BYU Law Review

Volume 1996 | Issue 2 Article 9

5-1-1996

Section 104(a)(2) After Commissioner u. Schleier: Litigating the Excludability of Statutory Damages "Received on Account of Personal Injuries"

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Section 104(a)(2) After *Commissioner v. Schleier*: Litigating the Excludability of Statutory Damages "Received on Account of Personal Injuries"

I. INTRODUCTION

Since the passage of the Revenue Act of 1918,[1] Congress has allowed taxpayers to exclude from their federal gross income damage awards resulting from personal injuries or sickness.[2] This exclusion is currently codified in § 104(a)(2) of the Internal Revenue Code ("I.R.C." or the "Code").[3] For decades the Internal Revenue Service (the "Service") and the judiciary interpreted[4] § 104(a)(2) to permit exclusion of damage awards whenever the underlying cause of action, whether statutory or common law, was tortlike.[5] In *Commissioner v. Schleier*,[6] however, the United States Supreme Court added another criterion to the tortlike requirement: the recovery must also be "on account of personal injuries"[7] to be excludable from gross income.[8] *Schleier*'s

1. Ch. 18, 40 Stat. 1057 (1919).

2. *Id.* § 213(b)(6), 40 Stat. at 1066. For purposes of this Note, subsequent use of the term "gross income" means federal gross income.

3. *See* I.R.C. § 104(a)(2) (1994). Scholars have vigorously debated the theory and policy underlying the exemption for personal injury awards. *See, e.g.*, Mark W. Cochran, *Should Personal Injury Damage Awards Be Taxed?*, 38 CASE W. RES. L. REV. 43 (1987-88) (arguing that there is no theoretical foundation justifying § 104(a)(2)); Bertram Harnett, *Torts and Taxes*, 27 N.Y.U. L. REV. 614, 626 (1952) (asserting that the exemption is a legislative grace, rooted in "emotional and traditional, rather than logical, factors"); Douglas A. Kahn, *Compensatory and Punitive Damages for a Personal Injury: To Tax or Not to Tax?*, 2 FLA. TAX REV. 327 (1995) (advocating the return of capital theory); *see also* Edward Yorio, *The Taxation of Damages: Tax and Non-Tax Policy Considerations*, 62 CORNELL L. REV. 701 (1977) (citing administrative concerns as a possible explanation for the exemption).

4. *See, e.g.*, United States v. Burke, 504 U.S. 229, 233-34 (1992); Roemer v. Commissioner, 716 F.2d 693, 700 (9th Cir. 1983); Threlkeld v. Commissioner, 87 T.C. 1294, 1297 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988).

5. *See* Treas. Reg. § 1.104-1(c) (as amended in 1970).

6. 115 S. Ct. 2159 (1995). *Schleier* involved a taxpayer's recovery under the Age Discrimination in Employment Act.

7. *Id.* at 2167; I.R.C. § 104(a)(2).

8. *Schleier*, 115 S. Ct. at 2167.

incorporation of the Code's plain language into its exclusion requirement is not surprising, but, in practical effect, *Schleier* provides little additional guidance for applying this new tier. It also provides no assistance in determining whether a "personal injury" exists for purposes of § 104(a)(2) or whether statutory damages are received "on account of" that injury.[9] Furthermore, the Court's analysis under the original criterion, that the underlying cause of action be tortlike, looked solely to the remedies available to the injured person to ascertain whether the statutory action was tortlike.

This Note argues that the Court's remedial approach should be expanded to encompass a more substantive analysis for determining whether a particular statutory action is tortlike.[10] To this end, it demonstrates that *Schleier* does not preclude lower courts from considering non-remedial factors in the tortlike inquiry. It further points out that the "on account of personal injuries" test suggests a notion of proximate cause and that recent federal circuit court decisions may provide useful guidance in arguing what the causal connection should be between the injury and the damages received.[11]

Because *Schleier* involved the excludability of a taxpayer's recovery under the Age Discrimination in Employment Act of 1967 ("ADEA" or the "Act"),[12] Part II summarizes the remedial provisions of the Act, as well as § 104(a)(2)'s exclusionary provision. Part III outlines the facts and the Court's reasoning in *Schleier*. Part IV analyzes the test set forth by the majority and how the decision affects practitioners litigating statutory § 104(a)(2) issues. Part V provides

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> In sum, the plain language of § 104(a)(2), the text of the applicable regulation, and our decision in *Burke* establish two independent requirements that a taxpayer must meet before a recovery may be excluded under § 104(a)(2). First, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is "based upon tort or tort type rights"; and second, the taxpayer must show that the damages were received "on account of personal injuries or sickness."

Id.

9. For an article arguing that Congress should amend § 104(a)(2) to provide for "reasonable fees or expenses incurred by the taxpayer on account of physical injuries . . . and necessary to make the taxpsyer whole again," see Robert C. Illig, Note, *Tort Reform and the Tax Code: An Opportunity to Narrow the Personal Injuries Exemption*, 48 VAND. L. REV. 1459, 1487 (1995).

10. *See infra* part IV.A.

11. *See infra* part IV.B.2.

12. Pub. L. No. 90-202, 81 Stat. 602-08 (1967) (codified as amended at 29 U.S.C. §§ 621-634 (1994)).

practitioners with a summary of the conclusions set forth in this Note that may be useful in litigating future cases involving statutory damage awards and § 104(a)(2).

II. BACKGROUND

Litigation surrounding § 104(a)(2) commonly involves federal statutory remedies.[13] *Schleier*, in particular, involved a taxpayer's ADEA recovery. A summary of the ADEA remedies and pertinent Code provisions therefore provides useful background to understand *Schleier*'s facts and holding.

A. *Age Discrimination in Employment Act of 1967*

In an effort to discourage age-based discrimination in the workplace,[14] Congress enacted the Age Discrimination in Employment Act of 1967. Section 4 of the ADEA[15] expressly prohibits age discrimination when terminating employees: "It shall be unlawful for an employer . . . to discharge any individual . . . because of such individual's age . . . ."[16] ADEA enforcement provisions in § 11[17] provide, *inter alia*, that a person may bring an action for "such legal or equitable relief as will effectuate the purposes of this chapter" and that such individual "shall be entitled to a trial by jury."[18] Additionally, § 11 incorporates the remedial provisions of the Fair Labor Standards Act ("FLSA")[19] with two significant modifications: "Amounts

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13. *See, e.g.*, United States v. Burke, 504 U.S. 229 (1992) (involving Title VII); Downey v. Commissioner, 33 F.3d 836 (7th Cir. 1994) (involving the ADEA), *cert. denied*, 115 S. Ct. 2567 (1995).

14. *See infra* note 18.

15. 29 U.S.C. § 623 (1994).

16. *Id.* § 623(a)(1). This provision is qualified by § 12, which, *inter alia*, makes § 4 applicable only to individuals between the ages of forty and seventy unless the employee works at an institution of higher learning. *Id.* § 631(a), (d).

17. *Id.* § 626.

18. *Id.* § 626(c). The purpose of the Act is threefold: (1) "to promote employment of older persons based on their ability rather than age"; (2) "to prohibit arbitrary age discrimination in employment"; and (3) "to help employers and workers find ways of meeting problems arising from the impact of age on employment." *Id.* § 621(b).

19. 29 U.S.C. §§ 201-219 (1994). The remedial provisions of the FLSA are in pertinent part:

> (b) Damages; right of action; attorney's fees and costs; termination of right of action
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> Any employer who violates the provisions of section 206 or section 207 of this title shall be liable to the employee or employees affected in the amount of their unpaid minimum wages, or their unpaid overtime com-

owing to a person as a result of a violation of [the ADEA] shall be deemed to be unpaid minimum wages," and "liquidated damages [of an equal amount] shall be payable *only* in cases of willful violations."[20] Historically, courts have focused on these remedial provisions to determine whether an ADEA recovery is excludable from gross income under § 104(a)(2).[21]

B. Sections 61(a) and 104(a)(2) of the Internal Revenue Code and Treasury Regulation § 1.104-1(c)

Under I.R.C. § 61(a), "gross income means all income from whatever source derived."[22] The broad scope[23] of this defini-

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pensation, as the case may be, and in an additional equal amount as liquidated damages. Any employer who violates the provisions of section 215(a)(3) of this title shall be liable for such legal or equitable relief as may be appropriate to effectuate the purposes of section 215(a)(3) of this title, including without limitation employment, reinstatement, promotion, and the payment of wages lost and an additional equal amount as liquidated damages.

Id. § 216(b).

20. 29 U.S.C. § 626(b) (emphasis added).

21. *See infra* part III.B.1.

22. I.R.C. § 61(a) (1994). Section 61(a) reads:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
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> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
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> (2) Gross income derived from business;
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> (3) Gains derived from dealings in property;
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> (4) Interest;
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> (5) Rents;
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> (6) Royalties;
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> (7) Dividends;
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> (8) Alimony and separate maintenance payments;
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> (9) Annuities;
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> (10) Income from life insurance and endowment contracts;
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> (11) Pensions;
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> (12) Income from discharge of indebtedness;
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> (13) Distributive share of partnership gross income;
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> (14) Income in respect of a decedent; and
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> (15) Income from an interest in an estate or trust.

Id. In Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955), the Court defined gross income as "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."

23. United States v. Burke, 504 U.S. 229, 233 (1992). "Congress intended through § 61(a) and its statutory precursors to exert 'the full measure of its taxing power,' and to bring within the definition of income any 'accessio[n] to wealth.'" *Id.* (citations omitted) (quoting Helvering v. Clifford, 309 U.S. 331, 334 (1940) and Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955)).

tion is diminished only by specific exclusions provided elsewhere in the Code, including those found in § 104(a). Section 104(a)(2) provides such an exclusion:

> Except in the case of amounts attributable to . . . deductions allowed under section 213 . . . for any prior taxable year, gross income does not include—
>
> . . . .
>
> (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness . . . .[24]

However, exclusions are to be "narrowly construed."[25] With regard to paragraph (2), then, the threshold question is whether damages were received on account of "personal injuries." Unfortunately, the plain language and the legislative history of § 104(a)(2) fail to define "personal injuries."[26]

In an attempt to rectify the ambiguity, the Commissioner of Internal Revenue ("Commissioner") promulgated Treasury Regulation § 1.104-1(c):

> Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term "damages received . . ." means an amount received . . . through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.[27]

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24. I.R.C. § 104(a)(2) (1994). In 1989, Congress inserted an additional restriction at the end of § 104(a)(2), that "[p]aragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness." *Id.* § 104(a). Aside from this amendment, § 104(a)(2) is substantially the same as its predecessor, originally enacted under the Revenue Act of 1918, ch. 18, § 213(b)(6), 40 Stat. 1057, 1066 (1919).

25. *Burke*, 504 U.S. at 248 (Souter, J., concurring in judgment) (citing United States v. Centennial Savings Bank FSB, 499 U.S. 573, 583-84 (1991) and Commissioner v. Jacobson, 336 U.S. 28, 49 (1949)).

26. *Burke*, 504 U.S. at 234 ("Neither the text nor the legislative history of § 104(a)(2) offers any explanation of the term 'personal injuries.'"); *see, e.g.*, H.R. REP. NO. 1337, 83d Cong., 2d Sess. 15 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 15-16 (1954); *see also* H.R. REP. NO. 767, 65th Cong., 2d Sess., pt. 2, at 9-10 (1918) (legislative history of the Revenue Act of 1918, which also fails to define "personal injuries").

27. Treas. Reg. § 1.104-1(c) (as amended in 1970). For a discussion of ethical issues that arise from excluding settlement awards given in a tort action, see William L. Raby, *Why Should Anyone Pay Taxes on Litigation Settlements?* TAX NOTES, April 11, 1994, at 215.

In 1992, in *United States v. Burke*,[28] the United States Supreme Court approved of the Commissioner's attempt to "link[] identification of a personal injury for purposes of § 104(a)(2) to traditional tort principles."[29] Recently, however, the Court clarified in *Commissioner v. Schleier*[30] that the "tort or tort type rights" requirement is not the end of the analysis.[31]

III. *COMMISSIONER V. SCHLEIER*

A. The Facts and Procedural History

Commissioner v. Schleier[32] arose from the involuntary termination of Erich E. Schleier ("Schleier"), who was an airline captain for United Airlines, Inc. ("United") until United involuntarily terminated him at age sixty pursuant to company policy.[33] Schleier sought relief in federal district court, alleging that United's termination policy violated the ADEA because it provided for automatic employee discharge based on the employee's age.[34] The district court consolidated Schleier's complaint with a class action suit brought against United by other discharged United employees.[35] A jury heard the case and found that United had willfully violated the ADEA.[36]

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28. 504 U.S. 229 (1992). *Burke* examined a taxpayer's Title VII recovery and held that it was not excludable under § 104(a)(2) because the underlying action was not tortlike.

29. *Id.* at 234; *see also* Threlkeld v. Commissioner, 87 T.C. 1294, 1305 (1986) ("The essential element of an exclusion under section 104(a)(2) is that the income involved must derive from some sort of tort claim against the payor. As a result, common law tort law concepts are helpful in deciding whether a taxpayer is being compensated for a personal injury." (quoting Glynn v. Commissioner, 76 T.C. 116, 119 (1981), *aff'd mem.*, 676 F.2d 682 (1st Cir. 1982)) (internal quotation marks omitted), *aff'd*, 848 F.2d 81 (6th Cir. 1988). Nevertheless, by a strict reading of the regulation, it also fails to provide a clear definition of "personal injuries"; more accurately, its "tort or tort type rights" limitation narrows the field for construing "damages received."

30. 115 S. Ct. 2159 (1995).

31. *Id.* at 2166 ("The regulatory requirement that the amount [of damages] be received in a tort type action is not a substitute for the statutory requirement that the amount be received on 'account of personal injuries or sickness'; [rather,] it is an additional requirement.").

32. *Id.*

33. *Id.* at 2161.

34. *Id.*; *see* 29 U.S.C. § 623(a)(1) (1994) ("It shall be unlawful for an employer . . . to discharge any individual . . . because of such individual's age . . . .").

35. *Schleier*, 115 S. Ct. at 2162.

36. *Id.*

Judgment was entered for the plaintiffs, but the Seventh Circuit reversed.[37] The parties subsequently reached a settlement agreement,[38] and as a result, Schleier received $145,629, half of which was attributed to back pay and the other half to liquidated damages.[39]

On their joint 1986 federal income tax return, Schleier and his wife reported only the back pay portion of the settlement as income.[40] The Commissioner of Internal Revenue issued a deficiency notice, averring that the liquidated damages portion of the settlement was considered gross income under § 61(a) of the Code and that Schleier should have reported it.[41] Schleier initiated proceedings in the Tax Court, maintaining that he had "properly excluded the liquidated damages" as gross income pursuant to § 104(a)(2) of the Code, and sought a refund for tax he paid on the back pay.[42] The Tax Court ruled that "the entire settlement constituted 'damages received . . . on account of personal injuries or sickness' within the meaning of § 104(a)(2) of the Code and was therefore excludable."[43] The

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37. Monroe v. United Air Lines, Inc., 736 F.2d 394 (7th Cir. 1984), *cert. dismissed sub nom.* United Air Lines, Inc. v. Higman, 469 U.S. 1198, *and cert. denied*, 470 U.S. 1004 (1985).

38. *Schleier*, 115 S. Ct. at 2162.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* Determination of overpayment is authorized in such a case under I.R.C. § 6512(b) (1994).

43. *Id.* (quoting I.R.C. § 104(a)(2) (1994)).

The following excerpt from the Petitioner's Brief reveals the background and interplay of the various cases leading up to *Schleier*:

> a. Proceedings on respondent's [Schleier's] case were deferred pending the Tax Court's disposition of the lead case relating to the United Airlines class action settlement, *Downey v. Commissioner*, 97 T.C. 150 (1991), supplemental opinion, 100 T.C. 634 (1993), rev'd, 33 F.3d 836 (7th Cir. 1994), petition for cert. pending, No. 94-999 (filed Dec. 5, 1994).
>
> In its original opinion in *Downey*, the Tax Court (in a reviewed opinion with six judges dissenting in part) held that back pay and liquidated damages received under the ADEA are excludable from gross income under Section 104(a)(2). With respect to back pay, the Tax Court expressly adopted the reasoning of *Rickel v. Commissioner*, 900 F.2d 655 (3d Cir. 1990), and *Pistillo v. Commissioner*, 912 F.2d 145 (6th Cir. 1990), which held that back pay awards under the ADEA are excludable from gross income because (i) an ADEA suit alleges a violation of duty that arises by operation of a statute and not by virtue of a contract and (ii) statutes addressing discrimination in the workplace had been characterized by other courts as involving personal injury.
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> With respect to liquidated damages, the Tax Court in *Downey* rejected the Commissioner's contention that ADEA liquidated damages—like puni-

Fifth Circuit affirmed.[44] The Commissioner petitioned for certiorari, which the United States Supreme Court granted[45] to resolve the inconsistent conclusions reached by the Courts of Appeals "as to the taxability of ADEA recoveries in general and of the United settlement in particular."[46]

The Supreme Court held that the taxpayer must show that two independent requirements have been met before excluding a recovery under § 104(a)(2): (1) "that the underlying cause of action . . . is 'based upon tort or tort type rights'" and (2) "that the damages were received 'on account of personal injuries or sickness.'"[47] The Court reversed the Fifth Circuit decision, concluding that Schleier had failed to satisfy the requirements.[48]

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tive damages—are paid because of the employer's willful misconduct, rather than "on account of personal injuries" to the employee, and are therefore not excludable from gross income under the plain language of the statute. The Tax Court held that, while ADEA liquidated damages serve a punitive purpose, these damages, when viewed from the victim's perspective, represent compensation for nonpecuniary losses.

b. The Tax Court withheld entry of its final decision in *Downey* pending this Court's decision in *United States v. Burke*, 112 S. Ct. 1867 (1992). . . .

After this Court issued its decision in *Burke*, the Tax Court granted the Commissioner's motion for reconsideration of the *Downey* decision. [The court in *Downey* determined that] the ADEA provides "a range of remedies, including both unpaid wages and 'liquidated damages'" [and that] the ADEA "evidences a tort-like conception of injury and remedy" because liquidated damages under the ADEA compensate the victim of age discrimination for nonpecuniary losses and also serve a deterrent or punitive purpose. The Tax Court therefore reaffirmed its prior holding in *Downey* that all damages received in ADEA litigation are excludable from gross income . . . .

Brief for the Petitioner at 4-7, *Schleier* (No. 94-500) (internal references and some citations omitted).

44. *Schleier*, 115 S. Ct. at 2162-63. Both the Tax Court and Fifth Circuit decisions are unreported and available on Westlaw: 1993 WL 767976 and 26 F.3d 1119, respectively. The Fifth Circuit relied on its decision in Purcell v. Sequin State Bank & Trust Co., 999 F.2d 950, 961 (1993), in which the court had adopted the Tax Court's reasoning in *Downey* before *Downey* was reversed by the Seventh Circuit. *See* Petitioner's Brief at 6-7, *Schleier* (No. 94-500).

45. Commissioner v. Schleier, 115 S. Ct. 507 (1994) (granting certiorari).

46. *Schleier*, 115 S. Ct. at 2163 (citing Downey v. Commissioner, 33 F.3d 836 (7th Cir. 1994), *cert. denied*, 115 S. Ct. 2567 (1995) and Schmitz v. Commissioner, 34 F.3d 790 (9th Cir. 1994), *cert. granted and vacated*, 115 S. Ct. 2573 (1995)).

47. *Id.* at 2167.

48. *Id.*

B. The Majority's Reasoning

1. "Tort or tort type rights"

Schleier, as respondent, purported[49] to rely upon *United States v. Burke*,[50] in which the Court concluded that the pre-1991 version of Title VII did not satisfy the "tort or tortlike rights" requirement because Title VII only addressed "'legal injuries of an *economic* character.'"[51] In particular, Schleier noted that the *Burke* decision stressed the right to a jury trial and the potential for punitive damages as indicia of a tort-type claim[52]—indicia that were absent from Title VII.[53] Schleier argued that because the ADEA provides for a jury trial and liquidated damages, an action based thereon is within the *Burke* conception of a tort-type right,[54] making the damages received excludable under § 104(a)(2).

In response, the majority[55] stated that such indicia, without more, were insufficient to exclude recovery from a statutory action.[56] Instead, the Court focused on "the availability of compensatory remedies"[57] as "the primary characteristic of an 'action based upon . . . tort type rights.'" The majority found that back pay was a remedy of an economic character and that liquidated damages did not serve as a compensatory remedy.[58] Therefore, the damages received, being without traditional compensatory function, did not meet the tort or tort-type rights requirement of the regulation. As a result, the Court deter-

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49. *See id.* at 2166.

50. 504 U.S. 229 (1992).

51. *Id.* at 239 (emphasis added) (quoting Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975)).

52. *Schleier*, 115 S. Ct. at 2166.

53. *See id.* at 2166; *Burke*, 504 U.S. at 238-40.

54. *Schleier*, 115 S. Ct. at 2166.

55. Justice Stevens, writing for the majority, was joined by Chief Justice Rehnquist and Justices Kennedy, Ginsburg, and Breyer. Justice Scalia concurred in the judgment. *Id.* at 2161.

56. *Id.* at 2166.

57. *Id.* Writing for the majority in *Burke*, Justice Blackmun cited R. HEUSTON, SALMOND ON THE LAW OF TORTS 9 (12th ed. 1957) for the proposition that

> "an action for damages" is "an essential characteristic of every true tort," and that, even where other relief, such as an injunction, may be available, "in all such cases it is solely by virtue of the right to damages that the wrong complained of is to be classed as a tort."

Burke, 504 U.S. at 235.

58. *Schleier*, 115 S. Ct. at 2167; *see infra* note 68 and text accompanying notes 68-71.

mined that the entire recovery should have been included in Schleier's gross income.[59]

The majority also scrutinized the language of § 104(a)(2) and determined that the statute required that a recovery not only issue from "tort or tort type rights" (pursuant to the regulation),[60] but that it also be received "on account of personal injuries."[61]

2. *"On account of personal injuries"*

Early in its opinion, the majority demonstrated what it considered an important distinction between a traditional personal injury case and *Schleier*.[62] In a traditional personal injury case, such as one involving an automobile accident,[63] the damages claimed are directly linked to the personal injury; that is, an act causes a personal injury (whether willfully, recklessly, or negligently), which in turn causes loss of wages and other damages.[64] The Court reasoned that age discrimination or an act that violates the ADEA "causes both personal injury and

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59. *See Schleier*, 115 S. Ct. at 2167 ("Thus, though this is a closer case than *Burke*, we conclude that a recovery under the ADEA is not one that is 'based upon tort or tort type rights.'").

60. *See id.* at 2165-67; Treas. Reg. § 1.104-1(c) (as amended in 1970).

61. *See Schleier*, 115 S. Ct. at 2163-65, 2167; I.R.C. § 104(a)(2).

62. *See Schleier*, 115 S. Ct. at 2163-64.

63. Justice Stevens presented the following hypothetical to illustrate "the usual meaning of 'on account of personal injuries'":

> Assume that a taxpayer is in an automobile accident, is injured, and as a result of that injury suffers (a) medical expenses, (b) lost wages, and (c) pain, suffering, and emotional distress that cannot be measured with precision. If the taxpayer settles a resulting lawsuit for $30,000 (and if the taxpayer has not previously deducted her medical expenses, see § 104(a)), the entire $30,000 would be excludable under § 104(a)(2). The medical expenses or injuries arising out of the accident clearly constitute damages received "on account of personal injuries." Similarly, the portion of the settlement intended to compensate for pain and suffering constitutes damages "on account of personal injury." Finally, the recovery for lost wages is also excludable as being "on account of personal injuries," as long as the lost wages resulted from time in which the taxpayer was out of work as a result of her injuries. The critical point this hypothetical illustrates is that each element of the settlement is recoverable not simply because the taxpayer received a tort settlement, but rather because each element of the settlement satisfies the requirement set forth in 104(a)(2) . . . that the damages were received "on account of personal injuries or sickness."

Id. (citations omitted) (footnote omitted).

64. *See id.*

loss of wages,"[65] but that these damages were not "linked" to the personal injury:[66] "The amount of back wages recovered is completely independent of the existence or extent of any personal injury."[67]

In addition, the Court examined Schleier's argument that because FLSA liquidated damages served as "'compensation, not [as] penalty or punishment,'"[68] their ADEA counterparts were excludable under § 104(a)(2), since such damages would be compensation "on account of personal injuries."[69] Nevertheless, relying on precedent, the Court maintained that ADEA liquidated damages were "'punitive in nature'"[70] and thus could not be considered compensatory for purposes of § 104(a)(2).[71]

C. *The Dissenting Opinion*

Justice O'Connor, writing for the dissent,[72] argued that "[a]ge discrimination inflicts a personal injury,"[73] that "amounts received as damages for such discrimination are received 'on account of personal injuries,'"[74] and that those damages are therefore excludable pursuant to § 104(a)(2). She observed that the majority's underlying premise was that "'personal injuries' . . . include only tangible injuries"[75] and asserted that the difference between the physical and mental injuries (i.e., tangible injuries) of the majority's hypothetical automobile

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65. *Id.* at 2164.

66. *Id.*

67. *Id.*

68. *Id.* (quoting Overnight Motor Transp. Co. v. Missel, 316 U.S. 572, 583-84 (1942)). *Missel* involved the FLSA liquidated damages provision, which is incorporated into the ADEA by reference. Indeed, the Court held in *Missel* that liquidated damages under the FLSA served as compensation for "damages too obscure and difficult of proof for estimate." *Missel*, 316 U.S. at 584, *quoted in Schleier*, 115 S. Ct. at 2164. However, in Trans World Airlines, Inc. v. Thurston, 469 U.S. 111, 125 (1985), the Court held that "Congress intended for [ADEA] liquidated damages to be punitive in nature." *See also* Lorillard v. Pons, 434 U.S. 575, 581 (1978) (observing that the ADEA liquidated damages provision, though incorporating the FLSA provision, significantly departs from it).

69. *Schleier*, 115 S. Ct. at 2164.

70. *Id.* at 2165 (quoting *Thurston*, 469 U.S. at 125).

71. *See id.*

72. Justice O'Connor's dissenting opinion was joined by Justice Thomas and, as to Part II of the opinion, Justice Souter. *Id.* at 2167.

73. *Id.* (O'Connor, J., dissenting).

74. *Id.* at 2170.

75. *Id.* at 2169.

accident[76] and the economic and stigmatic harms of discrimination is "a difference without relevance under § 104(a)(2)."[77]

Justice O'Connor recapped pre-*Burke* law by discussing the Tax Court's recognition in *Threlkeld v. Commissioner*[78] that "damages from a lawsuit were excludable under § 104(a)(2) so long as they were received 'on account of any invasion of the rights that an individual is granted by virtue of being a person in the sight of the law.'"[79] She also cited *EEOC v. Wyoming*[80] for the proposition that "[a]ge discrimination 'inflict[s] on individual workers the economic and psychological injury accompanying the loss of the opportunity to engage in productive and satisfying occupations.'"[81] Justice O'Connor then referred to her dissent in *Burke*, denouncing the majority's approach of looking primarily to the remedy to determine whether the statutory action is tortlike.[82] However, she neglected to indicate what would be a proper approach to the "tort or tort type rights" analysis.[83]

The second half of the dissenting opinion emphasized that the remedies available to Schleier were not limited to back pay and liquidated damages, but also included "'such *legal or equitable relief* as will effectuate the purposes' of the Act."[84] Justice O'Connor also addressed how Treasury Regulation § 1.104-1(c) should be interpreted, asserting that the term "damages received" is unambiguous and thus does not need to be defined by the regulations; rather, the term needing explanation is "per-

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76. *See* note 63 and accompanying text.

77. *Id.*

78. 87 T.C. 1294 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988).

79. *Schleier*, 115 S. Ct. at 2168 (O'Connor, J., dissenting) (quoting *Threlkeld*, 87 T.C. at 1308).

80. 460 U.S. 226 (1983).

81. *Schleier*, 115 S. Ct. at 2168 (O'Connor, J., dissenting) (alteration in original) (quoting EEOC v. Wyoming, 460 U.S. at 231). In other words, age discrimination, like any discrimination based on suspect characteristics, causes intangible personal injuries. *See* Price Waterhouse v. Hopkins, 490 U.S. 228, 265 (1989) (O'Connor, J., concurring).

82. *Schleier*, 115 S. Ct. at 2169 (O'Connor, J., dissenting).

83. Although Justice O'Connor did not suggest an alternative in *Schleier*, in *Burke* she stated that one should look to "the nature of the statute and the type of claim brought under it." United States v. Burke, 504 U.S. 229, 250 (1992) (O'Connor, J., dissenting).

84. *Schleier*, 115 S. Ct. at 2170 (quoting 29 U.S.C. § 626(c)(1) (1994)); *see also* 29 U.S.C. § 626(b) (1994) ("In any action brought to enforce this chapter the court shall have jurisdiction to grant such legal or equitable relief as may be appropriate to effectuate the purposes of this chapter . . . .").

sonal injuries."[85] Reasoning that the regulation should be read "as defining the entire scope of § 104(a)(2)" and "specifically the concept of 'personal injuries,'"[86] Justice O'Connor determined that Schleier's ADEA recovery met both the tortlike and the "on account of personal injuries" requirements. Accordingly, she concluded that Schleier's recovery should be wholly excludable from federal gross income.[87]

IV. ANALYSIS

This Part analyzes the two tiers of the *Schleier* test: (1) whether the underlying cause of action is based on "tort or tort type rights," and (2) whether the damages are "received on account of personal injuries."[88] As to the first tier, Section A argues that *Schleier* does not constrain lower courts from considering non-remedial factors in determining whether a particular statutory action is tortlike.[89] It further asserts that the lower courts may find persuasive the notion that punitive awards and vague, broad remedial provisions, such as "any legal or equitable relief," evidence an underlying tortlike action.[90] Regarding the second tier, Section B contends that, despite the possible analytical inference to the contrary, intan-

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85. *Schleier*, 115 S. Ct. at 2171-72 (O'Connor, J., dissenting).

86. *Id.* at 2172. "It is surely more reasonable to read the regulation as defining an ambiguous statutory phrase, rather than as imposing a superfluous precondition without any statutory basis." *Id.*

Indeed, for many years the Service applied the regulation to the term "personal injuries." *See, e.g.*, Rev. Rul. 85-98, 1985-2 C.B. 51; *see also* United States v. Burke, 504 U.S. 229, 242 n.1 (1992) (Scalia, J., concurring) ("Though this regulation purports expressly to define only the term 'damages received,' and not ['personal injuries'], the IRS has long treated the regulation as descriptive of the ambit of § 104(a)(2) as a whole.").

Although Justice O'Connor in *Schleier* disagreed with the Service's recent narrow construction of the statute and regulation, she additionally excepted to the majority's dicta that the force of an agency's interpretive rulings receive small consideration in the analysis of a statute or regulation. *See Schleier*, 115 S. Ct. at 2167 n.8. She asserted that even though the interpretive rulings of the Service do not rise to the authoritative level of regulations, the Court must give substantial deference to the Service's "reasonable interpretations." *Id.* at 2171 (O'Connor, J., dissenting); *see* Davis v. United States, 495 U.S. 472, 484 (1990) ("[W]e give an agency's interpretations and practices considerable weight where they involve the contemporaneous construction of a statute and where they have been in long use.").

87. *Schleier*, 115 S. Ct. at 2168 (O'Connor, J., dissenting).

88. *Id.* (quoting Treas. Reg. § 1.104-1(c) (as amended in 1970) and I.R.C. § 104(a)(2) (1994)).

89. *See infra* part IV.A.1.

90. *See infra* part IV.A.2.

gible harms may still constitute "personal injuries" for purposes of § 104(a)(2).[91] Section B also suggests that recent federal circuit court decisions provide useful guidance in arguing what the causal connection should be between the injury and the damages received.[92]

A. Tort or Tort-Type Rights

The first tier of the *Schleier* test comes from *Burke* and Treasury Regulation § 1.104-1(c): Damages received must arise from a cause of action "'based upon tort or tort type rights.'"[93] In determining whether the ADEA cause of action was tortlike, the majority looked to the Act's remedial provisions. The majority found that the recovery Schleier received was not traditionally available in an action "based upon tort or tort type rights" and thus the ADEA action was not tortlike.[94] This Section questions the Court's remedial approach and provides a more holistic method for evaluating the character of a statutory action. It further considers the significance of punitive and broad remedial provisions in light of the Court's remedial analysis.

1. Inadequacy of a remedial analysis

The Court's remedial analysis presupposes that statutory remedies accurately characterize the underlying action. The deficiency inherent in this approach was recognized by Prosser and exposed by the dissent in *Burke*: "[T]he remedies available to Title VII plaintiffs do not fix the character of the right they seek to enforce."[95] As Prosser stated: "The relation between

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91. *See infra* part IV.B.1.b.

92. *See infra* part IV.B.2.

93. United States v. Burke, 504 U.S. 229, 234 (1992) (quoting Treas. Reg. § 1.104-1(c) (as amended in 1970)).

94. Commissioner v. Schleier, 115 S. Ct. 2159, 2167 (1995). The Court found that the ADEA "unpaid wages" provision is merely back pay and thus economic rather than personal in character. Although back pay is indeed of economic character, it seems no more economic and no less personal when resulting from ago discrimination than would be lost wages as a result of the automobile accident in the majority's hypothetical.

95. *Burke*, 504 U.S. at 249 (O'Connor, J., dissenting), *quoted in Schleier*, 115 S. Ct. at 2169 (O'Connor, J., dissenting). Even if the Court's approach were wholly proper, in the present case the remedy included a separate provision for liquidated damages when the violation was willful. The majority urged that this remedy was punitive. *See Schleier*, 115 S. Ct. at 2164-65. Punitive damages clearly sound in tort but are traditionally not available under contract law. *See* 3 DAN B. DOBBS, DOBBS LAW OF REMEDIES § 12.5(2), at 118 (2d ed. 1993) ("The rule against puni-

the remedies in contract and tort presents a very confusing field, still in process of development, in which few courts have made any attempt to chart a path."[96] If by way of its decision in *Burke* and *Schleier* the Court has attempted to "chart a path," it has nevertheless neglected to explain why its remedial analysis in *Schleier* satisfies the regulation's "tort or tort type rights" test.

Granted, the type of remedy is and should be a prominent aspect of the tortlike inquiry; nevertheless, the regulation states that the "*action* [must be] based upon tort or tort type rights."[97] Assuming that the regulation is well founded, a more holistic approach would seem appropriate. To determine whether a statutory action is tortlike, a court should analyze the action in light of not only traditional tort remedies, but also the rudiments of a tort action; i.e., the nature of the interest invaded, the kind of wrongful conduct, and the nature of the harm.[98] Although the "tort or tort type rights" question is now settled as to ADEA actions, numerous other statutory regimes have yet to be litigated on the issue. With this potential in mind, the following discussion examines the tort elements and considers how the ADEA action could have been analyzed thereunder.

a. The nature of the interest invaded. In general, tort actions address the invasion of one's personality, property, and relational interests.[99] As to relational interests,[100] tort

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tive damages prevails even if the breach [of contract] is wilful or malicious."). Why the punitive award did not factor into the Court's analysis remains unclear. *See infra* part IV.A.2.a.

96. W. PROSSER, THE LAW OF TORTS 635 (3d ed. 1964), *quoted in Schleier*, 115 S. Ct. at 2169 (O'Connor, J., dissenting).

97. Treas. Reg. § 1.104-1(c) (as amended in 1970) (emphasis added).

98. LEON GREEN ET AL., CASES ON THE LAW OF TORTS 2-3 (2d ed. 1977); *see also Burke*, 504 U.S. at 250 (O'Connor, J., dissenting) ("The question whether Title VII suits are based on the same sort of rights as a tort claim must be answered with reference to the nature of the statute and the type of claim brought under it."); Wilson v. Garcia, 471 U.S. 261, 268 (1985) (examining § 1983 of Title 42 and comparing it to an action in tort based on the "essence of the claim" and "the elements of the cause of action").

Additionally, evidence of legislative intent to emulate, simplify (as to burden of proof), or preempt a tort action would clearly strengthen the argument that the damages received from such an action are based on "tort or tort type rights," since such evidence speaks to the core issue—the character of the underlying action. Other significant evidence might include the type of action historically employed to accomplish purposes similar to those articulated in the statute.

99. GREEN ET AL., *supra* note 98, at 2-3.

100. Commenting on such relational interests and tort theory, Prosser has stat-

law protects against interferences with one's trade, employment, family, community, professional, and political relations.[101] For example, an action under § 1981 of Title 42 protects nonwhite individuals from a relational interference with contract and rights of citizenship:[102] "All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts . . . to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens . . . ."[103] Commenting on § 1981, the Supreme Court in *Goodman v. Lukens Steel Co.*[104] stated that even though § 1981 deals with the right to contract, it is also "part of a federal law barring racial discrimination, which . . . is a fundamental injury to the individual rights of a person."[105] The Court went on to say that "economic consequences [of § 1981] . . . flow[] from guaranteeing the personal right to engage in

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ed:

> That many of these rights are intangible in nature does not deprive them of legal status, and an intended interference with them through the use of economic power is quite similar to other interferences with advantageous relations, with the result that liability is equally or more justified.

W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS, § 130, at 1030 (5th ed. 1984).

Actions for wrongful discharge, defamation, libel, slander, and wrongful death all involve an interference with a relational interest.

101. GREEN ET AL., *supra* note 98, at 3. Examples include interference with patronage, business operations, contractual relations, and rights of citizenship. *See* WILLARD H. PEDRICK ET AL., ADVANCED TORTS: INJURIES TO TRADE, FAMILY, AND COMMUNITY AND POLITICAL RELATIONS 302-03 (Temporary ed. 1994).

> The relational interest theory builds on the assumption that a person has rights of citizenship in addition to his rights of personality and property. . . . Intentional interference with these interests should be actionable, whether or not the same facts might also be characterized as a tortious injury to person or property. Recognition of this relational interest and a tort remedy for its protection has the potential to make certain injuries actionable that might not qualify as an injury to person or property.

Id. at 302.

102. *See* Goodman v. Lukens Steel Co., 482 U.S. 656, 661 (1987) (finding that 42 U.S.C. § 1981 unequivocally sounds in tort). Similarly, the Court has found that an action pursuant to § 1983 of Title 42 sounds in tort. *See* Wilson v. Garcia, 471 U.S. 261 (1985).

Rights of citizenship are those rights or privileges that a citizen may exercise without coercion or interference by others, such as voting and making and enforcing contracts. *See* PEDRICK ET AL., *supra* note 101, at 302-03; KEETON ET AL., *supra* note 100, § 130, at 1030.

103. 42 U.S.C. § 1981 (1994).

104. 482 U.S. 656 (1987).

105. *Id.* at 661.

economically significant activity free from racially discriminatory interference."[106]

Similarly, the ADEA is a federal law that bars age discrimination in the workplace. Such discrimination is an interference with one's citizenship right "to engage in economically significant activity free from [federally prohibited] discrimination."[107] Therefore, an ADEA action protects against an interference with a relational interest, which is an interest protected in tort.[108]

b. The kind of wrongful conduct or basis of liability. To be actionable in tort, wrongful conduct must be done intentionally, recklessly, or negligently. Strict liability can also be the basis for tort liability.[109] Like many federal statutes, the ADEA imposes strict liability on violations of its provisions and recognizes willful (i.e., intentional) violations in determining additional damages.[110] Thus, the basis of liability for ADEA actions is tortlike.

c. The nature of the harm. Tort law has long recognized intangible harms, such as those resulting from defamatory statements or torts against dignity.[111] That age discrimination in the workplace results in intangible harms is uncontroverted and indeed conceded by the *Schleier* majority.[112]

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106. *Id.* at 661-62.

107. *Id.*

108. An ADEA action may also be compared to a common-law action for wrongful discharge. Wrongful discharge or wrongful termination occurs "when an 'at will' employee is discharged for exercising some public duty or privilege . . . or for refusing to perform some illegal act for the employer." PEDRICK ET AL., *supra* note 101, at 303.

109. DAN B. DOBBS, TORTS AND COMPENSATION: PERSONAL ACCOUNTABILITY AND SOCIAL RESPONSIBILITY FOR INJURY § 1, at 5-6 (2d ed. 1993); KEETON ET AL., *supra* note 100, § 130, at 31-32; *see also* Monroe v. Pape, 365 U.S. 167 (1961) (finding that in interpreting federal civil rights statutes, though strict liability is not express, negligence is clearly not the standard).

110. 29 U.S.C. § 626(b) (1994).

111. *See* 2 DOBBS, *supra* note 95, §§ 7.1(1), 7.3(1); GREEN ET AL., *supra* note 98, at 1166; KEETON ET AL., *supra* note 100, § 130, at 1030. Professor Dobbs observes that, in addition to physical harms, tort law envelops purely economic and dignitary harms. DOBBS, *supra* note 109, § 1, at 6-7. Classic examples of tort actions arising out of such intangible harms include actions for defamation, invasion of privacy, intentional infliction of emotional distress, and dignitary assaults and batteries. *See* New York Times Co. v. Sullivan, 376 U.S. 254 (1964) (libel under American common law); Pavesich v. New England Life Ins. Co., 50 S.E. 68 (Ga. 1905) (invasion of privacy); LaBrier v. Anheuser Ford, Inc., 612 S.W.2d 790 (Mo. Ct. App. 1981) (intentional infliction of emotional distress); Cassidy v. Daily Mirror Newspapers, Ltd., 2 K.B. 331 (1929) (available in 69 A.L.R. 720 (1930)) (libel under the English common law).

112. *See* Commissioner v. Schleier, 115 S. Ct. 2159, 2165 n.6 (1995). In addi-

Hence, the nature of the harm redressed by the ADEA is one addressed by tort law.[113]

In sum, because the regulation asks whether the underlying *action* is "based upon tort or tort type rights," a remedial analysis by itself appears wanting. To read *Schleier* as requiring only a remedial analysis to satisfy the first tier would make "the availability of compensatory remedies" not merely "the primary characteristic"[114] of a tortlike action, but the only characteristic. Such a conclusion lacks justification.[115] The *Schleier* and *Burke* opinions state that "'[o]ne of the hallmarks of traditional tort liability is the availability of a broad range of damages to compensate the plaintiff "fairly for injuries caused by the violation of his legal rights."'"[116] Indeed that availability is only "*one* of the hallmarks." Hence, lower courts may justifiably consider not only the remedy, but also the whole tort concept in a § 104(a)(2) analysis, and practitioners should argue accordingly.[117]

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tion, Justice O'Connor declared that the intangible harms redressed by the ADEA have been characterized as akin to "harm to reputation and loss of business caused by a dignitary tort." *Id.* at 2169 (O'Connor, J., dissenting). Further, the majority in *Burke* stated that "the victim of a 'dignitary' or nonphysical tort such as defamation may recover not only any actual pecuniary loss (e.g., loss of business or customers), but also for 'impairment of reputation and standing in the community, personal humiliation, and mental anguish and suffering.'" United States v. Burke, 504 U.S. 229, 235-37 (1992) (quoting Gertz v. Robert Welch, Inc. 418 U.S. 323, 350 (1974)) (footnote omitted); *see also* 2 DOBBS, *supra* note 95, §§ 7.1(1), 7.3(1).

Consider also the broad purpose of the Act. *See supra* note 18.

113. Scholars have attempted to characterize harms addressed in tort as physical, appropriational, relational, defamatory, or dignitary harms. *See* 2 DOBBS, *supra* note 95, §§ 7.1(1), 7.3(1); GREEN ET AL., *supra* note 98, at 3; KEETON ET AL., *supra* note 100, § 7, at 31-32. Because these categories are a compilation of the distinctions used by various tort scholars, there is naturally significant overlap, especially among the latter four. However, regardless which theory is embraced, all the theories have recognized intangible harms, whether resulting from discrimination or other abstract interferences.

114. *Schleier*, 115 S. Ct. at 2166.

115. Though not a proper justification, the Court may have employed a remedial analysis in lieu of a broader examination in order to promote judicial and administrative economy; that is, with a quick glance, the Court can supposedly determine whether an action is tortlike. But as pointed out by the dissent as well as tort scholars, the type of remedy "do[es] not fix the character of the [underlying action]." *Id.* at 2169 (O'Connor, J., dissenting); *see* PROSSER, *supra* note 96, at 2-3.

116. *Schleier*, 115 S. Ct. at 2166-67 (quoting *Burke*, 504 U.S. at 235 (quoting Carey v. Piphus, 435 U.S. 247, 257 (1978))).

117. Similarly, in a plurality opinion, four Justices of the United States Supreme Court concluded that in analyzing whether a new cause of action demands a jury trial, a court must "examine both the nature of the issues involved and the remedy sought." Chauffeurs, Teamsters and Helpers Local No. 391 v. Terry, 494 U.S. 558, 565 (1990) (plurality opinion).

2. Remedial issues not analyzed by the majority

Once it is integrated into a coherent system, the Court's approach becomes meaningful; that is, the relevance of the remedial analysis is limited to what it addresses—one of several characteristics of a tort action. Indeed, an ADEA action for unpaid wages has contract implications,[118] but other factors make the action appear tortlike as well. For example, punitive damages are a traditional tort remedy, as are broad compensatory remedies. Because *Schleier* did not expressly address the ADEA's punitive and broad remedial provisions for purposes of the "tort type rights" test, practitioners should not dismiss arguing the significance of these and similar tort remedies in subsequent cases involving statutory damages and § 104(a)(2).

a. Punitive awards. Although the true character and purpose of the ADEA liquidated damages provision is debatable,[119] the Court's finding that they are "punitive in nature" appears to undercut the conclusion that the underlying action was not tortlike. Unequivocally, punitive damages sound in tort.[120] Yet, since the Court did not address the argument that punitive remedies evidence an underlying tortlike action,

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118. "Back pay . . . is quintessentially a contractual measure of damages." *Burke*, 504 U.S. at 247 (Souter, J., concurring). Yet, the similarity between back pay (or unpaid wages) as a result of discrimination and those damages available as result of an automobile accident is difficult to ignore. As Justice O'Connor pointed out, the analytical inference is that intangible injuries are not "personal injuries." *Schleier*, 115 S. Ct. at 2169-70 (O'Connor, J., dissenting). *But see infra* part IV.B.1.b.

119. *See* H.R. CONF. REP. NO. 950, 95th Cong., 2d Sess. 7 (1978), *reprinted in* 1978 U.S.C.C.A.N. 504, 528; *cf. Schleier*, 115 S. Ct. at 2165 n.5 (addressing, but also dismissing, a statement by the EEOC that "'[t]he legislative history of the liquidated damages provision in the ADEA . . . shows that such damages are designed to provide *full compensation* to the employee, rather than primarily to punish the employer'" (emphasis added) (quoting Brief for the EEOC at 36, Trans World Airlines v. Thurston, 469 U.S. 111 (1985) (Nos. 83-997 and 83-1325))).

Indeed, Overnight Motor Transp. Co. v. Missel, 316 U.S. 572 (1942), held that FLSA liquidated damages "are compensation, not a penalty or punishment," and that they could compensate for "damages too obscure and difficult of proof for estimate." *Id.* at 583-84, *quoted in Schleier*, 115 S. Ct. at 2164. *But see Schleier*, 115 S. Ct. at 2165 ("[E]ven if we assume that Congress was aware of the Court's observation in *Overnight Motor* . . . , it does not necessarily follow that Congress would have understood that observation as referring to injuries that were personal rather than economic.").

120. 3 DOBBS, *supra* note 95, § 12.5(2), at 118. Though the lack of a punitive remedy does not conclusively indicate that the underlying action is outside the realm of tort, neither must an action provide a compensatory remedy for that action to be in tort. Consider, for example, a replevin action and other tort actions providing restitutionary remedies.

one could infer that such evidence is insufficient to satisfy the Court's remedial inquiry.[121]

The result is perplexing, since contract law does not recognize punitive damage awards.[122] Indeed characterizing an underlying cause of action as tortlike because of its punitive remedy would seem as rational as finding an action to be contractlike because of its back pay provision.[123] Thus a punitive damage award should be at least evidence of an action "based upon tort or tort type rights," though not conclusive.

b. "Any legal or equitable relief." The Court stated that "the primary characteristic of an 'action based upon . . . tort type rights'" is "the availability of compensatory remedies."[124] The ADEA expressly provides for any appropriate "legal or equitable relief . . . to effectuate the purposes of [the ADEA]."[125] Though the Court recited this provision, it neglected to analyze it and explain why the provision did not satisfy the Court's remedial inquiry.[126]

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121. The message to lawmakers would thus be that if Congress wants statutory recoveries for personal injuries to be excludable from gross income, it must only codify the remedies that are exclusively available in tort. Unfortunately, when Congress has attempted to amend legislation to conform with the Court's rulings in order to demonstrate congressional intent to allow a tax exclusion (i.e., an attempt to make the action or its remedies look tortlike), the Court has subsequently changed the rules. *See* Illig, *supra* note 9, at 1476 ("[A] pattern seems to be emerging wherein the Supreme Court holds a type of claim to be outside the scope of section 104(a)(2), then Congress amends the claim to meet the standard set by the Court, then the Court changes its standard again.").

Consider for example that Congress amended Title VII to include a provision for jury trials, punitive damages, and other tortlike remedies mentioned in *Burke*. Civil Rights Act of 1991, Pub. L. No. 102-166, § 102, 105 Stat. 1071 (codified as amended at 42 U.S.C. § 1981a (1994)). Now the Court has again changed the standard in *Schleier*. For a brief recitation of the case history in this area, see *Schleier*, 115 S. Ct. at 2168-69 (O'Connor, J., dissenting) (discussing the prior rules under Threlkeld v. Commissioner, 87 T.C. 1294, 1299 (1986), *aff'd*, 848 F.2d 81 (6th Cir. 1988) and United States v. Burke, 504 U.S. 229 (1992)).

In *Schleier*, the majority implied that it was not changing the standard, but that "the holding of *Burke* is narrower than [Schleier] suggest[ed]." *Schleier*, 115 S. Ct. at 2167. Yet, the same "on account of personal injuries" issue was present in *Burke* when the Court there looked primarily to the regulation for interpreting § 104(a)(2), *see* 504 U.S. at 234-42, and when Justice Scalia in his *Burke* concurrence stated that the regulation is "descriptive of the ambit of § 104(a)(2) as a whole." *Id.* at 242 n.1 (Scalia, J., concurring).

122. 3 DOBBS, *supra* note 95, § 12.5(2), at 118 ("The rule against punitive damages prevails even if the breach [of contract] is willful or malicious.").

123. In fact, the argument may be more than reasonable since unpaid wages (or lost wages) are recoverable in both tort and contract, whereas punitive damages are only recoverable in tort or as a result of a willful tortious harm.

124. *Schleier*, 115 S. Ct. at 2166-67.

125. 29 U.S.C. § 626(b)-(c) (1994).

126. Notably, when *Burke* was decided, Title VII's provision allowing additional

Because *Schleier* implicitly rejects the notion that the ADEA's "legal or equitable relief" provision encompasses compensatory remedies, practitioners cannot rely upon such vague and broad remedial provisions for § 104(a)(2) purposes.[127] However, if another remedy is available that can be characterized as compensatory, that remedy plus the "legal or equitable relief" provision may be sufficient to meet a court's conception of "'a broad range of damages to compensate the plaintiff "fairly for injuries caused by the violation of his legal rights."'"[128]

B. On Account of Personal Injuries

In an apparent attempt to narrow the scope of § 104(a)(2),[129] the Court added a second tier to the "tort type rights" test. This tier comes from the plain language of § 104(a)(2): damages received must be "on account of personal injuries or sickness."[130] Though the Court provided an appropriate grounding in the plain language of the Code, it failed to provide additional guidance as to the scope of the term "personal injuries" for purposes of § 104(a)(2). As a result, practitioners and lower courts are left to reflect upon the Court's approval in *Burke* of "link[ing] identification of a personal injury . . . to traditional tort principles."[131] Hence, at first glance, *Schleier*'s

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appropriate relief included only "equitable relief." 29 U.S.C. § 216(b) (1994). As previously mentioned, the Court in *Burke* found that the pre-1991 Title VII was void of compensatory remedies. Hence, in further light of the *Schleier* decision, whether a catch-all remedial provision mentions legal relief, equitable relief, or both, is irrelevant for purposes of the Court's analysis. Yet this seems contrary to the Court's statement in *Burke* that a federal discrimination statute providing for "a jury trial" and "'*both* equitable and legal, including compensatory and, under certain circumstances, punitive damages'" is tortlike. United States v. Burke, 504 U.S. 229, 240 (1992) (empbasis added) (quoting Johnson v. Railway Express Agency, Inc., 421 U.S. 454, 460 (1975)).

127. Why the ADEA's "legal and equitable relief" provision fails to make available compensatory remedies under *Schleier* is unclear. Indeed, the Court in *Burke* suggested that such a provision would have satisfied the Court's remedial analysis there. *See Burke*, 504 U.S. at 240.

128. *Schleier*, 115 S. Ct. at 2167 (quoting *Burke*, 504 U.S. at 235 (quoting Carey v. Piphus, 435 U.S. 247, 257 (1978))).

129. "The only reasonable explanation [for the Court's new test] is that the Court was attempting to narrow the scope of section 104(a)(2)." Illig, *supra* note 9, at 1474.

130. I.R.C. § 104(a)(2) (1994).

131. *Burke*, 504 U.S. at 234. Unfortunately, in practical effect, *Burke* (or the first tier) requires the court to analyze every statutory scheme that comes into question to see if the cause of action it creates is tortlike. Considering the tediousness of the task and the likelihood of varying results among the circuits, one

first tier, which requires the cause of action to be based on "tort or tort type rights," swallows the second.[132]

The usefulness of the second tier, however, lies in its recognition of a causality requirement—that is, a causal connection must exist between the personal injury and the damages received.[133] Unfortunately, the Court's explanation of this tier is limited essentially to a hypothetical example involving an automobile accident—the inferences from which are useful primarily in analyzing fact patterns atypical of those giving rise to statutory actions. Nevertheless, the hypothetical and lower court interpretations of the "on account of" language provide some insight into the parameters of the required causal connection.

1. The scope of "personal injuries"

a. Judicial concerns. The Court in *Schleier* avoided defining "personal injuries." Had it expressly held that intangible harms do not constitute "personal injuries," which Justice O'Connor suggests is the Court's implicit holding, the Court would have overturned well-established precedent.[134] Alternatively, the Court could have attempted to provide a precise definition, in essence making "personal injuries" a term of art. Such was not the intent of the provision's drafters, however, or

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should question whether even the *Burke* analysis provides an acceptable standard.

132. *See* Illig, *supra* note 9, at 1474 (presenting Justice Stevens' conclusion that "ADEA claims are not based on personal injuries," and arguing that "[i]f thia is so, why . . . add a[] . . . new test when [the Court] could have based its decision entirely on *Burke*?").

Ironically, this second tier is the only part of the test found within the plain language of the statute.

133. *See* O'Gilvie v. United States, 66 F.3d 1550, 1557 n.12 (10th Cir. 1995) (finding useful the Court's statement that "each element of a hypothetical settlement" must "satisf[y] the requirement . . . that the damages were received on account of personal injuries or sickness" (internal quotation marks omitted) (quoting *Schleier*, 115 S. Ct. at 2164)), *cert. granted*, 116 S. Ct. 1316 (1996).

134. *See, e.g., Burke*, 504 U.S. at 235-36 n.6 ("[T]he courts and the IRS [have] long . . . recognized that § 104(a)(2)'s reference to 'personal injuries' encompasses, in accord with common judicial parlance and conceptions, nonphysical injuries to the individual, such as those affecting emotions, reputation, or character, as well." (citations omitted)); Roemer v. Commissioner, 716 F.2d 693, 697 (9th Cir. 1983) ("[Section 104(a)(2)] says nothing about physical injuries," and "[t]he ordinary meaning of a personal injury is not limited to a physical one."); Threlkeld v. Commissioner, 87 T.C. 1294, 1308 (1986) (holding that there is no valid distinction between damages received for injury to personal reputation and those received for injury to professional or business reputation for purposes of § 104(a)(2)), *aff'd*, 848 F.2d 81 (1988); *see also infra* part IV.B.1.b.

at least no such intent is manifest in the legislative history.[135] Moreover, any definition that would give the term a more specific meaning could create confusion and encourage inconsistent application as the term is applied in various statutes. Hence, the Court was prudent in not providing a succinct definition, and its reluctance in doing so may give practitioners arguing a broad application of § 104(a)(2) further advantage.

b. Precedent supporting a broad definition of "personal injuries." Although one might infer, as did Justice O'Connor, that intangible harms are no longer "personal injuries" for purposes of § 104(a)(2), the Court is unlikely to overturn recent precedent[136] embracing the broader notion. With regard to intangible, nonphysical personal injuries, the Court in *Burke* noted the following:

> [T]he courts and the IRS . . . have recognized that § 104(a)(2)'s reference to "personal injuries" encompasses, in accord with common judicial parlance and conceptions, nonphysical injuries to the individual, such as those affecting emotions, reputation, or character, as well. . . .
>
> Congress' 1989 amendment to § 104(a)(2) provides further support for the notion that "personal injuries" includes physical as well as nonphysical injuries. Congress rejected a bill that would have limited the § 104(a)(2) exclusion to cases involving "physical injury or physical sickness." At the same time, Congress amended § 104(a) to allow the exclusion of *punitive* damages only in cases involving "physical injury or physical sickness." The enactment of this limited amendment addressing only punitive damages shows that Congress assumed that other damages (i.e., compensatory) would be excluded in cases of both physical *and* nonphysical injury.[137]

It seems, therefore, that both Congress and the Court have recognized intangible harms as "personal injuries" under § 104(a)(2).

Moreover, in a footnote, the *Schleier* majority expressly declared: "We . . . have no doubt that intangible harms of discrimination can constitute personal injury, and that the com-

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135. *See, e.g.*, H.R. REP. NO. 1337, 83d Cong., 2d Sess. 15 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 15-16 (1954); H.R. REP. NO. 767, 65th Cong., 2d Sess., pt. 2, at 9-10 (1918).

136. *See, e.g., Burke*, 504 U.S. at 235-37; *see also* Goodman v. Lukens Steel Co., 482 U.S. 656, 661-62 (1987) (finding that the intangible harm of "racial discrimination . . . is a fundamental injury").

137. *Burke*, 504 U.S. at 235-36 n.6 (citations omitted).

pensation for such harms may be excludable under § 104(a)(2)."[138] Thus, the position that intangible harms constitute "personal injuries" is still well-founded,[139] and statutory actions with remedies compensating for such harms should still fit the "personal injuries" aspect of *Schleier*'s second tier. More difficult is establishing the causal connection between the personal injuries redressed by a particular statute and the damages received pursuant to the statute.

2. *Causation analysis*

In the majority's hypothetical automobile accident,[140] where the victim suffered a personal physical injury, pain and suffering, emotional distress, medical expenses, and lost wages, the majority determined that recovery from these harms "con-

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138. *Schleier*, 115 S. Ct. at 2165 n.6. Some scholars note that the majority's statement ostensibly contradicts an inference made earlier in *Schleier* that the taxpayer did not suffer a personal injury since the damages he received failed the "tort type rights" test. JOSEPH M. DODGE ET AL., TEACHER'S MANUAL FOR FEDERAL INCOME TAX: DOCTRINE, STRUCTURE AND POLICY 178 n.1 (1995). They suggest that "[p]erhaps the only way to reconcile [Justice Stevens'] language is to note that [footnote six] is in the part of the opinion dealing with whether the amounts were awarded 'on account of' the personal injury, not whether there *was* a personal injury." *Id.*; *see Schleier*, 115 S. Ct. at 2166-67.

The majority stated: "However to acknowledge that discrimination may cause intangible harms is not to say that the ADEA compensates for such harms, or that any of the damages received were on account of those harms." In response, the dissent stated that "[t]he logic of th[e] argument is rather hard to follow." Without clearly addressing the majority's causality concern and apparently attempting to articulate a more straightforward rationale than that embraced by the majority, the dissent declared: "If the harms caused by discrimination constitute personal injury, then amounts received as damages for such discrimination are received 'on account of personal injuries' and should be excludable under § 104(a)(2)." *Id.* at 2170 (O'Connor, J., dissenting).

139. Noteworthy, however, is the Court's rationale in *Burke* regarding Title VII remedies:

> It is beyond question that discrimination in employment on the basis of sex, race, or any of the other classifications protected by Title VII is . . . an invidious practice that causes grave harm to its victims. The fact that employment discrimination causes harm to individuals does not automatically imply, however, that there exists a tort-like "personal injury" for purposes of federal income tax law.

Burke, 504 U.S. at 238. This argument seems odd since neither the Court nor Congress has ever defined or expressly limited the meaning of "personal injuries" under § 104(a)(2). *See supra* note 135 and accompanying text. Hence the assertion should be read narrowly; that is, the Court was merely pointing out a logical deficiency in the taxpayer's argument.

140. For a brief explanation of the hypothetical, see *supra* note 63.

stitute[d] damages 'on account of personal injuries.'"[141] The majority commented:

> The critical point this hypothetical illustrates is that each element of the settlement is recoverable not simply because the taxpayer received a tort settlement, but rather because each element of the settlement satisfies the requirement set forth in [§] 104(a)(2) . . . that the damages were received "on account of personal injuries or sickness."[142]

The "on account of" language ostensibly employs a causal analysis. In the recovery of lost wages under the majority's hypothetical, some negligent or wrongful conduct caused an accident resulting in personal injury to the victim, which personal injury caused the victim to miss work, resulting in lost wages. Hence, there was some causal link between the damages received and the personal injury. Unfortunately, the majority did not explain what the link was nor how close the link must be for a recovery to come within the reach of § 104(a)(2).[143]

Even though the extent of the required causal relationship is still unclear, some federal circuit courts have considered two alternatives: (1) the personal injury need only be a prerequisite to receiving the damages, or (2) the personal injury itself must justify the damages.[144] Whether a practitioner should argue one or the other will, of course, depend on the jurisdiction in which the action is brought and the facts of the particular

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141. *Schleier*, 115 S. Ct. at 2163-64. Lost wages are excludable only if they are incurred when "the taxpayer was out of work *as a result of* her injuries." *Id.* at 2164 (emphasis added).

142. *Id.* Not only is the majority's distinction difficult to perceive, but from a tax policy point of view it is difficult to ascertain why the distinction is relevant. *See supra* note 94; *see also Schleier*, 115 S. Ct. at 2170 (O'Connor, J., dissenting) ("If the harms caused by discrimination constitute personal injury, then amounts received as damages for such discrimination are received 'on account of personal injuries' and should be excludable under § 104(a)(2).").

143. Claudia MacLachlan, *ADEA Back Pay, Punies Are Held Taxable by Court*, NAT'L L.J., June 26, 1995, at B1, B2 (quoting Thomas F. Joyce of Chicago's Bell, Boyd & Lloyd, who served as counsel to Respondent Schleier, as stating that "[t]here is the uncertainty of when there is a sufficiently close link between damages and personal injury. Unfortunately we don't know what that [link] is" (alteration in original)).

144. *See* O'Gilvie v. United States, 66 F.3d 1550, 1557, 1560 (10th Cir. 1995) (noting that four circuits have suggested these two possibilities; implicitly adopting the second possibility), *cert. granted*, 116 S. Ct. 1316 (1996).

case.[145] However, the tenor of *Schleier* seems to reflect a very narrow application of all the requirements involved in a § 104(a)(2) analysis. In fact, the majority's hypothetical implies a notion of proximate causation.[146] According to the Court, ADEA back pay is not excludable because it results from the illegal discrimination, not from the personal injury caused by the discrimination. In light of this notion, a practitioner would probably be more successful arguing the second alternative, which holds that the personal injury itself must justify the damages.[147] Nevertheless, at least one circuit has embraced the first alternative as a sufficient link between the personal injury and the damage award.[148]

V. CONCLUSION: PRACTITIONER NOTES

Schleier adds confusion to an already uncertain legal analysis—the applicability of § 104(a)(2) to statutory damage awards. Notwithstanding this failing, practitioners must decipher what the decision stands for and, more importantly, what it does not stand for with regard to future litigation over § 104(a)(2) application. This final Part addresses these concerns by summarizing the conclusions set forth in this Note.

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145. At least five circuits have adopted, whether expressly or implicitly, the narrower possibility. *See O'Gilvie*, 66 F.3d at 1560; Wesson v. United States, 48 F.3d 894 (5th Cir. 1995); Hawkins v. United States, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995); Reese v. United States, 24 F.3d 228 (Fed. Cir. 1994); Commissioner v. Miller, 914 F.2d 586 (4th Cir. 1990).

The Sixth Circuit ostensibly adopted the first possibility in Horton v. Commissioner, 33 F.3d 625 (1994). However, as a result of *Schleier*, *Horton* has been severely criticized. *See O'Gilvie*, 66 F.3d at 1556-57.

146. In tort theory, there are two main causal analyses. Proximate cause limits the scope of liable actors in the chain of events leading to a particular harm. Some scholars depict this analysis as merely policy based, whereas others treat it as descriptive of a molecular or factual connection. *See, e.g.*, Marshall v. Nugent, 222 F.2d 604, 610 (1st Cir. 1955). *See generally* KEETON ET AL., *supra* note 100, §§ 41-42. The second type of analysis is "but for" causation, which entails a counter-factual hypothesis. *See generally id.* § 41, at 265-68. Again, however, it is curious that a tax provision would look to causation as the triggering mechanism for an exemption from gross income. For various articles discussing the policy (or lack thereof) underlying § 104(a)(2), see articles cited *supra* note 3.

147. The majority of the circuits addressing the issue have adopted the second, narrower interpretation. *See supra* note 145 and cases cited therein.

148. *See supra* note 145 (noting that the Sixth Circuit's decision in *Horton* suggests that the first alternative is a proper interpretation of the "on account of" language, but recognizing that after *Schleier*, the validity of the first alternative is dubious).

A. Schleier *Invokes a New Test*

Prior to *Schleier*, the Commissioner and lower courts had interpreted I.R.C. § 104(a)(2) and Treasury Regulation § 1.104-1(c) to invoke a "tort or tort type rights" (or tortlike) test to the underlying cause of action. According to the Court in *Burke*, whether the action is tortlike depended on whether the remedy sounds in tort.[149] In *Schleier*, the Court apparently attempted to narrow the scope of § 104(a)(2) by adding a second tier to the *Burke* test which requires that the damages be received "on account of personal injuries." Additionally, the Court shifted the focus of its remedial approach to the "availability of compensatory remedies" as the "primary characteristic" of a tortlike action.[150]

B. *The First Tier (*Burke *Test) May Not Be Limited to a Remedial Analysis*

It is not clear, however, that the proscribed remedy fixes the character of the underlying action. The resourceful practitioner will argue that *Schleier* leaves open the possibility that non-remedial factors may be given significant weight in the "tort or tort type rights" determination. In particular, practitioners should argue that a more substantive approach is to examine a statutory action in light of the rudiments of tort actions—that is, the nature of the interest invaded, the kind of wrongful conduct, and the nature of the harm—as well as traditional tort remedies.

As to traditional tort remedies, punitive damages provide at least some evidence of an underlying tortlike action, since they are usually available solely in tort. Accordingly, when a

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149. *See* United States v. Burke, 504 U.S. 229, 234-35, 240 (1992). In examining an action brought under Title VII, the Court in *Burke* stated:

> Indeed, the circumscribed remedies available under Title VII stand in marked contrast not only to those available under traditional tort law, but under other federal antidiscrimination statutes, as well. For example, Rev. Stat. § 1977, 42 U.S.C. § 1981, permits victims of race-based employment discrimination to obtain a jury trial at which "both equitable and legal relief, including compensatory and, under certain circumstances, punitive damages" may be awarded. The Court similarly has observed that Title VIII of the Civil Rights Act of 1968, whose fair housing provisions allow for jury trials and for awards of compensatory and punitive damages, "sounds basically in tort" . . . .

Id. at 240 (footnotes and citations omitted).

150. Commissioner v. Schleier, 115 S. Ct. 2159, 2166 (1995).

statutory remedial scheme includes a punitive award, practitioners and courts should consider such evidence in determining the action's characterization for purposes of § 104(a)(2).[151] Moreover, broad remedial provisions, such as those making additional "legal and equitable relief" available, may suggest an underlying tortlike action if accompanied by a compensatory remedy. A statutory provision incorporating both a compensatory and a broadly stated remedy may qualify as "a broad range of damages to compensate the plaintiff,"[152] which the Court stated would evidence an underlying tortlike action.

C. The Second Tier ("on Account of Personal Injuries" Test) Probably Requires Proximate Causality

The usefulness and application of the "on account of personal injuries" tier is uncertain unless one knows what "personal injuries" means for § 104(a)(2) purposes. It seems clear that intangible harms still constitute "personal injuries." Furthermore, the "on account of" language, which apparently employs a causation analysis, may provide practitioners some notion of the required relationship between the personal injuries and the damages received. Two possibilities of the required causal relationship are (1) the personal injury need only be a prerequisite to receiving the damages, or (2) the personal injury itself must justify the damages. Most circuits addressing the issue have adopted the more narrow interpretation, and such would seem consistent with the Supreme Court's apparent intent to narrow the scope of the § 104(a)(2) exclusion.

In conclusion, the Court's holding in *Schleier* suggests that § 104(a)(2) is narrower than is readily apparent from the text of the Code. The Court, however, has neglected to provide a coherent mechanism for making consistent decisions in the lower courts as statutory remedial regimes are litigated for § 104(a)(2) purposes. Though a remedial analysis is helpful, it

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151. Though a court might be reluctant to give credence to the argument in light of *Schleier*, the practitioner should point out that the argument was not addressed in the *Schleier* opinion. Furthermore, it was not clearly presented in the briefs, although the Brief for Respondent addressed generally the non-contractual nature of punitive damages. *See* Brief for Respondent at 31-32, *Schleier* (No. 94-500) ("Petitioner's claim that liquidated damages are a remedy for breach of contract cannot be reconciled with her contentions that ADEA liquidated damages are exclusively punitive. Contractual remedies do not allow for punitive damages." (citations and internal quotation marks omitted)).

152. *Schleier*, 115 S. Ct. at 2167.

is incomplete for ascertaining the character of the underlying statutory action. By examining both the remedy and the underlying action with a view to the components of a tort action, courts can more accurately determine whether the action is tortlike, as required by the regulation and *Burke*. Furthermore, recent federal circuit court decisions may aid practitioners in addressing the required proximity of the statutory damages to the personal injury.

T. James Lee, Jr.