate in the same year that they are paid. The example discussed in Part V demonstrated that the income averaging approach can lower the average discrimination plaintiff's effective tax rate from 31.72% to 25% (the latter represents the percentage the plaintiff would have paid if there had been no discrimination).[147]

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[143] Solutions to both the double taxation of attorney's fees and the imposition of a higher marginal tax rate on front and/or back pay damages were proposed in the first version of the CRTRA in 2001. *See* Civil Rights Tax Relief Act, H.R. 840, 107th Cong. §§ 2, 3 (2001). For a discussion of the double taxation of attorney's fees *see supra* note 62.

[144] *See, e.g.*, 42 U.S.C.A. § 2000e-5(k) (West, Westlaw through P.L. 112-3) (providing attorney's fees for Title VII plaintiffs); 42 U.S.C.A. § 2000e-5(g)(1) (West, Westlaw through P.L. 112-3) (providing back pay damages for Title VII plaintiffs).

[145] *See supra* note 60.

[146] *See supra* note 63.

[147] *See* discussion *supra* note 129.

There are several benefits associated with the income averaging approach articulated in the CRTRA. First, the method creates a sense of horizontal equity among employment discrimination plaintiffs and non-discriminated employees,[148] placing the victims of discrimination in the same position as if the discrimination never occurred.[149] Second, the income averaging method is easier to apply compared to the gross up method because income averaging does not require the courts to hear expert testimony and conduct complex calculations.[150]

Despite these benefits, critics of the CRTRA and the income averaging approach correctly point out that the proposal is not without its flaws. Some critics of the CRTRA believe that it does too little, and these critics contend that all tax burdens imposed on discrimination damages should be eliminated.[151] It is worthwhile to address whether the income averaging

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[148] Horizontal equity is a concept used in tax law to judge the fairness of taxes and ensure similarly situated taxpayers are treated the same. *See* Joseph J. Cordes, *Horizontal Equity*, THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY (Oct. 1, 1999), *available at* http://www.taxpolicycenter.org/publications/url.cfm?ID=1000533.

[149] Although a regime that taxes discrimination victims at the same rate as non-discrimination victims is an improvement over the current Tax Code, some scholars contend that pecuniary damages in employment discrimination cases should be tax-free. *See, e.g.*, Minihan, *supra* note 65.

[150] Some courts have found that a failure to provide sufficient evidence regarding the necessary size of a tax offset can be grounds for denying the request for the offset altogether. *See, e.g.*, Hukkanen v. Int'l Union of Operating Eng'rs, Hoisting & Portable Local No. 101, 3 F.3d 281, 287 (8th Cir. 1993) (denying the plaintiff's request for a tax offset because she "failed to present evidence of the enhancement's amount or a convenient way for the court to calculate the amount"); Cange v. Phila. Parking Auth., No. 08-3480, 2010 U.S. Dist. LEXIS 8427 at *35-37 (E.D. Pa. Feb. 1, 2010) (holding that a tax expert is required to establish a claim for negative tax consequences); Ellis v. Ethicon, Inc., No. 05-726, 2009 U.S. Dist. LEXIS 106620, at *73 (D.N.J. Nov. 13, 2009) (finding that in order for the Court to award an offset, the plaintiff must provide evidence regarding the shift in the tax burden to avoid speculation).

[151] *See* Laura Spitz, *I Think Therefore I am; I Feel, Therefore I am Taxed: Descartes, Tort Reform, and the Civil Rights Tax Relief Act*, 35 N.M. L. REV. 429, 445-47 (2005) (contending that like lost wages damages that result from physical injury, pecuniary damages resulting from non-physical injury should be exempt from income taxes).

approach fairly shifts the plaintiff's higher tax burden to the taxpayers at large, or whether that burden should rest with the discriminating defendant. Society will collect less tax revenue if the income averaging approach is ever implemented because discrimination pecuniary damages will be taxed at a lower rate. Although negative tax consequences are not classified as part of the plaintiff's actual damages,[152] they are caused by unlawful discrimination. Forcing the defendant to internalize the full consequences of its discrimination, rather than pushing these costs onto the public in the form of foregone tax revenue, is a strong justification to favor the gross up method over income averaging.[153]

Despite these contentions, the benefits of an income-averaging regime outweigh any potential equitable concerns or costs. The government's public policy goal to make victims of discrimination whole outweighs the concern over lost revenue because such lost revenue is relatively small.[154] Also, if discrimination plaintiffs are prohibited from using income averaging and the only remedy left is a gross up, then many plaintiffs will be forced to bear the increased tax burden because courts will not readily shift the plaintiff's tax problems onto defendants.[155] It is worth noting that income averaging reduces the cost of settling an employment discrimination suit because plaintiffs would no longer be required to negotiate for additional sums to compensate for added tax liabilities.[156]

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[152] *See* discussion *supra* note 137.

[153] Some scholars have reasoned that the discriminating defendant should bear the plaintiff's increased tax burden. *See, e.g.*, Polsky & Befort, *supra* note 66, at 119-20 (discussing the need for the courts to use their equitable powers to shift the plaintiff's tax burden to the defendant).

[154] One organization estimates that the entire CRTRA (including provisions that would allow for the complete exemption of non-pecuniary damages in discrimination suits) would cost the taxpayers $50 million annually. *Advocacy: Civil Rights Tax Relief Act*, NATIONAL EMPLOYMENT LAWYERS ASSOCIATION, http://www.nela.org/NELA/index.cfm?event=showPage&pg=crtra (last visited April 23, 2011).

[155] *See supra* note 142.

[156] *See* Jon Hyman, *3rd Circuit Decision Illustrates Need for the Civil Rights Tax Relief Act*, OHIO EMPLOYER'S LAW BLOG (Feb. 4, 2009),

When considering the above-mentioned factors, the income averaging approach contained in the CRTRA is a good default remedy to the dilemma caused by taxing lump sum pecuniary damages at normal progressive rates. The benefits, such as increased horizontal equity and the decreased cost of settlement far outweigh the costs to society. In the event that the CRTRA ever passes into law,[157] the method of income averaging would prove to be an adequate solution to over taxing discrimination victims. The next section briefly explores the need for courts to exercise their equitable powers to gross up a plaintiff's damages in an income averaging regime.

THE OPTIMAL SOLUTION: INCOME AVERAGING WITH JUDICIAL DISCRETION TO IMPOSE GROSS UPS

Under the current tax regime, where income averaging is not available for victims of employment discrimination, courts have found that the power to grant gross ups to offset negative tax consequences are within the broad equitable power of anti-discrimination laws.[158] While tax consequences do not meet the strict definition of an "actual damage," or a direct injury as a result of employment discrimination, they are a cost borne by the victims of discrimination.[159] In the absence of income

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http://ohioemploymentlaw.blogspot.com/2009/02/3rd-circuit-decision-illustrates-need.html; NATIONAL EMPLOYMENT LAWYERS ASSOCIATION, supra note 154. *But see* Walter Olson, *Taxation of Employment-Law Damages*, POINT OF LAW.COM (Oct. 16, 2007, 12:59 AM), http://www.pointoflaw.com/archives/2007/10/taxation-of-emp.php (contending that the CRTRA would make employment lawsuits more lucrative thereby increasing their frequency).

[157] The current version of the CRTRA has bipartisan support in the House of Representatives and the Senate, but like other non-healthcare proposals, little committee action has been taken to assure the proposals passage. *See Civil Rights Tax Relief Act*, AMERICAN BAR ASSOCIATION, http://www.abanet.org/poladv/priorities/civilrightstax/home.shtml (last visited Apr. 23, 2011).

[158] *See, e.g.*, Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441-42 (3d Cir. 2009); O'Neill v. Sears, Roebuck & Co., 108 F. Supp. 2d 443, 446-47 (E.D. Pa. 2000).

averaging, the most equitable solution is for courts to grant a gross up and for defendants to internalize the additional costs borne by the victims of its discriminatory practices.

Despite the legal and economic justifications for gross ups, some federal courts do not recognize such measures as a valid remedy under federal employment discrimination statutes;[160] therefore, this issue is ripe for Supreme Court review. Proponents of the CRTRA claim the provision provided therein would obviate the need for the Supreme Court to review this issue, effectively ending the debate over gross ups.[161] However, it is conceivable that, even if the CRTRA is adopted, there will be some instances in which gross ups will be necessary to prevent inequities.

One instance in which the CRTRA's version of income averaging may not provide tax relief could occur in cases with deceased plaintiffs. In *Sears v. Topeka & Santa Fe Railway Company*, the litigation was protracted, with nearly 40% of the class members deceased, and, although a scheme of income averaging was on the books at that time, Treasury Regulations did not allow estates to use income averaging.[162] If the CRTRA is ever enacted into law, it is unclear how the IRS would interpret this new form of income averaging. If the IRS adopts its regulations from previous income averaging schemes, and prohibits estates from receiving the benefits of income averaging, then the estates of deceased discrimination victims will bear an inequitable tax burden.

Additionally, there may be other unintended and unforeseeable implications of imposing income taxes on discrimination victims, and courts should be prepared to

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[159] *See* Blaney v. Int'l Ass'n of Machinists & Aerospace Workers, 87 P.3d 757, 764 (Wash. 2004) (holding that while negative tax consequences are not a part of the victim's actual damages, granting such an award is within the equitable powers of the court).

[160] *See supra* note 142.

[161] *See* Hyman, *supra* note 156.

[162] Sears v. Atchison, Topeka & Santa Fe Ry., Co., 749 F.2d 1451, 1456 (10th Cir. 1984).

address such occasions with a gross up. The statutory language of any income averaging scheme, whether contained in the CRTRA or a similar law, should preserve the vast equitable powers conferred on courts by Title VII, ADEA, ADA, FMLA, and other anti-discrimination statutes. A complete solution to the dilemma created by taxing discrimination damages requires a system of income averaging and (in rare instances) judicially imposed gross ups.

CONCLUSION

In an attempt to correct the recognized social ills of employment discrimination, Congress has provided victims with a wide array of remedies, including front and back pay. Contrary to the spirit of this legislation, changes made in 1996 to the Tax Code have frustrated the effectiveness of these remedies by imposing higher marginal tax rates on discrimination victims compared to similarly situated, non-discriminated employees.

Courts have the power under federal employment discrimination statutes to "gross up" an employment discrimination plaintiff's pecuniary damages to offset negative tax consequences. In theory, the imposition of a gross up is economically rational because defendants should internalize all costs arising from the discrimination; however, in practice, some courts are reluctant to shift the plaintiff's tax burden to the defendant. Additionally, courts have struggled to assess a proper value for the gross up, which involves complex testimony from tax experts.

A better solution, embodied in the CRTRA, would be to levy the effective marginal tax rate on the discrimination damages that the plaintiff would have paid had the income been earned without the interference of unlawful discrimination. The best solution would be to impose a CRTRA-like income averaging scheme that explicitly preserves courts' abilities to gross up damages. Courts should retain the power to gross up plaintiffs' award in extreme circumstances when income averaging presents an inadequate remedy either because of deceased class members or because of changes in the Tax Code. Irrespective of the Tax Code, courts have a duty to consider all circumstances when wielding the equitable power to make employment discrimination victims whole.