"MAKE WHOLE": THE NEED FOR GROSS-UPS IN EMPLOYMENT DISCRIMINATION CASES*

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ABSTRACT

A primary purpose of federal anti-discrimination remedies is to place the victim in the same economic position she would have occupied had no discrimination occurred. However, a lump-sum award for lost pay will be taxed in the year it is received, exposing the plaintiff to increased marginal tax rates. In order to neutralize the often harsh tax consequences of lump-sum wage awards, many courts have begun "grossing-up" the plaintiff's award, relying on the "make whole" remedial purpose of anti-discrimination statutes. Some courts, however, still force plaintiffs to bear this additional tax burden, even though it was caused by the defendant's discriminatory conduct. This article provides an overview of federal discrimination statutes and the available relief; explains the adverse tax consequences of a lump-sum award in employment cases; and reviews case law and statutes supporting gross-ups, outlining the differing jurisdictional treatments and arguing for wider adoption based on the "make whole" doctrine.

I. OVERVIEW

A primary purpose of federal anti-discrimination remedies is to place the victim in the same economic position he would have occupied had no discrimination occurred.[1] However, an unintended consequence under current federal tax law frustrates this purpose by taxing awards for lost wages, sometimes for multiple years, more heavily when awarded as a lump-sum in the year the award is received. Although the Internal Revenue Code (I.R.C.) excludes non-punitive damages awarded for personal physical injuries from income,[2] whether awarded as lump-sums or period payments, lost wages fall within I.R.C. section 61(a)'s broad definition of gross income and are not excludable.[3] Moreover, when a person is wrongfully terminated and is awarded lost wages covering a span of years, the lumped-sum is taxable income in the year awarded, often at a higher marginal tax rate than if taxed over a span of years.[4] In fact, in some circumstances, the victim might be worse off because of the adverse tax consequences caused by the lump-sum award than he or she would have been prior to the lawsuit.[5]

For example, ignoring the complexities relating to wage growth, present value of future wages, pre-judgment interest, attorney's fees, state taxes, Medicare taxes, Social Security taxes, and tax exemptions and deductions, suppose that a single plaintiff

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1. The main federal statute prohibiting job discrimination is Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-2 (prohibiting employment discrimination on the basis of race, color, religion, sex or pregnancy, or national origin). The Age Discrimination in Employment Act (ADEA) prohibits age discrimination in employment. 29 U.S.C. § 623(a)(1) (2014). The Americans with Disabilities Act (ADA) prohibits employment on the basis of disability. 42 U.S.C. § 12112(a) (2014).

2. I.R.C. § 104(a)(2) (2015) (whether as lump-sums or as periodic payments).

3. I.R.C. § 61(a)(1) ("Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) . . . (1) Compensation for services, including fees, commissions, fringe benefits, and similar items . . . ."); *see also* I.R.C. §§ 101–140 (no exception for lost wages in the non-personal-physical injury context); United States v. Burke, 504 U.S. 229, 233–37 (1992) (applying the exclusion only if the victim has suffered a tort-type personal injury).

4. *See, e.g.*, Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (victim of age discrimination required to pay higher taxes due to receiving his back-pay in lump-sum rather than as salary paid out over period of years); *see also* I.R.C. § 1 (2015) (federal income tax brackets).

5. *See* Kenseth v. Comm'r, 114 T.C. 399, 425–26 (2000) (Beghe, J., dissenting) (noting that if the ratio of attorney's fees to gross settlement amount is large enough, a pre-tax gain could be transmuted into an after-tax loss because the employee may be subject to a rate of tax in excess of 100%); Adam Liptak, *Tax Bill Exceeds Award To Officer in Sex Bias Suit*, N.Y. TIMES (Aug. 11, 2002), http://www.nytimes.com/2002/08/11/us/tax-bill-exceeds-award-to-officer-in-sex-bias-suit.html [http://perma.cc/K8MN-65XW] (telling the story of a plaintiff who ended up with a $99,000 loss, despite obtaining a $1,250,000 judgment in her favor); *see also*, Spina v. Forest Pres. Dist. of Cook Cty., 207 F. Supp. 2d 764, 767 (N.D. Ill. 2002) (plaintiff losing $154,322 of her remittitured $300,000 award when she had to pay income taxes on $1 million in attorney's fees and costs).

earns $40,000 per year in wages from 2004 to 2013. In 2014, a court finds that the plaintiff would have earned $65,000 per year over that same period absent unlawful discrimination, and awards $250,000 in back-pay ($25,000 for each of the ten previous years) and $100,000 as front-pay (for the years of 2014–2017) in one lump-sum in 2014.[6] Even though the plaintiff would have earned this amount over a fourteen-year period, the entire $350,000 award is taxed in 2014, when the defendant pays the judgment. Thus, his 2014 taxable income is $390,000—his $40,000 in regular income from a new employer and $350,000 in pecuniary damages. As a result, his 2014 federal income tax liability is $135,212.[7] Had the plaintiff not received the award in 2014, he would have had only $40,000 in taxable income, yielding an $8,327 tax liability.[8] Assuming that the 2014 tax rates remained constant from 2004 to 2017, had the plaintiff not suffered the discrimination, and instead received the additional salary as wages over each of the fourteen years, his $65,000 salary would have resulted in an annual federal tax of $15,672.[9] Of this amount, $7,345[10] is attributed to the $25,000 difference in salary. Thus, in each of the fourteen years, the plaintiff would have paid an additional $7,345 in taxes, totaling $102,830.

In this hypothetical, the lump-sum award caused the plaintiff to suffer an adverse tax consequence in the amount of $32,382.[11] This is because of our nation's progressive tax system, and the fact that the $390,000 taxable income in 2014 moves the plaintiff to the highest tax bracket in 2014, even though he would have been in the middle tax bracket if taxed in each of the fourteen years. Note that simply awarding the plaintiff an additional $32,382 gross-up amount will not "make him whole" since there would also be taxes owed on the gross-up. An iterative process is usually used to estimate the correct gross-up award.[12]

In order to avoid the problem with lump-sum wage awards, many, but not all, courts "gross-up" the plaintiff's award to

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6. For a definition of back and front pay and how these differ from past and future earning capacity, *see* Thomas R. Ireland, *Possible Damage Elements in Wrongful Termination Litigation: Back Pay, Front Pay and Lost Earning Capacity*, 18 J. LEGAL ECON. 93 (2012).

7. $79,772, plus 39.6% of the excess over $250,000. I.R.C. § 1(e).

8. $3,315, plus 28% of the excess over $22,100. *Id.*

9. $12,107, plus 31% of the excess over $53,500. *Id.*

10. Calculated by subtracting the $8,327 tax on $40,000 from the $15,672 tax on $65,000.

11. Calculated by subtracting the $135,212 tax on $390,000 in income from the $102,830 additional taxes that he would have paid but for the discrimination.

12. Barry Ben-Zion, *Neutralizing the Adverse Tax Consequences of a Lump-Sum Award in Employment Cases*, 13 J. FORENSIC ECON. 233, 237 (2000).

neutralize these harsh and unjust consequences.[13] These courts rely on the "make whole" remedial purpose of anti-discrimination statutes.[14] However, the Supreme Court has not spoken on the issue, and some courts continue to force plaintiffs to bear this additional tax burden even though it was caused by the defendant's discriminatory conduct.[15] Given the complexities and nuances associated with the tax code and the enforcement provisions in federal discrimination statutes, this article will focus on three areas: (1) providing an overview of federal discrimination statutes and the available relief; (2) explaining the adverse tax consequences of a lump-sum award in employment cases; (3) reviewing case law and statutes supporting gross-ups, outlining the various jurisdictional gross-up treatment and arguing for a wider adoption of tax gross-ups based on the "make whole" doctrine. Ireland and Taylor,[16] Tyler Bowles,[17] Barry Ben-Zion,[18] and James D. Rogers[19] have addressed methodologies used to consider a gross-up for adverse taxes in employment and other matters, and Thomas Ireland "provided guidance with respect to Social Security and Medicare payroll taxes which are also taxed in the year of an award" and addressed additional complications that can arise in the calculations of gross-ups.[20]

II. FEDERAL DISCRIMINATION STATUTES AND AVAILABLE RELIEF

In order to thoroughly discuss the adverse tax problem, a review of the federal employment discrimination statutes and the available remedies is necessary. Primarily, this article will discuss Title VII of the Civil Rights Act of 1964 (Title VII), the main federal statute prohibiting employment discrimination on the basis of race, color, religion, sex or pregnancy, or national origin,[21]

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13. *See, e.g.*, Eshelman v. Agere Sys., Inc., 554 F.3d 426, 442–43 (3d Cir. 2009) (departing from no gross up precedent and granting a plaintiff over $6,000 to neutralize "adverse" federal tax consequences).

14. *See, e.g.*, *id.*

15. *See, e.g.*, Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam) (denying a gross up because of "the complete lack of support in existing case law for" such relief); *see also* Fogg v. Gonzalez, 492 F.3d 447, 455–56 (D.C. Cir. 2007) (refusing to overturn *Dashnaw*).

16. Paul C. Taylor & Thomas R. Ireland, *Accounting for Medicare, Social Security Benefits and Payroll Taxes in Federal Cases: Federal Case Law and Errors by Many Forensic Economists*, 2 LITIG. ECON. DIG. 79 (1996).

17. *See* Tyler J. Bowles & W. Chris Lewis, *Taxation of Damage Awards: Current Law and Implications*, 2 LITIG. ECON. DIG. 73 (1996).

18. *See* Ben-Zion, *supra* note 12, at 233.

19. James D. Rogers, *Handling Taxes in Employment Law Cases*, 16 J. FORENSIC ECON. 225, 236 (2003).

20. Thomas R. Ireland, *Tax Consequences of a Lump Sum Award in Wrongful Termination Cases,* J. LEGAL ECON., Oct. 17, 2010, 51.

21. 42 U.S.C. § 2000e-2 (2014).

the Age Discrimination in Employment Act (ADEA), which prohibits age discrimination in employment,[22] and the Americans with Disabilities Act (ADA), which prohibits employment discrimination based on disability.[23] However, the topics discussed are equally applicable to other federal statutes such as the Family Medical Leave Act; 42 U.S.C. § 1981; 42 U.S.C. § 1983; the Fair Labor Standards Act; the National Labor Relations Act; the Employee Retirement Income Security Act; and state anti-discrimination statutes. Because most of the available remedies apply irrespective to the particular discrimination statute, this Part will discuss remedies relevant to the adverse tax problem. Although this article briefly describes back- and front-pay, Thomas Ireland has thoroughly covered the topic and described how these components of damages differ from past and future earning capacity.[24]

A. *Back-Pay*

Back-pay is the primary pecuniary remedy available to a victim of employment discrimination. In *Albemarle Paper Co. v. Moody*, the Supreme Court found that back-pay damages were integral to federal employment discrimination laws and that there is a strong presumption that victims of discrimination are entitled to back-pay damages.[25] Back-pay compensates a victim for past lost wages and past lost benefits (e.g., employer-paid fringe benefits, health and life insurance benefits, defined contribution and defined payment retirement and savings benefits, etc.)[26] and is an equitable remedy available under Title VII of the 1964 Civil Rights Act, the ADA, and the ADEA.

The back-pay period for victims of employment discrimination laws usually begins on the date the economic loss starts.[27] However, under Title VII and the ADA, back-pay liability cannot accrue from a date more than two years prior to the filing of a charge with the Equal Employment Opportunity Commission.[28] When calculating a plaintiff's back-pay, courts first determine the plaintiff's probable employment history had no discrimination occurred and then define the back-pay period.[29]

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22. 29 U.S.C. § 623(a)(1) (2014).

23. 42 U.S.C. § 12112.

24. *See generally* Ireland, *supra* note 6.

25. Albemarle Paper Co. v. Moody, 422 U.S. 405, 420–21 (1975).

26. *See* 42 U.S.C. § 2000e-5(g)(1).

27. EEOC v. Joint Apprenticeship Comm. of Joint Indus. Bd. of Elec. Indus., 164 F.3d 89, 100 (2d Cir. 1998).

28. 42 U.S.C. § 2000e-5(g)(1); 42 U.S.C. § 12117(a).

29. Michael K. Hulley, Jr., Note, *Taking Your Lump Sum or Just Taking Your Lumps? The Negative Tax Consequences in Employment Dispute Recoveries and Congress's*

When necessary to make the victim whole, many courts use their equitable power to augment back-pay awards with prejudgment interest.[30] However, there is no per se rule that requires prejudgment interest to be included in an award.[31] Finally, the court will reduce the award if the plaintiff failed to mitigate damages.[32]

B. *Front-Pay*

Although not expressly mentioned in federal employment discrimination statutes, the Supreme Court has held that front-pay is an equitable remedy available to compensate plaintiffs during the period between judgment and reinstatement or in lieu of reinstatement.[33] In other words, front-pay is awarded to victims of employment discrimination to compensate them for the continuing future effects of discrimination until they can be made whole.[34] Similar to back-pay, front-pay can be awarded for future lost wages, defined contribution and defined payment retirement and savings benefits, health benefits, and other fringe benefits.[35] Since the plaintiff receives the front-pay award in one lump-sum, courts must discount the award to reflect time value of money principles.[36]

Importantly, when a plaintiff works after being wrongfully terminated in order to mitigate damages, he or she will pay taxes on those earnings in the year earned, but any unmitigated lump-sum damages could be taxed at a higher rate when added to the mitigating income. But for the discrimination, fringe benefits provided by the employer would normally not be taxed at all but would be taxed when included in a lump-sum damages award.

Role in Fashioning a Remedy, 2012 MICH. ST. L. REV. 171, 198 n.190 (citing CHARLES A. SULLIVAN & LAUREN M. WALTER, 1 EMP. DISCRIMINATION L. & PRAC. § 13.09[B][1] (4th ed. 2009)).

30. 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 back-pay remedy."); *see also* 42 U.S.C. § 2000e; 29 U.S.C. § 621 (2014) (ADEA).

31. Hadley v. VAM P T S, 44 F.3d 372, 376 (5th Cir. 1995).

32. Hulley, *supra* note 29, at 198 n.190.

33. Pollard v. E.I. du Pont de Nemours & Co., 532 U.S. 843, 849–54 (2001); *see also* 42 U.S.C. § 2000e-5(g)(1); Whittington v. Nordam Grp. Inc., 429 F.3d 986, 1000–01 (10th Cir. 2005); Chisholm v. Memorial Sloan-Kettering Cancer Ctr., 824 F. Supp. 2d 573, 576 (S.D.N.Y. 2011); Sands v. Menard, Inc., 787 N.W.2d 384, 401 (Wis. 2010).

34. *See, e.g.*, Pitre v. Western Elec. Co., Inc., 843 F.2d 1262, 1278 (10th Cir. 1988); McGuffey v. Brink's, Inc., 598 F. Supp. 2d 659, 667 (E.D. Pa. 2009).

35. *See, e.g.*, Blum v. Witco Chem. Corp., 829 F.2d 367, 373–75 (3d Cir. 1987).

36. *See, e.g.*, Rhodes v. Guiberson Oil Tools, 82 F.3d 615, 622 (5th Cir. 1996) (noting the district court's use of present value principles to discount the front-pay award); Cassino v. Reichhold Chems., Inc., 817 F.2d 1338, 1346–47 (9th Cir. 1987) (discussing a jury's competence to reduce a front-pay award to present value).

C. *Marriage and Discrimination Awards*

Back-pay awards to a married plaintiff who was single at the time the back wages would have been earned may be subjected to a higher rate because of his new marital status.[37] However, some damages experts avoid this problem by ignoring post-injury marriage and using the actual family income status prior to the termination to establish a tax rate. Likewise, with regard to front-pay awards, many experts traditionally do not attempt to model the future income of a spouse and how changes in the pre-termination spousal income might impact future tax rates. To what extent a spouse's changing income or other family characteristics, such as marriage, divorce or future family size, should be included in an analysis of tax liability is unclear in the legal and forensic economic fields.

D. *Changing Tax Rates*

Because the I.R.C. requires that lump-sum awards be taxed in the year awarded, the rates used to calculate a plaintiff's tax liability, whether back-pay or front-pay, are the rates for that year.[38] However, Congress may have raised marginal tax rates over the course of the discrimination, forcing the taxpayer to pay a higher rate on back-pay awards than he or she would have paid had no discrimination occurred—creating an adverse tax consequence.[39]

E. *Attorney's Fees*

Courts have discretion under most federal employment discrimination statutes to require an employer pay the victim's reasonable attorney's fees.[40] For example, section 626(b) of the ADEA incorporates section 16 of the Fair Labor Standards Act,

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37. Gregg D. Polsky & Stephen F. Befort, *Employment Discrimination Remedies and Tax Gross Ups*, 90 IOWA L. REV. 67, 73 (2004) (citing Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1429–31 (1975) (discussing the marriage penalty); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1, 21–22 (1980) (same); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L. J. 63, 64 (1993) (same); Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573, 1586 (1977) (same)).

38. I.R.C. § 441 (2015).

39. Polsky & Befort, *supra* note 37, at 76.

40. *See, e.g.*, 29 U.S.C. § 626(b) (2014) (ADEA) (incorporating section 16 of the FLSA, which authorizes an award of attorney's fees); 42 U.S.C. 2000e-5(k) (2014) (allowing courts to award attorney's fees to successful discrimination plaintiffs); 42 U.S.C. § 12117 (ADA) (adopting the remedies and enforcement procedures of Title VII); *see also*, 42 U.S.C. § 1988 (2014); Hensley v. Eckerhart, 461 U.S. 424, 429–33 (1983).

which authorizes awards for attorney's fees.[41] Likewise, Title VII allows courts to award attorney's fees to successful discrimination plaintiffs.[42] The ADA, through section 12117, also allows for attorney's fee awards, because it adopts Title VII's enforcement remedies.[43] Section 1988 of the Civil Rights Attorney's Fees Awards Act of 1976 also authorizes courts to award reasonable attorney's fees to prevailing parties in civil rights litigation.[44]

After the passage of the Small Business Job Protection Act in 1996, employment discrimination victims became liable for federal income taxes on the amounts received in compensation for attorney's fees.[45] However, in response to criticism from legal scholars and civil rights organizations, Congress passed the Civil Rights Tax Relief Act of 2004, which provided discrimination victims an above the line (i.e., a deduction occurring before or above the line of taxable income), Alternative Minimum Tax (AMT) exempt income tax deduction for litigation expenses paid in connection with a discrimination lawsuit.[46]

1. The Alternative Minimum Tax is Still an Issue

Although the Civil Rights Tax Relief Act alleviated one problem caused by the Small Business Job Protection Act, it failed to resolve the adverse tax consequences of a lump-sum award,[47] and only partially resolved the attorney's fee problem.[48] First, the Act updated I.R.C. section 62(a)(20) to include tax protection for attorney's fees and court costs relating to discrimination claims, but not for other awards relating to the same discrimination lawsuit, such as emotional distress.[49] Thus, attorney's fees related

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41. 29 U.S.C. § 626(b).

42. 42 U.S.C. § 2000e-5(k).

43. 42 U.S.C. § 12117.

44. 42 U.S.C. § 1988.

45. 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)); 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); *see also id.* (refusing to apply to American Jobs Creation Act of 2004 retroactively, but acknowledging that "had the Act been in force for the transactions . . . under review, these cases likely would not have arisen").

46. 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).

47. *See, e.g.*, Jon Hyman, *3rd Circuit Decision Illustrates Need for the Civil Rights Tax Relief Act*, OHIO EMPLS. L. BLOG (Feb. 4, 2009), http://ohioemploymentlaw.blogspot.com/2009/02/3rd-circuit-decision-illustrates-need.html [http://perma.cc/493C-RJPT].

48. I.R.C. § 62(a)(20) (providing protection for "attorney fees and court costs" but not for other expenses or awards).

49. Hulley, *supra* note 29, at 187.

to non-litigation damages may still be calculated as income.[50] Second, the Act failed to grant an income exclusion or AMT relief when attorney's fees are not awarded. If the plaintiff was not awarded attorney's fees, he or she would most likely seek to claim the fees paid as a miscellaneous itemized deduction under I.R.C. section 67, which allows for miscellaneous itemized deduction for attorney's fees paid to the extent that the aggregate of such deductions exceeds 2% of adjusted gross income.[51] However, when individuals with high incomes use tax exemptions and deductions to significantly reduce their tax liability under the regular rules, the AMT comes into play under I.R.C. section 56, forcing taxpayers to recalculate their taxable income to include income normally excludable and expenses otherwise deductible.[52]

F. *Other Taxes*

This article has focused on adverse effects of federal taxes, but there are also state taxes, Social Security taxes, and Medicare taxes that may need to be modeled in a determination of total tax adjustments for an adverse tax consequence. For instance, in *United States v. Cleveland Indians Baseball Co.*, the Supreme Court recognized that the I.R.S. calculates both Social Security and Medicare taxes according to the year they are paid.[53] The Court noted that I.R.S. regulations interpreting FICA and FUTA tax provisions[54] specify that the taxes attach "at the time that the wages are paid by the employer,"[55] and are "computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid."[56] Thus, back-pay and front-pay awards are subject to FICA and FUTA according to the year the wages are paid.[57]

For example, Social Security and Medicare taxes will also be due on a lump-sum award, including the 0.9% Medicare

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50. *Id.* at 188 (citing Robert W. Wood, *Tax Aspects of Settlements and Judgments*, *in* BNA U.S. INCOME PORTFOLIOS: INCOME, DEDUCTIONS, CREDITS AND COMPUTATION OF TAX 522 § V.G.2 (3d ed. 2005) ("The IRS may argue that the attorney's fees should be allocated between the discrimination and nondiscrimination claims.")).

51. I.R.C. § 67; *see also* I.R.C. § 63 (defining taxable income).

52. I.R.C. § 56; CONG. BUDGET OFFICE, THE INDIVIDUAL ALTERNATIVE MINIMUM TAX (2010).

53. United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 209 (2001).

54. I.R.C. § 3111(a) (FICA tax); I.R.C. § 3301 (FUTA tax).

55. *Cleveland Indians Baseball Co.*, 532 U.S. at 219 (quoting 26 C.F.R. § 31.3111–3 (2000)).

56. *Id.* (quoting 26 C.F.R. § 31.3111–2(c) and citing 26 C.F.R. §§ 31.3301–2, –3(b) (same for FUTA)).

57. *Id.* at 209; *see also* Noel v. N.Y. State Office of Mental Health Cent. N.Y. Psychiatric Ctr., 697 F.3d 209, 213 (2d Cir. 2012) (holding that employer was correct to withhold income and FICA taxes from plaintiff's Title VII back-pay and front-pay award).

supplement due on income above $200,000 (the current wage base for a single taxpayer) under I.R.C. section 3101(b)(2). This supplement may apply with multiple years of back-pay and front-pay damages or higher income plaintiffs.[58] As noted by Ireland (2010), there may also be savings on Social Security taxes from a lump-sum award since Social Security taxes are capped (currently the wage base is $117,000).[59] For example, the plaintiff may not have to pay 6.2% of income on each of five years' back-pay income, but rather only on the wage base, which limits the amount of annual wages subject to tax in the year of the award.[60]

To summarize, under Title VII, the ADEA, and the ADA, a court may award a victim of employment discrimination back-pay and front-pay as equitable remedies in order to compensate the victim for past lost wages and other benefits and for the continuing future effects of discrimination until he or she can be made whole. However, in contrast to the annual wages and benefits the victim would have received had no discrimination occurred, these awards redressing the victim's damages will be taxed as one lump-sum—which more often than not places the taxpayer in a higher marginal tax bracket. Moreover, part of the award—such as fringe benefits—would normally not be taxable income to the victim. Even worse, the victim may be subject to higher taxes than he or she would have paid because of marriage or changing tax rates at the time of the award. Although Congress has resolved the issue with victims of employment discrimination being taxed on awarded attorney's fees, Congress still has not resolved the issues related to these other aspects of the victim's award.

III. THE INTERNAL REVENUE CODE AND ADVERSE TAX CONSEQUENCES

Internal Revenue Code section 61 casts a large and wide net as to cash receipts constituting taxable gross income, capturing "all income from whatever source derived" unless excepted by the tax code.[61] Although Congress's directive as to whether awards for discrimination suits were subject to the federal income tax was initially unclear, in *United States v. Burke*, the Supreme Court held that the I.R.C. section 104(a)(2) income exclusion required a

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58. *Questions and Answers for the Additional Medicare Tax*, INTERNAL REVENUE SERVICE, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax (last updated June 14, 2016) [http://perma.cc/8WR6-D7B7].

59. *Fact Sheet: 2014 Social Security Changes*, Soc. Sec. Admin., http://www.ssa.gov/pressoffice/factsheets/colafacts2014.pdf (last visited Sept. 3, 2016) [http://perma.cc/HSU7-E2M8].

60. Ireland, *supra* note 20, at 54–55.

61. I.R.C. § 61 (2012).

tort-like personal injury recovery and that a back-pay award for lost wages in a Title VII discrimination suit did not satisfy that requirement.[62] The Court quickly extended this holding to the ADEA in 1995,[63] and one year later, Congress ratified the Court's decision by amending I.R.C. section 104(a)(2) to exclude from income only non-punitive damages received for personal physical injuries, not for discrimination awards.[64] Thus, under I.R.C. section 104(a)(2), back-pay and front-pay awards in employment discrimination actions are subject to the federal income tax because they are not awarded to compensate for a physical injury.[65]

The two main sources of the adverse tax consequences of a lump-sum award are the I.R.C.'s annual accounting system and the progressive tax rate structure.[66] First, I.R.C. section 441 requires that a taxpayer's income be calculated based on gains actually or constructively received during the calendar year in question.[67] Thus, when an injured plaintiff receives a lump-sum back-pay or front-pay award in recovery for multiple years of discrimination, the award is taxed in the year paid. Second, because the United States uses a progressive income tax structure, meaning that the marginal tax rate increases as the amount of taxable income increases, the lump-sum award can significantly increase a plaintiff's tax liability compared to what he or she would have paid on that amount had it been received over the span of years in which the discrimination occurred.[68]

In other contexts, when income earned over a period of years is received in a single year, such as the sale of real property or investment securities, the I.R.C. provides protection from the

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62. United States v. Burke, 504 U.S. 229, 238–42 (1992) (holding that Title VII damages were subject to the federal income tax); *see also* Comm'r v. Schleier, 515 U.S. 323, 336–37 (1995) (same result under the ADEA); Johnson v. United States, 76 F. App'x 873, 877 (10th Cir. 2003) (same result under the ADA).

63. *Schleier*, 515 U.S. at 336–37.

64. 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)) (2012); *see also* Rev. Rul. 96-65, 1996-2 C.B. 6.

65. *See* I.R.C. § 104(a)(2).

66. Polsky & Befort, *supra* note 37, at 76–77 (discussing the root of the "bunching" problem).

67. I.R.C. § 441; *see also* United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 219 (2001) (applying income taxes to back-pay for the year the settlement was paid, not the years the wages should have been paid); Rev. Rul. 78-336, 1978-2 C.B. 255 (ruling that dismissed federal employees must report income for back-pay in the year paid); 26 C.F.R. § 1.446-1(c)(1)(i) (2016).

68. Hulley, *supra* note 29, at 184 (citing Richard Schmalbeck, *Income Averaging After Twenty Years: A Failed Experiment in Horizontal Equity*, 1984 DUKE L.J. 509, 509–10) (differentiating a progressive income tax from a flat tax (e.g., Social Security tax) and a regressive tax (e.g., Medicare tax)).

adverse tax consequences of a one-time cash receipt.[69] For example, I.R.C. section 121(a) states that "[g]ross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more."[70] Similarly, I.R.C. section 1(h) provides for preferential tax rates for the sale of capital assets.[71] However, these provisions to do not apply to monetary awards of lost or future wages arising from wrongful discrimination.

The leading case highlighting the propriety of gross-ups to protect against adverse taxes in employment discrimination cases, *Sears v. Atchison, Topeka & Santa Fe Railway*, occurred in 1984—when income averaging was still permitted.[72] Sears had prevailed in a class-action discrimination claim under the Civil Rights Act of 1964 against his employer, arguing that a segregated job structure existed between predominantly white brakemen and African American porters, in violation of Title VII.[73] The defendants appealed the district court's tax gross-up.[74] The Tenth Circuit noted that the award covered seventeen years of back-pay and that the award would "likely place the living members of the class in the highest income tax bracket."[75] Next, the court explained that, even though the living class members could average their income, they could only consider the three years preceding the computation year.[76] Moreover, nearly 40% of the class members had died and were, therefore, ineligible for income averaging.[77] Thus, the court held that the district court did not abuse its discretion when it included a tax component in the back-pay award to compensate class members for their additional tax liability as a result of receiving over seventeen years of back-pay in one lump-sum.[78]

Similarly, in *Eshelman v. Agere Systems, Inc.*, Eshelman, a cancer survivor, prevailed in her wrongful termination suit

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69. *See* I.R.C. § 121(a) ("Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more."); IRC § 1(h) (providing preferential tax rates for capital assets).

70. I.R.C. § 121(a).

71. I.R.C. § 1(h).

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

73. *Id.* at 1453.

74. *Id.*

75. *Id.* at 1456.

76. *Id.*

77. *Id.*

78. *Id.*

brought under the ADA,[79] and was awarded $170,000 in back-pay and $30,000 in compensatory damages.[80] Eshelman then filed a motion for an additional monetary award to offset the negative tax consequences of receiving the back-pay award in a single lump-sum,[81] supporting the motion with an affidavit from an economic expert who calculated the amount of tax-effect damages based upon the back-pay award, the applicable tax rates, and Eshelman's income tax returns for the appropriate years.[82] The trial judge granted the motion, increasing Eshelman's award by $6,893 to compensate her for the negative tax consequences of receiving a lump-sum back-pay award.[83] After finding that the trial judge had the authority to grant the increased award, the Third Circuit held that the court did not abuse its discretion, in part because the defendant did not rebut the expert's affidavit and did not dispute the accuracy of the figure awarded.[84]

Legal ethics can also play a role in adverse tax consequences. ABA Model Rule 1.4(b) requires that lawyers explain matters to the extent reasonably necessary to permit clients to make informed decisions regarding the representation.[85] Explaining the potential adverse tax consequences of a lump-settlement or judgment appears to stem from this rule. For example, in *Jalali v. Root*, a California state appellate decision, a plaintiff alleged malpractice by her attorney after he told her that her $2.75 million settlement for a discrimination claim would be taxed at "forty percent of [her] share."[86] In fact, because of the AMT, the attorney's advice was incorrect, and the plaintiff ended up owing $310,000 more in taxes than estimated by her attorney. She sued to recover this amount, based on her attorney's erroneous tax advice, and a jury awarded the plaintiff $310,000. On appeal, the court held for the attorney because "the plaintiff had failed to provide evidence that the erroneous advice had caused the plaintiff any damages." According to the appellate court, in order to prevail, the plaintiff was required to prove that, but for the erroneous advice, the plaintiff would have turned down the $2.75 million offer and ultimately received a larger recovery."[87]

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79. Eshelman v. Agere Sys., Inc., 554 F.3d 426, 430–31 (3d Cir. 2009).

80. *Id.* at 432.

81. *Id.*

82. *Id.* at 442.

83. *Id.* at 442–43.

84. *Id.*

85. MODEL RULES OF PROF'L CONDUCT r. 1.4(b) (AM. BAR ASS'N 2014) (but a Rule violation is not per se malpractice).

86. Gregg D. Polsky, *The Contingent Attorney Fee Trap: Ethical, Fiduciary Duty, and Malpractice Implications,* 23 VA. TAX REV. 615, 620–21, 626 (2004) (discussing Jalali v. Root, 1 Cal. Rptr. 3d 689, 692 (Cal. Ct. App. 4th 2003)).

87. *Id.* at 621.

In the 1960s through the late 1980s, the tax code contained an income-averaging provision that alleviated this problem to some extent because taxpayers receiving unusually high incomes in one year could apply a lower marginal rate to that income.[88] However, the income-averaging provision was repealed by the Tax Reform Act of 1986, which also flattened the tax rate structure to eliminate the necessity of the averaging provision.[89] Although the tax code has become more progressive since 1986, Congress has not sought to revisit income averaging.[90] Thus, victims of discrimination are now at the mercy of the courts as to whether the victim or the wrongdoer will be responsible for the additional tax liability caused by a large lump-sum award.

IV. STATUTORY AND JUDICIAL AUTHORITY SUPPORTING THE CONCEPT OF TAX GROSS-UPS

To ameliorate the adverse tax consequences of a lump-sum award, many courts gross-up the plaintiff's award,[91] relying on the "make whole" remedial purpose of anti-discrimination statutes.[92] However, the gross-up concept is not universally accepted, and some courts continue to force plaintiffs to bear the additional tax burden even though it was caused by the defendant's discriminatory conduct.[93] This Part will first discuss the current split in the federal courts of appeals, and then show that courts already have the power to use gross-ups to neutralize the adverse tax consequences of a lump-sum award and argue that Congress should expand or clarify that power.

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88. Revenue Act of 1964, Pub. L. No. 88-272, § 232, 78 Stat. 19, 105-12; I.R.C. § 1302(c)(2) (1982) (repealed by Tax Reform Act of 1986, Pub. L. No. 99-514, § 141, 100 Stat. 2085, 2117); *see also* Richard Schmalbeck, *Income Averaging After Twenty Years: A Failed Experiment in Horizontal Equity*, 1984 DUKE L.J. 509, 512–23.

89. Tax Reform Act of 1986, Pub. L. No. 99-514, § 141, 100 Stat. 2085, 2117.

90. Polsky & Befort, *supra* note 37, at 78.

91. *See, e.g.*, Eshelman v. Agere Sys., Inc., 554 F.3d 426, 442–43 (3d Cir. 2009) (departing from no gross-up precedent and granting a plaintiff over $6,000 to neutralize "adverse" federal tax consequences).

92. *See, e.g.*, *id.* (the court's decision was driven by the "make whole" remedial purpose of anti-discrimination statutes; without this equitable relief in appropriate cases, it would not be possible to restore the employee to the economic status quo that would exist but for the employer's conduct).

93. *See, e.g.*, Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curiam) (denying a gross-up because of "the complete lack of support in existing case law for" such relief); *see also* Fogg v. Gonzalez, 492 F.3d 447 (D.C. Cir. 2007) (refusing to overturn *Dashnaw*).

A. *Split Among the Federal Courts of Appeals*

As discussed earlier, *Sears v. Atchison*[94] is the leading case in support of gross-ups.[95] In that case, the Tenth Circuit affirmed the trial court's gross-up award, holding that courts have wide discretion to fashion remedies to make discrimination victims whole.[96] Interestingly, this case occurred while income-averaging was still allowed, but the court found that the income-averaging provision provided insufficient relief for the plaintiffs due to the sheer size of their recoveries.[97]

However, in 1994, the D.C. Circuit firmly announced in *Dashnaw v. Pena* that it had no authority to gross-up the plaintiff's ADEA back-pay award to compensate for the adverse effect of the lump-sum award.[98] Specifically, the court stated:

> Absent an arrangement by voluntary settlement of the parties, the general rule that victims of discrimination should be made whole does not support "gross-ups" of back-pay to cover tax liability. We know of no authority for such relief, and appellee points to none. Given the complete lack of support in existing case law for tax gross-ups, we decline to extend the law in this case.[99]

Dashnaw was not simply a one-off case; over a decade later, in *Fogg v. Gonzales*, the D.C. Circuit overturned the district court's 14% Title VII tax gross-up award, citing *Dashnaw*.[100] Currently, like the D.C. Circuit,[101] the Sixth[102] and Seventh[103] Circuits refuse to recognize tax gross-ups as an available remedy for the adverse impacts of a lump-sum award in employment discrimination

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

95. *See supra* notes 72–78 and accompanying text.

96. *Sears*, 749 F.2d at 1456.

97. *Id.* at 1456 (citing I.R.C. § 1302(c)(2) (1982) (repealed 1986)).

98. Dashnaw v. Pena, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (per curium).

99. *Id.*

100. *See* Fogg v. Gonzales, 492 F.3d 447, 455–56 (D.C. Cir. 2007). *But see* Barbour v. Medlantic Mgmt. Corp., 952 F. Supp. 857, 865 (D.D.C. 1997) (refusing to award a tax gross up but recognizing that "an income tax adjustment due to a lump-sum payment is warranted only where the Court has sufficient evidence to calculate an appropriate adjustment."), *aff'd sub nom.* Barbour v. Merrill, No. 97-7044, 1997 WL 702331 (D.C. Cir. Oct. 9, 1997).

101. *Dashnaw*, 12 F.3d 1112.

102. *See* Pollard v. E.I. DuPont de Nemours, Inc., 338 F. Supp. 2d 865, 883 (W.D. Tenn. 2003) (indicating that the court was somewhat receptive to gross-ups by refusing to compensate the plaintiff for the adverse tax consequences of a lump-sum front-pay award because the expert's calculation was merely an estimate that was inadequate to avoid adverse tax consequences but also stating that such an award would contradict the literature and case law on the subject), *aff'd*, 412 F.3d 657 (6th Cir. 2005).

103. Best v. Shell Oil Co., 4 F. Supp. 2d 770, 776 (N.D. Ill. 1998) (denying request for gross-up award on remand from Seventh Circuit because of lack of authority to grant such request).

cases.[104] Citing *Dashnaw*, in *Pollard v. E.I. DuPont de Nemours, Inc.*, a district court in the Sixth Circuit refused to recognize tax gross-ups as an available remedy and held that "such an award would contradict the literature and case law on the subject."[105] Similarly, the Northern District of Illinois, a Seventh Circuit court, refused the remedy in *Best v. Shell Oil Co.*, citing a lack of authority to grant the plaintiff's gross-up request.[106]

By contrast, the First,[107] Third,[108] and Tenth[109] Circuits have explicitly recognized their power to grant a gross-up award. For example, in *Eshelman v. Agere Sys., Inc.*, the Third Circuit granted a plaintiff over $6,800 to neutralize "adverse" federal tax consequences in a discrimination suit brought under the ADA based on its equitable power.[110] After the entry of judgment, the plaintiff filed a post-trial motion, requesting that the court enhance her recovery for the adverse tax consequences she would incur, submitting an affidavit from a financial expert who calculated the tax "penalty" based on the amount of back-pay, applicable tax rates, and her income tax liabilities for the affected years.[111] The Court based its decision on the "make whole" remedial purpose of anti-discrimination statutes, and explained that "without this equitable relief in appropriate cases, it would not be possible 'to restore the employee to the economic status quo that would exist but for the employer's conduct.'"[112] The court also compared grossing up to the well-accepted practice of including pre-judgment interest in a back-pay award.[113] Likewise, in *Broderick v. Evans*, the First Circuit affirmed the district court's $563,626 gross-up award to cover taxes on back-pay and front-pay

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104. Lane v. Grant Cty., No. CV-11-309-RHW, 2013 WL 5306986, at *10 (E.D. Wash. Sept. 20, 2013) (citing Thomas R. Ireland, *Tax Consequences of Lump Sum Awards in Wrongful Termination Cases*, J. LEGAL ECON., Oct. 17, 2010, 51, at 53 (noting that the Third and Tenth Circuits have held that gross-ups should be made, while the D.C. Circuit has stated in very definite terms that gross-ups should not be made).

105. Pollard, 338 F. Supp. 2d at 883.

106. *Best*, 4 F. Supp. 2d at 776.

107. *See, e.g.*, Broderick v. Evans, 570 F.3d 68, 72 (1st Cir. 2009) (affirming the court compensation of $563,626 to cover taxes on the plaintiff's award without giving it too much thought).

108. *See, e.g.*, Eshelman v. Agere Sys., Inc., 554 F.3d 426, 442–43 (3d Cir. 2009) (departing from no gross-up precedent and granting award to neutralize "adverse" federal tax consequences by relying on the "make whole" remedial purpose of anti-discrimination statutes). However, the District of New Jersey has held that *Eshelman* is inapplicable where the parties entered into a voluntary settlement agreement. Josifovich v. Secure Computing Corp., No. CIV. 07-5469FLW, 2009 WL 2390611, at *6 (D.N.J. July 31, 2009).

109. *See, e.g.*, Sears v. Atchison, Topeka & Santa Fe Ry. Co., 749 F.2d 1451, 1456 (10th Cir. 1984) (citing I.R.C. § 1302(c)(2) (1982) (repealed 1986)).

110. *Eshelman*, 554 F.3d 426 at 440–43.

111. *Id.* at 432–33, 442.

112. *Id.* at 442 (quoting *In re* Continental Airlines, 125 F.3d 120, 135 (3d Cir. 1997)).

113. *Id.*

recovered in a claim brought under 42 U.S.C. § 1983.[114] However, courts are not granting the relief outside of reimbursement for lump-sum front-pay and back-pay awards, such as other compensatory damages.[115] However, district courts in the Third Circuit have also held that *Eshelman* is inapplicable where the parties entered into a voluntary settlement agreement, holding, that "[a] settlement agreement is a contract and, consequently, a court will not rewrite that contract simply to provide one party with a better bargain than the one she negotiated."[116]

Notably, some states, such as New Jersey, Washington, and Ohio, have also held that their state discrimination statutes allow for a gross-up to offset the tax consequences of receiving a lump-sum damage award.[117] For example, in *Ferrante v. Sciaretta*, a New Jersey Superior Court ordered that the defendant compensate the plaintiff for the adverse tax consequences of receiving a damages payment in a lump-sum.[118] Likewise, in *Blaney v. International Association of Machinists & Aerospace Workers*, the Washington Supreme Court awarded a tax gross-up in a discrimination suit brought under Washington's state anti-discrimination statute.[119] Finally, in *Warden v. Ohio Department. of Natural Resources*, an Ohio trial court awarded a tax gross-up, explaining that it, like an award for pre-judgment interest, "may be necessary to achieve complete restoration of the prevailing employee's economic status quo."[120]

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114. Broderick v. Evans, 570 F.3d 68, 72 (1st Cir. 2009).

115. *See, e.g.*, O'Neill v. Sears, Roebuck and Co., 108 F. Supp. 2d 443 (E.D. Pa. 2000) (enhancing damages to offset tax consequences of lump-sum payment of front-and back-pay, but not for compensatory damages).

116. Josifovich v. Secure Computing Corp., CIV. No. 07-5469FLW, 2009 WL 2390611, at *6 (D.N.J. July 31, 2009).

117. *See, e.g.*, Blaney v. Int'l Ass'n of Machinists & Aerospace Workers, 87 P.3d 757 (Wash. 2004) (awarding gross-up in discrimination suit brought under Washington Law Against Discrimination, West's RCWA § 49.60.030(2)); Ferrante v. Sciaretta, 839 A.2d 993 (N.J. Super. 2003) (requiring that the defendant to compensate the plaintiff for the adverse tax consequences of receiving a damages payment in a lump-sum); Warden v. Ohio Dept. of Nat. Res., No. 2011-01232, 2013 WL 417664 (Ohio Ct. Cl. Jan. 15, 2013), *aff'd in part rev'd in part*, 7 N.E.3d 533 (Ohio Ct. App. 2014) (explaining that a tax gross-up, like an award for pre-judgment interest, "may be necessary to achieve complete restoration of the prevailing employee's economic status quo").

118. *Ferrante*, 839 A.2d 993.

119. *Blaney*, 87 P.3d 757 (discussing West's RCWA § 49.60.030(2)).

120. *Warden*, 2013 WL 417664.

Although the Second,[121] Fourth,[122] Fifth,[123] Eighth,[124] Ninth,[125] and Eleventh[126] Circuits have not granted the gross-up remedy, they have implicitly recognized the availability of such relief. Typically, the issue comes down to an evidentiary matter—whether the court possesses sufficient evidence to be able to grant relief to the adverse effect of a lump-sum award.[127] For example, in *Hukkanen v. International Union of Operating Engineers, Hoisting & Portable Local No. 101*, the Eighth Circuit ignored the plaintiff's adverse tax consequences associated with receiving multiple years of pay and retirement benefits in a single year because "she failed to present evidence of the amount or a convenient way for the [lower] court to calculate the amount."[128]

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121. *See, e.g.*, Pappas v. Watson Wyatt & Co., No. 3:04CV304EBB, 2008 WL 45385, at *12–13 (D. Conn. Jan. 2, 2008) (refusing to recognize Plaintiff's claim because it was not for an adjustment for a lump-sum payment of back-pay or front-pay caused by a higher marginal tax rate, but rather a gross-up award for COBRA contributions not deductible from her gross income, and also because the plaintiff failed to meet her burden of proving that her award should be increased to reflect adverse tax consequences).

122. *See, e.g.*, Bryant v. Aiken Reg'l Med. Ctrs. Inc., 333 F.3d 536, 549 n.5 (4th Cir. 2003) (noting that a trial court has "broad equitable discretion to fashion remedies to make the plaintiff whole for injuries resulting from a violation" of Title VII, and that a trial court's decision to grant or deny a request in equity for an adjustment for the adverse consequences of a lump-sum award is reviewed only for an abuse of discretion).

123. *See, e.g.*, Huang v. Admin. Review Bd. U.S. Dep't of Labor, CIV. No. 12-0035, 2013 WL 4042008, at *7 (S.D. Tex. Aug. 8, 2013), *aff'd sub nom.* Huang v. Admin. Review Bd., U.S. Dep't of Labor, 579 F. App'x 228, 235 (5th Cir. 2014) (implicitly recognizing the availability of tax gross-ups, but holding that the plaintiff failed to allege that competent evidence of the amount and refusing to grant the award based on speculation); Powell v. N. Ark. Coll., CIV. No. 08-3042, 2009 WL 1904156, at *2–3 (W.D. Ark. July 1, 2009) (extending right to equitable gross-up for increased taxes plaintiff may have to pay on back-pay award under Family Medical Leave Act (FMLA) because like Title VII, the enactment of the FMLA was intended to "protect the right to be free from gender-based discrimination in the workplace") (internal quotations omitted)).

124. Hukkanen v. Int'l Union of Operating Eng'rs, Hoisting & Portable Local No. 101, 3 F.3d 281, 287 (8th Cir. 1993) (implicitly adopted, but did not award the plaintiff's requested tax gross-up because "she failed to present evidence of the amount or a convenient way for the [lower] court to calculate the amount."). *But see* Arneson v. Callahan, 128 F.3d 1243, 1245–47 (8th Cir. 1997) (holding that the plaintiff cannot get a gross up when suing the Social Security Administration or other government defendants).

125. Lane v. Grant Cnty., No. CV-11-309-RHW, 2013 WL 5306986, at *10–11 (E.D. Wash. Sept. 20, 2013) (declining "to exercise its discretion to increase Plaintiff's damages award to account for tax consequences" because "[w]ithout any methodology, the Court cannot determine what the tax consequences would be for the reduced back pay award").

126. *See, e.g.*, Garner v. G.D. Searle Pharm. & Co., No. 290CV688-MHT, 2013 WL 568871, at *15 (M.D. Ala. Feb. 14, 2013) ("In the absence of an evidentiary basis supporting a methodology for crafting an appropriate award, the court declines to award money damages to offset whatever increased tax liability the plaintiffs will experience by receiving a lump-sum award."); EEOC v. Joe's Stone Crab, Inc., 15 F. Supp. 2d 1364, 1380 (S.D. Fla. 1998) (refusing to grant plaintiff's requested tax gross-up because there was not sufficient evidence to permit the court to make the calculations).

127. *Lane*, 2013 WL 5306986, at *10–11.

128. *Hukkanen*, 3 F.3d at 287 (holding that a plaintiff must introduce some statistical or financial evidence in the record to have a chance at a gross-up); *see also* Shovlin v.

As that court explained, a necessary component of receiving an adverse tax gross-up is to present calculations showing an estimate of what the proper gross-up should be—a plaintiff must introduce some statistical or financial evidence in the record to have a chance for a gross-up.[129] This aligns with Third Circuit precedent. For example, in *Shovlin v. Timemed Labeling Systems, Inc.*, the Eastern District of Pennsylvania denied the plaintiff's request for a tax gross-up because the plaintiff did not produce an expert tax witness.[130] A district court in the Ninth Circuit followed this logic in *Lane v. Grant County*, where the Eastern District of Washington declined "to exercise its discretion to increase Plaintiff's damages award to account for tax consequences" because "[w]ithout any methodology, the Court cannot determine what the tax consequences would be for the . . . back-pay award."[131]

District courts in the Eleventh Circuit also require that plaintiffs satisfy an evidentiary threshold before granting a tax gross-up request. For example, in *Garner v. G.D. Searle Pharmaceuticals & Co.*, an Alabama district court denied the plaintiff's tax gross-up request, holding that, "[i]n the absence of an evidentiary basis supporting a methodology for crafting an appropriate award, the court declines to award money damages to offset whatever increased tax liability the plaintiffs will experience by receiving a lump-sum award."[132] Likewise, in *EEOC v. Joe's Stone Crab, Inc.*, the Southern District of Florida refused to grant the plaintiff's requested tax gross-up because there was not sufficient evidence to permit the court to make the calculations.[133]

In *Huang v. Administrative Review Board U.S. Department of Labor*, the Southern District of Texas also implicitly recognized the availability of tax gross-ups, but held that the plaintiff had failed to provide competent evidence of the amount and refused to grant the award based on speculation.[134] The Fifth Circuit Court of Appeals affirmed the decision.[135] Even more, in *Powell v. North Arkansas College*, the Western District of Arkansas extended the right to equitable gross-ups for increased taxes a plaintiff may have to pay on a back-pay award under Family Medical Leave Act

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Timemed Labeling Sys., Inc., No. 95-CV-4808, 1997 WL 102523, at *7 (E.D. Pa. Feb. 28, 1997) (denying a gross up because the plaintiff did not produce an expert witness).

129. *Hukkanen*, 3 F.3d at 287.

130. *Shovlin*, 1997 WL 102523, at *7.

131. *Lane*, 2013 WL 5306986, at *10–11.

132. *Garner*, 2013 WL 568871, at *15.

133. EEOC v. Joe's Stone Crab, Inc., 15 F. Supp. 2d 1364, 1380 (S.D. Fla. 1998).

134. *See* Huang v. Admin. Review Bd. U.S. Dep't of Labor, No. CIV.A. 12-0035, 2013 WL 4042008, at *7 (S.D. Tex. Aug. 8, 2013), *aff'd sub nom.* Dongsheng Huang v. Admin. Review Bd., U.S. Dep't of Labor, 579 F. App'x 228 (5th Cir. 2014).

135. Dongsheng Huang v. Admin. Review Bd., U.S. Dep't of Labor, 579 F. App'x 228, 235 (5th Cir. 2014).

because, like Title VII, the enactment of the FMLA was intended to "protect the right to be free from gender-based discrimination in the workplace."[136]

Similarly, although courts in the Second Circuit have not granted a tax gross-up to date, district courts in that circuit have implicitly recognized that such a tax-adjusted award might be available when requested as an adjustment for a lump-sum payment of back- or front-pay caused by a higher marginal tax rate. Specifically, in *Pappas v. Watson Wyatt & Co.*, the District of Connecticut rejected the plaintiff's gross-up request because the requested adjustment did not relate to the negative consequence of a lump-sum award, but instead was a gross-up request for COBRA contributions not deductible from her gross income.[137] By contrast, in *Bryant v. Aiken Regional Medical Centers, Inc.*, the Fourth Circuit Court of Appeals affirmed the district court's discretionary refusal to grant a tax gross-up request, noting that trial courts have "broad equitable discretion to fashion remedies to make the plaintiff whole for injuries resulting from a violation" of Title VII and that a trial court's decision to grant or deny a request in equity for an adjustment for the adverse consequences of a lump-sum award is reviewed only for an abuse of discretion.[138]

Additionally, some states such as California and Texas have not explicitly recognized that adjustments for lumped back- and front-pay awards are available; however, their case law implies that such relief is available in equity if requested and supported by sufficient evidence.[139] For example, in *San Antonio Water Systems v. Nicholas*, the Fourth Court of Appeals of Texas in San Antonio interpreted the Texas Human Rights Act as authorizing back- and front-pay as forms of equitable relief necessary to satisfy the *essential make-whole purpose* of the Texas statute.[140] Given that courts like the Fourth Court of Appeals of Texas rely on the

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136. Powell v. N. Ark. College, No. CIV. 08-3042, 2009 WL 1904156, at *2–3 (W.D. Ark. July 1, 2009) (citing Nev. Dep't of Human Res. v. Hibbs, 538 U.S. 721, 728 (2003)).

137. Pappas v. Watson Wyatt & Co., No. 3:04CV304EBB, 2008 WL 45385, at *12–13 (D. Conn. Jan. 2, 2008).

138. Bryant v. Aiken Reg'l Med. Ctrs., Inc., 333 F.3d 536, 549 (4th Cir. 2003) (citing Brinkley-Obu v. Hughes Training, Inc., 36 F.3d 336, 356 (4th Cir. 1994) (internal quotations omitted)).

139. *See, e.g.*, McCoy v. Pac. Mar. Ass'n, 156 Cal. Rptr. 3d 851, 873 (Cal. Ct. App. 2013) ("[T]he underlying statutory objective of FEHA . . . is to make the victim of discrimination whole." (internal quotations omitted)); Cloud v. Casey, 90 Cal. Rptr. 2d 757, 763 (Cal. Ct. App. 1999) ("[E]ffective remedies under FEHA should be fashioned so as to make the individual whole."); San Antonio Water Sys. v. Nicholas, 441 S.W.3d 382, 404 (Tex. App.—San Antonio 2013), *rev'd on other grounds,* 461 S.W.3d 131 (Tex. 2015).

140. *Nicholas*, 441 S.W.3d at 404; *see also* TEX. LAB. CODE § 21.258 (non-exclusive forms of equitable relief). Note that the Texas Human Rights Act also allows for an equitable award of prejudgment interest. *See, e.g.*, City of Austin v. Gifford, 824 S.W.2d 735, 743 (Tex. App.—Austin 1992).

"make whole" purpose of anti-discrimination statutes to allow for equitable front-pay awards, there is a strong argument that these jurisdictions would also permit an adjustment for a lump-sum back- or front-pay award to offset the adverse tax consequences of that award.

B. *Judicial Power to Gross-Up for Adverse Taxes and Why Congress Should Expand that Power*

An established tenant of the American legal system is that injured plaintiffs should be made whole for the injury suffered.[141] In other words, our legal system seeks to restore injured parties to the same position they would have been had the wrongful conduct not occurred.[142] As the Third Circuit recognized in *Gurmankin v. Costanzo*, adopting the "make whole" standard is necessary "to restore the victim as fully as possible to the economic position in which s/he would have been in the absence of the employment discrimination."[143] However, in contrast to areas such as pre-judgment interest, present value discounting, and attorney's fees,[144] many courts still refuse to recognize the make whole doctrine in the context of the adverse tax consequences in employment discrimination cases.[145] Pre-judgment interest is different because it "accrues for the period before entry of judgment," while post-judgment interest "accrues on the amount of a damage award, including prejudgment interest, from the date judgment was entered to the date of payment."[146] But Congress intended and explicitly mandated that federal employment discrimination statutes make injured plaintiffs whole.[147] In fact,

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141. Hurley v. Racetrac Petrol., 146 F. App'x 365, 368 (11th Cir. 2005).

142. *See, e.g.*, Colwell v. Rite Aid Corp., 602 F.3d 495 (M.D. Pa. 2010); Gurmankin v. Costanzo, 626 F.2d 1115, 1121 (3d Cir. 1980) ("The necessity of adopting a standard of relief which would restore the victim as fully as possible to the economic position in which s/he would have been in the absence of the employment discrimination has been recognized by this court which has, in numerous cases, adopted the 'make whole' standard.").

143. *Gurmankin*, 626 F.2d at 1121.

144. 42 U.S.C. § 1988 (2006); *see, e.g.*, Reed v. Mineta, 438 F.3d 1063, 1067 (10th Cir. 2006) ("Prejudgment interest, as the term suggests, accrues for the period before entry of judgment. Interest after entry of judgment is addressed through post judgment interest, which accrues on the amount of a damage award, including prejudgment interest, from the date judgment was entered to the date of payment."); Hensley v. Eckerhart, 461 U.S. 424, 429–33 (1983); Sinyard v. Comm'r of Internal Revenue, 268 F.3d 756, 759 (9th Cir. 2001)); *see also* Addie v. Kjaer, No. 2004-135, 2009 WL 1140006, at *3 (D.V.I. Apr. 28, 2009) ("As a general rule, prejudgment interest is to be awarded when . . . the relief granted would otherwise fall short of making the claimant whole because he or she has been denied the use of the money which was legally due.").

145. *See, e.g.*, Fogg v. Gonzales, 492 F.3d 447 (D.C. Cir. 2007).

146. *Reed*, 438 F.3d at 1067.

147. *See, e.g.*, 29 U.S.C. §§ 160(c), 216(b), 1132(a)(3)(B) (2006); 42 U.S.C. § 2000e-5(g)(1).

the Supreme Court has stated that the very purpose of the full equitable powers that Congress granted to courts hearing employment discrimination is "to make persons whole for injuries suffered on account of unlawful employment discrimination."[148] Moreover, like post-judgment interest awards, a post-judgment gross-up for adverse tax consequences does not implicate the Seventh Amendment's prohibition on additur.[149] This Section will briefly discuss various employment discrimination statutes and case law supporting that Congress armed the courts with the power to eliminate the adverse tax consequences of I.R.C. sections 61 and 104(a)(2).[150]

1. Title VII of the Civil Rights Act of 1964 (Title VII)

The main federal statute prohibiting job discrimination is Title VII of the Civil Rights Act of 1964, which prohibits employment discrimination on the basis of race, color, religion, sex or pregnancy, or national origin.[151] The original remedial provision of Title VII[152] authorized courts to enjoin discriminatory practices and "order such affirmative action as *may be appropriate*."[153] Congress significantly expanded this grant of authority in its 1972 amendments by adding the phrase "or *any other equitable relief as the court deems appropriate*."[154] The legislative history of the 1972 amendments shows that Congress intended that courts have the broadest equitable power to ensure that injured plaintiffs are made whole. Specifically, the language above was added by

148. Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975) ("It is also the purpose of Title VII to make persons whole for injuries suffered on account of unlawful employment discrimination. This is shown by the very fact that Congress took care to arm the courts with full equitable powers. For it is the historic purpose of equity to secur(e) complete justice." (internal quotations omitted)).

149. *See, e.g.*, Stentor Elec. Mfg. Co. v. Klaxon Co., 125 F.2d 820, 826 (3d Cir. 1942) (holding that augmenting a jury verdict to include an additional amount awarded as interest did not violate the additur prohibition when the award was authorized by statute, regardless of whether the jury was so instructed). However, gross-ups have also been denied on constitutional grounds. *See* Kelley v. City of Albuquerque, No. CIV 03-507 JB/ACT, 2006 WL 1304954, at *1, *6 (D.N.M. 2006) (mem. op.) (holding that gross ups are unconstitutional because additur violates the Seventh Amendment).

150. For a detailed analysis of precedential support for the expansion of tax gross-ups beyond the employment discrimination context, see Eirik Cheverud, Note, *Increased Tax Liability Awards After* Eshelman*: A Call for Expanded Acceptance Beyond the Realm of Anti-Discrimination Statutes*, 56 N.Y.L. SCH. L. REV. 711, 733–45 (2012) (discussing 42 U.S.C. §§ 1981, 1983; the Fair Labor Standards Act, 29 U.S.C. §§ 201–219d; the National Labor Relations Act, 29 U.S.C. § 151 et seq.; and the Employment Retirement Income Security Act, 29 U.S.C. §§ 1001–1461).

151. 42 U.S.C. § 2000e-2 et seq.

152. Civil Rights Act of 1964, Pub. L. No. 88-352, § 706, 78 Stat. 241, 241 (1964).

153. *Id.* (emphasis added).

154. Equal Employment Opportunity Act of 1972, Pub. L. No. 92-261, § 4, 86 Stat. 103, 107 (1972) (codified as amended at 42 U.S.C. § 2000e-5(g) (2000)) (emphasis added).

amendment on the Senate floor,[155] with a subsequent Conference Committee Report providing:

> The provisions of this subsection are intended to give the courts wide discretion exercising their equitable powers to fashion the most complete relief possible. In dealing with the present section 706(g) the courts have stressed that the scope of relief under *that section of the Act is intended to make the victims of unlawful discrimination whole*, and that the attainment of this objective rests not only upon the elimination of the particular unlawful employment practice complained of, but also requires that persons aggrieved by the consequences and effects of the unlawful employment practice be, so far as possible, *restored to a position where they would have been were it not for the unlawful discrimination*.[156]

The Supreme Court recognized this broad equitable power in *Albemarle Paper Co. v. Moody* when it held that one of the two primary objectives of Title VII is "to make persons whole for injuries" resulting from unlawful discrimination.[157] In that case, the Supreme Court observed that this objective is demonstrated by the fact that Congress empowered the courts with "full equitable powers" to provide restorative justice.[158] Years later, the Tenth Circuit embraced the concept of gross-ups to compensate for adverse tax consequences caused by lump-sum awards when it held that the trial court did not abuse its discretion "when it included a tax component in the back-pay award to compensate class members for their additional tax liability."[159] Specifically, the court stated, "[a] tax component may not be appropriate in a typical Title VII case. But this case presents special circumstances in view of the protracted nature of the litigation."[160]

2. Age Discrimination in Employment Act (ADEA)

The Age Discrimination in Employment Act (ADEA) prohibits age discrimination in employment.[161] The ADEA grants courts "such legal and equitable relief as may be appropriate to effectuate the purposes of the Act."[162] In *McKennon v. Nashville Banner Publishing Co.*, the Supreme Court stated that the ADEA and

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155. Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (1991).

156. 118 Cong. Rec. 7,168 (1972) (emphasis added).

157. Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975).

158. *Id.*

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

160. *Id.*

161. 29 U.S.C. § 623(a)(1) (2006).

162. *Id.* § 626(b).

Title VII share common objectives of deterrence and compensation[163] and went on to explain that the purpose of the compensatory goal is "to restore the employee to the position he or she would have been in absent the discrimination."[164] Moreover, in *O'Neill v. Sears, Roebuck and Co.*, an ADEA employment discrimination case, the Eastern District of Pennsylvania enhanced the back-pay and front-pay awards to compensate for the negative tax consequences of the lump-sum award.[165] The court stated that "[t]he goal of the ADEA is to allow plaintiff to keep the same amount of money as if he had not been unlawfully terminated. Compliance with this goal requires . . . reimbursement for the higher taxes [the plaintiff] must pay on his back-wages by getting this money in a lump-sum."[166]

3. Americans with Disabilities Act (ADA)

The Americans with Disabilities Act prohibits employment discrimination based on disability.[167] The ADA makes the remedies available under Title VII of the Civil Rights Act of 1964 for ADA violations.[168] Thus, under the ADA, courts have the same authority to grant "any other equitable relief" that it deems "appropriate" as allowed under Title VII.[169] Courts utilize this power to "make persons whole for injuries suffered on account of unlawful employment discrimination."[170]

4. The Seventh Amendment's Prohibition on Additur

Plaintiffs usually request a gross-up for adverse tax consequences through a Rule 59(e) post-judgment motion to alter or amend the judgment.[171] However, some legal commentators have argued that gross-up requests should be made part of the damages request rather than reserved for a post-trial motion to avoid risking a Seventh Amendment challenge.[172] But most courts deciding on tax gross-ups do not address the Seventh

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163. McKennon v. Nashville Banner Publ'g Co., 513 U.S. 352, 358 (1995).

164. *Id.* at 362.

165. O'Neill v. Sears, Roebuck and Co., 108 F. Supp. 2d 443, 446 (E.D. Pa. 2000).

166. *Id.* at 447.

167. 42 U.S.C. §§ 12101 *et seq.*

168. 42 U.S.C. § 12117 (making available the remedies in 42 U.S.C. § § 2000e-4 to -9 for violations of the ADA).

169. 42 U.S.C. § 2000e-5(g)(1).

170. Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975); *see also* Eshelman v. Agere Sys., Inc., 554 F.3d 426, 440 (3d Cir. 2009).

171. *See, e.g.*, EEOC v. Massey Yardley Chrysler Plymouth, Inc., 117 F.3d 1244, 1252 (11th Cir. 1997).

172. Don Zupanec, *Employment Discrimination—Lump-Sum Back Pay Award—Tax Consequences—Augmented Award*, 24 FED. LITIG. 16 (2009).

Amendment's prohibition against additur—a procedure by which a judge increases or "corrects" a jury's damage award rather than granting a new trial.[173] One reason for this might be that the Seventh Amendment is not violated when courts award pre-judgment interest.[174] Specifically, the Supreme Court made clear in *Osternick v. Ernst & Whinney* that additional judge-made awards for prejudgment interest are a permissible court-mandated alteration of a jury verdict, eliminating any room for a Seventh Amendment attack.[175] Likewise, courts do not violate the Seventh Amendment "where the jury has found the underlying liability and there is no genuine issue as to the correct amount of damages."[176] Thus, because pre-judgment interest and gross-up awards for adverse tax consequences are both collateral matters that are elements of complete compensation,[177] the majority rule and more sensible approach is that gross-up awards do not implicate the Seventh Amendment's prohibition on additur.[178]

5. Legislative Efforts

When Congress passed the American Jobs Creation Act of 2004, it failed to address the adverse tax consequences of lump-sum awards harming discrimination victims.[179] However, the Civil Rights Tax Relief Act of 2007 sought to allow victims of unlawful discrimination to average their front-pay and back-pay damage awards over the years used in their calculation, but it did not pass into law.[180] The bill was reintroduced in 2009 and 2011, but also

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173. U.S. CONST. amend. VII ("In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and *no fact tried by a jury, shall be otherwise reexamined* in any Court of the United States, then according to the rules of the common law." (emphasis added)); BLACK'S LAW DICTIONARY 41 (8th ed. 2004).

174. Osternick v. Ernst & Whinney, 489 U.S. 169, 175 (1989).

175. *Id.*

176. *Massey*, 117 F.3d at 1252.

177. West Virginia v. United States, 479 U.S. 305, 306 (1987).

178. *See, e.g.*, Stentor Elec. Mfg. Co. v. Klaxon Co., 125 F.2d 820, 826 (3d Cir. 1942) (holding that augmenting a jury verdict to include an additional amount awarded as interest did not violate the additur prohibition when the award was authorized by statute, regardless of whether the jury was so instructed). *But see* Kelley v. City of Albuquerque, No. CIV 03-507 JB/ACT, 2006 WL 1304954, at *1, *6 (D.N.M. 2006) (mem. op.) (holding that gross ups are unconstitutional because additur violates the Seventh Amendment).

179. *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)).

180. S. 1360, 111th Cong. (1st Sess. 2009); H.R. 3035, 111th Cong. (1st Sess. 2009). H.R. 3035 sought "to exclude from gross income amounts received on account of claims based on certain unlawful discrimination and to allow income averaging for back-pay and front-pay awards received on account of such claims, and for other purposes." Civil Rights Tax Relief Act of 2009, H.R. 3035, 111th Cong. (2009).

failed to become law.[181] In 2013, an analogous bill, titled the Civil Justice Tax Fairness Act of 2013, was introduced that would also allow for income averaging for back-pay and front-pay awards.[182] One benefit of the averaging approach is that it is easier to apply than gross-ups because no expert testimony or complex calculations are required.[183] However, this approach also shifts the increased tax burden to the taxpayers at large, instead of the defendant whose discrimination caused the adverse tax consequences in the first place.[184]

To summarize this Part, current tax law frustrates the remedial purposes of federal anti-discrimination statutes by taxing lumped-sum back-pay and front-pay awards in the year received, thus forcing victims into a higher marginal tax bracket and preventing them from being made whole. However, there is no doubt that courts have equitable authority under current law to adjust these awards to account for the adverse tax consequences of the lumped award. Nevertheless, the D.C., Sixth, and Seventh Circuits refuse to recognize this authority, even though Congress intended and explicitly mandated that federal employment discrimination statutes empower courts to make victims of discrimination whole. Although the Second, Fourth, Fifth, Eighth, Ninth, and Eleventh Circuits have not explicitly adopted the gross-up remedy, they have at least recognized the availability of such relief when sufficient evidence is offered to enable the court to calculate the adverse tax effect of lump-sum awards. Unless current congressional efforts to remedy the inequities of the current tax code come to fruition, the Supreme Court should step in to resolve the split among the circuits, and attorneys should continue to advise their clients of the implications of the tax code and argue for post-judgment relief to effectuate the "make whole" purpose of anti-discrimination statutes.

V. CONCLUSION

Congress provided victims of employment discrimination with a wide array of remedies, including pecuniary remedies such as back-pay and front-pay. Moreover, Congress armed the judiciary with broad equitable powers to ensure that victims of

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181. Civil Rights Tax Relief Act of 2011, H.R. 3195, 112th Cong. (2011); S. 1781, 112th Cong. (2011).

182. Civil Justice Tax Fairness Act of 2013, H.R. 2509, 113th Cong. (2013); S. 1224, 113th Cong. (2013).

183. Richard Barca, Note, *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*, 8 RUTGERS J. L. & PUB. POL'Y 673, 704 (2011).

184. *Id.* at 704–05.

employment discrimination are placed in the same economic position they would have occupied had no discrimination occurred. Courts, in their efforts to ensure that plaintiffs are "made whole" (but not overcompensated for their damages), provide relief through pre-judgment interest and require discounting to present value of future damages. Courts also make adjustments for attorney's fees. However, current tax law frustrates the remedial purposes of federal anti-discrimination statutes by taxing lump-sum back-pay and front-pay awards in the year received, thus moving victims into a higher marginal tax bracket and preventing them from being made whole. In order to avoid the problem with lumped back-pay and front-pay awards, many courts have begun grossing-up the plaintiff's award to neutralize these harsh and unjust consequences if sufficient evidence is offered to enable the court to calculate the adverse tax effect of lump-sum awards when there is a need to do so. Hopefully this need will be met, either judicially or legislatively, and prevailing plaintiffs will be made whole in the context of the adverse tax consequences in employment discrimination cases.