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TAXATION OF PERSONAL INJURY AWARDS: ADDRESSING THE MIND/BODY DUALISM THAT PLAGUES § 104(A)(2) OF THE TAX CODE

G. Christopher Wright

The National Taxpayer Advocate’s 2009 Annual Report to Congress stated that taxation of personal injury awards—specifically whether Internal Revenue Code (Tax Code) § 104(a)(2) excludes compensatory-damage awards in personal injury cases from gross income—is one of the most litigated issues in federal courts for a fifth consecutive year.1 Section 104(a)(2) excludes compensatory damages from personal injuries or sicknesses that are “physical” from gross income.2 Further, for purposes of the physical-injury or sickness exclusion, emotional distress is not considered “physical.”3 Because the statute, regulations, and courts do not define the terms “physical” and “emotional distress,”4 taxpayers are often confused about whether their personal injury damages stem from physical injuries or sicknesses and are thus excluded from gross income.5 This lack of clarity creates predictability problems for taxpayers; taxpayers should be able to self-assess their tax liabilities with certainty.6

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3. Id. § 104(a).
4. I.R.S. Priv. Ltr. Rul. 200041022 (July 17, 2000); see also 2009 ANNUAL REPORT, supra note 1, at 447 (“It is clear from... cases we reviewed that many questions remain as to how ‘physical’ is to be defined under IRC § 104(a)(2).”).
5. 2008 ANNUAL REPORT, supra note 1, at 474; see also NAT’L TAXPAYER ADVOCATE, 2007 ANNUAL REPORT TO CONGRESS 584 (2007) [hereinafter 2007 ANNUAL REPORT], available at http://www.irs.gov/advocate/article/0,,id=177301,00.html (“Although the legislative history is quite clear, the relationship between mind and body and the biological and neurological basis of mental problems, is not always as clear.”).
6. See, e.g., Lynch v. Comm’r, 801 F.2d 1176, 1179 (9th Cir. 1986) (criticizing the tax court’s interpretation of the law because it “undermines the ability of taxpayers to... know the tax consequences with certainty”).
Section 104(a)(2) is one of several sections in the Tax Code under the heading “Items specifically excluded from gross income.” Taxpayers determine federal income tax owed by multiplying a tax rate by taxable income. Taxpayers determine taxable income by first calculating gross income. Gross income is “all income from whatever source derived,” including damages received from lawsuits. However, if a taxpayer demonstrates that a damage award falls within the § 104(a)(2) exclusion, the award is excluded from gross income and escapes federal income taxation.

Until 1996, the text of § 104(a)(2) was largely unchanged from the time of its original enactment. Before 1996, the statute excluded damages received on account of personal injury or sickness from gross income; there was no requirement that the injury or sickness be physical. In the Small Business Job Protection Act of 1996, Congress amended the statute by inserting the word “physical” before injury and sickness and excluded emotional distress from the definition of physical injury or sickness.

8. Id. § 1.
9. Id. § 63(a).
10. Id. § 61(a).
11. Id. § 104(a)(2). Without this exclusion, for example, a taxpayer who receives a $100,000 personal injury award would have to include this amount in taxable income. Assuming a marginal tax rate of twenty-eight percent, the taxpayer’s award would effectively be reduced by $28,000.
15. § 1605(a)(2), 110 Stat. at 1838.
16. § 1605(b), 110 Stat. at 1838. Congress added the “physical” and “emotional distress” language in an attempt to clarify § 104(a)(2). See H.R. REP. NO. 104-586, at 143 (1996) (Conf. Rep.). Congress’s specific reason for changing § 104(a)(2) in 1996 was that the “confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation.” Id.; see also Venable v. Comm’r, 86 T.C.M. (CCH) 254, 259 (2003) (“Legislative history . . . reveals that the change was intended [to] . . . reduce or eliminate ambiguity . . . .”), aff’d, 110 F. App’x 421 (5th Cir. 2004). Despite its attempt to reduce litigation, confusion and litigation continued; taxpayers are just as confused today by the § 104(a)(2) exclusion as they were prior to the 1996 amendment. See 2008 ANNUAL REPORT, supra note 1, at 474–75 (“The increase in cases litigating the issue of damage awards could suggest that Murphy v. Commissioner, discussed in detail in the 2006 and 2007 Annual Reports to Congress, did not help to resolve the confusion surrounding the treatment of settlement and damage awards.”); see also Susan A. Berson, The Taxation of Tort Damage Awards and Settlements: When Recovering More for a Client May Result in Less, 78 J. KAN. B.A. 21, 22 (2009) (“Confusion often surrounds how the tax code treats compensation for emotional distress. This is because emotional distress is not technically considered a physical injury or physical sickness.”); Robert W. Wood, Bruises, Settlements, and the Proposed 104 Regs, 124
The case of Charles Allen, a train operator involved in an accident in Bloomfield Hills, Michigan further illustrates the issue. Allen was operating a train while a city-operated school bus attempted to maneuver through lowered gates at a railroad crossing. Unable to stop the train in time, Allen plowed into the school bus at sixty-five miles per hour. He did not suffer a single bruise, cut, or broken bone; however, a Positron Emission Topography (PET) scan revealed abnormalities in his brain that suggested that he suffered from post-traumatic stress disorder (PTSD).

Allen filed suit against the Bloomfield Hills School District, but the trial court dismissed the suit, concluding that he “did not suffer a ‘bodily injury’ as required by the statute. The court of appeals reversed and remanded, holding that “as a matter of medicine and law, there should be no difference medically or legally between an objectively demonstrated brain injury, whether the medical diagnosis is . . . PTSD, Alzheimer’s, brain tumor, epilepsy, etc. A brain injury is a ‘bodily injury.’”

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18. Id.
19. Id.
20. Id. Fortunately, there were no children on board, but the driver of the bus was critically injured. Id.
22. Allen, 760 N.W.2d at 815. Indeed, the doctors noted that the PET scan revealed “decreases in frontal and subcortical activity consistent with . . . post traumatic stress disorder and that the abnormalities in . . . Allen’s brain as depicted on the . . . PET scan are quite pronounced.” Id. (emphasis omitted) (internal quotation marks omitted).
23. Id. at 812 (internal citations omitted); see id. at 813 (“[T]he broad immunity afforded [to a governmental agency] by the statute is limited by several narrowly drawn exceptions . . . [and o]ne of these exceptions . . . [is] for bodily injury . . . .”) (citation omitted).
24. Id. at 817. The court of appeals noted that the statute did not define the term “bodily injury.” Id. at 814. For guidance, the court looked at the definition of “bodily injury” in Random House Webster’s College Dictionary and Black’s Law Dictionary. Id. at 815. The court noted that Webster’s “defines ‘bodily’ as ‘of or pertaining to the body . . . as contrasted with spiritual or mental.’ . . . Black’s Law Dictionary . . . also defines ‘bodily injury’ as ‘[p]hysical damage to a person’s body.’” Id. (quoting BLACK’S LAW DICTIONARY 789 (7th ed. 1999)); RANDOM HOUSE WEBSTER’S DICTIONARY (4th ed. 2001); cf. I.R.S. Priv. Ltr. Rul. 200041022 (July 17, 2000) (referring to Black’s Law Dictionary to define the term “personal physical injuries” because the term is not defined in § 104(a)(2)).
25. Allen, 760 N.W.2d at 816. The majority then rejected the dissent’s assertion that “because all thoughts and emotions are connected to brain activity, accepting plaintiff’s injury as a ‘bodily injury’ would require completely breaking down the barrier between emotional and physical harms.” Id. A state court’s definition of “bodily injury” is not controlling for purposes
Allen still must receive a damage award from the school district. But assuming he eventually receives an award, will his award be excluded from gross income under the § 104(a)(2) exclusion for personal physical injury and escape federal income taxation? To be excluded, Allen must show that PTSD is a physical injury or sickness, not simply a form of emotional distress.

This Comment provides courts with a definition of and a distinction between physical injury or sickness and emotional distress that comports with the language and intent of the statute in the continued absence of promulgated regulations interpreting § 104(a)(2). It will also help resolve the confusing question that taxpayers like Charles Allen face: whether a personal injury award is compensation for a physical injury or sickness or for emotional distress. It concludes by analyzing current interpretations of § 104(a)(2) to determine whether brain-based illnesses, such as major chronic depression and

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27. Some commentators have suggested that the award would be taxable. See, e.g., Margarita R. Karpov, Note, To Tax or Not to Tax—That Is the Question in the Midst of Murphy v. I.R.S., 23 AKRON TAX J. 143, 178 (2008) (concluding under a hypothetical that awards based on PTSD would be taxable). Under this view, PTSD and depression are not physical sicknesses; rather, PTSD and depression symptoms like “insomnia, headaches, [and] stomach disorders” are included in “emotional distress.” See H.R. REP. NO. 104-737, at 301 n.56 (1996) (Conf. Rep.).

On the other hand, Robert Wood suggests that the answer is not so obvious. See Robert W. Wood, What's Excludable? Despite Amendment, IRC Sec. 104 Leaves Some Questions Unanswered, 75 CAL. CPA 31, 31 (2006) (“Distinguishing between mere symptoms of emotional distress (no exclusion) and physical sickness (excludable) isn’t easy . . . .”).


29. Some scholars have called for legislative or administrative change. See William H. Volz & Vahe Tazian, The Tax Treatment of Sexual Harassment Awards: Clarifying the Threshold for Exclusion, 30 J. LEGIS. 275, 277 (2004) (proposing regulations that physical injury or sickness include medically diagnosed mental illnesses like PTSD, major depression, and panic disorder); see also Laura Spitz, I Think, Therefore I Am; I Feel, Therefore I Am Taxed: Descartes, Tort Reform, and the Civil Rights Tax Relief Act, 35 N.M. L. REV. 429, 447 (2005) (calling for a constitutional challenge of § 104(a)(2) under the equal protection clause); Mark J. Wolff, Sex, Race, and Age: Double Discrimination in Torts and Taxes, 78 WASH. U. L.Q. 1341, 1486 (2000) (suggesting a return to the pre-1996 version of § 104(a)(2) as well as a revenue offset in the form of denied deductions for payments made by the tortfeasor); Kurt A. Leeper, Note, Arguably Arbitrary: Taxation and the Physical Injury Requirement of I.R.C. Section 104(a)(2), 55 CASE W. RES. L. REV. 1039, 1068–71 (2005) (calling for a return to the post-1989 statute, which required that punitive damages involve only physical injury or sickness to be excluded from gross income, or a complete repeal of § 104(a)(2)). But see Young v. United States, 332 F.3d 893, 895–96 (6th Cir. 2003) (rejecting an equal-protection challenge to § 104(a)(2)). Even the National Taxpayer Advocate recommends legislation that would exclude from gross income settlements received for “mental anguish, emotional distress, and pain and suffering.” 2009 ANNUAL REPORT, supra note 1, at 323.
PTSD, are physical injuries or sicknesses or whether they are emotional distress.

Part I of this Comment discusses § 104(a)(2) prior to the 1996 amendment. It then analyzes the legislative record of the 1996 amendment and discusses how the Internal Revenue Service (IRS) and courts have interpreted the amendment. Next, this Comment surveys existing legal and medical literature, as well as Congress’s recent Mental Health Parity and Equity Addiction Act of 2008, to highlight legal, medical, and societal changes regarding the definition of physical injury or sickness. Part II analyzes several interpretations of § 104(a)(2)’s physical injury or sickness requirement. Finally, Part III proposes that courts adopt the definitions of “physical injury or sickness” and “emotional distress” provided by the Restatement (Third) of Torts, and asserts that brain-based injuries or sicknesses fit within the meaning of “physical” under § 104(a)(2), as well as its historical underpinnings.

I. THE EXCLUSION OF PHYSICAL INJURY DAMAGES UNDER I.R.C. § 104(A)(2) AND MODERN-DAY DISTINCTIONS BETWEEN PHYSICAL INJURY OR SICKNESS AND EMOTIONAL DISTRESS

A. Section 104(a)(2) Before 1996: Interpreting “Personal Injury” Broadly and More Favorably to Taxpayers

The Tax Code has included a form of § 104(a)(2) since 1918. The historic rationale for the exclusion is closely related to the tenet that a return of capital is not income: for example, if a taxpayer buys corporate stock for $100 and then sells that stock for $200, the first $100 received on the sale is not taxed because it is a return of the taxpayer’s original investment. Personal-injury damage awards are seen as making the human whole again, thus returning the “human capital” lost to the injury. Under this “return of human capital” doctrine, personal injury awards are similar to a return of financial capital, and therefore are not considered income.

Prior to 1996, § 104(a)(2) excluded damage awards received on account of personal injury or sickness from gross income. The statute read, in pertinent part: “gross income does not include . . . the amount of any damages received . . . on account of personal injuries or sickness.” Courts articulated broad
definitions of personal injury or sickness, encompassing a wide range of both physical and nonphysical injuries including, damages to reputation and character. Because the statute, regulations, and legislative history provided little guidance, § 104(a)(2) prompted significant litigation that ultimately led to three U.S. Supreme Court cases.

1. The Two-Prong Test Established in Burke and Schleier: Tort or Tort-Type Rights and on-Account-of Personal Injuries

The Supreme Court first analyzed § 104(a)(2) in United States v. Burke. Burke filed a discrimination suit under Title VII of the Civil Rights Act of 1964 against the Tennessee Valley Authority (TVA), his employer. The suit resulted in a settlement award from which the TVA withheld taxes. Burke later requested a refund of the withheld taxes, but the IRS denied his request. The Court held that the award was not excluded from gross income under § 104(a)(2) because Title VII, “whose sole remedial focus is award of back wages, [does not] redress[] a tort-like personal injury within the meaning of § 104(a)(2).” Burke thus requires that a taxpayer’s personal injury award be based in tort to be excluded from gross income under § 104(a)(2).

The Supreme Court emphasized the tort requirement in Commissioner v. Schleier. Schleier created a two-prong test to determine whether a damage

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37. See United States v. Burke, 504 U.S. 229, 235 n.6 (1992); Volz & Tazian, supra note 29, at 277 (pointing out that the exclusion was interpreted broadly).


39. Burke, 504 U.S. at 230; see Volz & Tazian, supra note 29, at 281 (discussing the Burke decision as the first of three Supreme Court decisions regarding § 104(a)(2)).


41. Id. at 231.

42. Id. at 232.

43. Id. at 241; cf. id. at 241 n.12 (declining to apply the remedial scheme of the Civil Rights Act of 1991, which allows for redress of tort-like personal injury awards). In its decision, the Court emphasized a long-held requirement under the § 104(a)(2) regulations that the personal injury be “linked” to “traditional tort principles.” Id. at 234; see also Johnson v. Comm'r, 97 T.C.M. (CCH) 1860, 1862 (2009) (noting that because a breach of contract is not a tort, the award is taxable).

award is excluded under § 104(a)(2). Schleier filed suit against United Airlines (United) for terminating him in violation of the Age Discrimination in Employment Act (ADEA). Schleier and United reached a settlement providing $145,629 in “backpay” and “liquidated damages.” He excluded the liquidated damages from his gross income but included the backpay.

The United States Tax Court held that the settlement should be excluded from Schleier’s gross income, and the Fifth Circuit affirmed. In reversing the Fifth Circuit, the Court focused its decision on the language of § 104(a)(2), that an award would be excluded “on account of personal injuries or sickness.” Because the taxpayer’s ADEA award was not “on account of personal injuries or sickness,” but rather was for backpay, the plain language of § 104(a)(2) precluded exclusion from gross income. The Court reiterated the two-prong test that taxpayers must satisfy before personal injury or sickness damages 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.’”

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45. Schleier, 515 U.S. at 337.
46. Id. at 325.
47. Id. at 326. Schleier did not report the settlement on his 1986 tax return and the IRS issued a notice of deficiency. Id. at 327.
48. Id. at 327.
49. Id.
50. Id.
51. Id. at 329.
52. Id. at 330 (“Whether one treats respondent’s attaining the age of 60 or his being laid off on account of his age as the proximate cause of respondent’s loss of income, neither the birthday nor the discharge can fairly be described as a ‘personal injury’ or ‘sickness.’”).
53. Id. at 336–37. The IRS issued proposed regulations on September 15, 2009, that would reverse the decision in Burke and eliminate the first prong: the requirement that the injury or sickness be based in “tort or tort type rights.” Prop. Treas. Reg. § 1.401-1, 74 Fed. Reg. 47,152 (Sept. 15, 2009). If codified, this would allow taxpayers to exclude physical injury or sickness damages “even though the injury giving rise to the damages is not defined as a tort under state or common law.” Id. at 47,153. The proposed regulation would have prevented the taxpayer in Burke from losing simply because the statute under which he filed suit did not provide for a remedy based in tort. Id.; cf. United States v. Burke, 504 U.S. 229, 241 (1992). Although the legislative history of the 1996 amendment supports this view, courts held steady to this requirement. Compare Johnson v. Comm’r, 97 T.C.M. (CCH) 1860, 1862 (2009) (holding that breach of contract is not a tort and does not satisfy the first prong of Schleier), and Phelps v. Comm’r, 95 T.C.M. (CCH) 1336, 1340–41 (2008) (noting that relief granted under the Fair Labor Standards Act is not for personal injury and therefore fails the first prong of Schleier), with Prop. Treas. Reg. § 1.401-1, 74 Fed. Reg. at 47,153 (concluding that “legislative and judicial developments [after Burke] eliminated the need to base the section 104(a)(2) exclusion on tort and remedies concepts”).

The proposed regulation, however, does not address the real problem: physical injury or sickness and emotional distress are still not defined. See Letter from John J. McCulloch, Vice
2. Interpreting the "on Account of Personal Injuries" Requirement: More than a "but for" Test

The third case to reach the Supreme Court on this issue was *O'Gilvie v. United States*. O'Gilvie received a jury award of actual and punitive damages from a tort suit he filed after his wife died from toxic shock syndrome. The Court had to determine whether the punitive damages received were "on account of personal injuries" as required by § 104(a)(2), and thus excluded from gross income. The taxpayer asserted that "but for" the tort, no punitive damages would have been awarded. The government countered that § 104(a)(2) requires a more direct link between the damages and the injury or sickness that formed the basis of the tort.

The Court adopted the government's more restrictive reading because, among other reasons, the government's interpretation was "more faithful to the history of the statutory provision . . . [and] basic tax-related purpose" of § 104(a)(2). The Court noted that the original enactment of § 104(a)(2) suggested that Congress excluded personal injury damages from the definition of income because they were paid, to make the person whole; therefore, they

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55. *O'Gilvie*, 519 U.S. at 81. *O'Gilvie* and his family received $1,525,000 in actual damages and $10,000,000 million in punitive damages from suit brought on behalf of his wife's estate. *Id.*

56. *Id.* (emphasis omitted) (internal quotation marks omitted). However, the 1996 amendment made punitive damages taxable. Small Business Job Protection Act of 1996, Pub. L. No. 104-88, § 1605, 110 Stat. 1755, 1838 (1996); see infra Part I.C.

57. *O'Gilvie*, 519 U.S. at 82.

58. *Id.* at 83. Moreover, the punitive damages were not paid "because of . . . the personal injuries," but rather to punish the tortfeasor. *Id.*

59. *Id.* The Court also held in favor of the government because its interpretation was more consistent with the holding in *Schleier* that damages are excluded under the statute "not simply because the taxpayer received a tort settlement, but rather because each element . . . satisfies the requirement . . . that the damages were received 'on account of personal injuries or sickness.'” *Id.* at 84 (quoting *Comm'r v. Schleier*, 515 U.S. 323, 330 (1995), superseded by statute, Small Business Job Protection Act of 1996, Pub. L. 104-188, 110 Stat. 1755) (omissions in original); see also *Fabry*, 223 F.3d at 1269–70 ("[I]n order to . . . qualify for the exclusion, it appears that a cause and effect relationship must be established between the tort, the personal injury resulting, and the amount received in settlement.").

60. *O'Gilvie*, 519 U.S. at 84–85.
were a "return [of] the victim's personal or financial capital." Consequently, a taxpayer had to do more than show he suffered a personal injury. He had to show that the damages paid were because of that injury.

3. Courts Look Beyond the Words of the Settlement Agreement to Discern the Payor's Intent Behind the Payment of Damage Awards

Section 104(a)(2) excludes damages received "by suit or agreement." When addressing damages included in settlement agreements, courts consider several factors to determine whether those damages satisfy Schleier's second prong and were paid "on account of personal injury." Courts must determine the payor's real reason for paying damages to the taxpayer apart from the words of the agreement. For example, if the damages were for backpay, then they were not paid "on account of personal injury" and cannot be excluded from gross income under § 104(a)(2).

In Greer v. United States, the IRS asserted that a settlement agreement between Greer and his former employer provided Greer with severance payments, not personal injury damages. The Sixth Circuit held that a number of factors should be considered to determine the nature of a settlement agreement. First, courts should question the character of the plaintiff's claim to determine whether the agreement was based on "tort or tort type rights." Second, courts should determine whether the plaintiff's claim actually "existed at the time of the settlement." Third, the claim must relate to an injury that is

61. *Id.* at 86 (internal quotation omitted); *see also* Spitz, *supra* note 29, at 439; Wolff, *supra* note 29, at 1359; Leeper, *supra* note 29, at 1044–45.
62. *O'Gilvie*, 519 U.S. at 85–86.
64. Schleier, 515 U.S. at 329.
66. *See, e.g.,* Schleier, 515 U.S. at 327 (noting that the taxpayer included a backpay award as gross income). Of equal importance is whether the terms of the settlement agreement were the result of "good faith, adversarial, arm's-length negotiations." Knoll v. Comm'r, 86 T.C.M. (CCH) 396, 400–01 (2003) ("The claim must be bona fide, but it need not be sustainable or valid."); *see also* Goode, 91 T.C.M. (CCH) at 902 (finding that courts are not required to accept settlement agreements "where circumstantial factors reveal that the designation of the settlement proceeds was not the result of adversarial, arm's length, and good faith negotiations").
67. Greer v. United States, 207 F.3d 322, 325 (6th Cir. 2000). Greer believed he was wrongfully terminated by Ashland Oil, Inc. (AOI). Although Greer did not file suit, AOI agreed to pay him $331,968 in exchange for his agreement to release AOI from any claims of wrongful discharge. *Id.* Greer argued that the settlement was paid for wrongful discharge and injuries to personal and professional reputation, excluding it from gross income under § 104(a)(2). *Id.* at 327–28. The district court agreed with Greer, and the government appealed. *Id.* at 325–26.
68. *Id.* at 327.
69. *Id.; see also* Schleier, 515 U.S. at 334–35.
70. Greer, 207 F.3d at 327. This factor does not require that the taxpayer actually file suit. *Id.* at 328; *see* Stocks v. Comm'r, 98 T.C. 1, 10 (1992) ("Where a settlement agreement exists,
Finally, and most importantly, courts should examine the "motivation behind the agreement itself. . . . If the agreement lacks express language . . . [then courts should consider] other evidence that may shed light on 'the intent of the payor as to the purpose in making the payment.'" Applying these factors in Greer, the court reversed and remanded for further proceedings, finding a lack of transparent intent on the part of the taxpayer's employer.

4. The Definition of Personal Injury Under § 104(a)(2) Before 1996 Included Many Different Types of Injuries

The interpretation of a personal injury under the pre-1996 form of § 104(a)(2) was quite broad. Courts articulated a long list of personal injuries that fell within the § 104(a)(2) exclusion. Most notable are the following: "injuries . . . affecting the emotions, reputation, or character," "intangible as well as tangible harms," "emotional distress," "mental pain and suffering," injury to personal and professional reputation, "distress, humiliation, and mental anguish," intentional infliction of emotional distress, and "the intangible harms of discrimination." Almost any kind of tort or tort-type injury fell within the scope of the § 104(a)(2) personal injury or sickness requirement before the 1996 amendment.

determining the exclusion from gross income depends on the nature of the claim that was the actual basis for settlement rather than the validity of the claim." (second emphasis added)).

72. Id. at 329 (quoting Knuckles v. Comm'r, 349 F.2d 610, 613 (10th Cir. 1965)).
73. Greer, 207 F.3d at 329. The court found AOI's intent in paying $331,968 was not easily discernable, particularly considering that the normal severance payment for an employee of Greer's length of service was approximately $51,000. Id. at 334. On remand, the district court found that the damages were paid on account of Greer's personal injuries, and therefore excluded most of the payment he received from AOI from his gross income. Greer v. United States, 2001-1 U.S.T.C. (CCH) 87,865, 87,869 (E.D. Ky. 2001).
74. See Venable v. Comm'r, 86 T.C.M. (CCH) 254, 256 (2003) (noting that prior to the amendment, personal injury "embrace[d] 'nonphysical injuries to the individual, such as those affecting emotions, reputation, or character'" (quoting United States v. Burke, 504 U.S. 229, 236 (1992))), aff'd, 110 F. App'x 421 (5th Cir. 2004).
75. See Burke, 504 U.S. at 235 n.6.
76. Id.
78. See Burke, 504 U.S. at 235.
80. See Threlkeld v. Comm'r, 848 F.2d 81, 83-84 (6th Cir. 1988) (including defamation under California law); see Fabry v. Comm'r, 223 F.3d 1261, 1270 (11th Cir. 2000) (holding that damage to business reputation is a personal injury).
81. See Greer, 207 F.3d at 328.

The Small Business Jobs Protection Act of 1996 (SBJPA) changed the scope of § 104. Congress narrowed the pre-1996 exclusion by adding the word "physical" to the statute. In signing the bill into law, President William Jefferson Clinton expressed doubt about narrowing the statute. The SBJPA included an amendment to § 104 that narrowed the personal injury or sickness exclusion in two ways. First, only those personal injuries and personal sicknesses that are considered "physical" are excluded from income. Second, emotional distress is not considered physical under the statute.

The amended statute states that "gross income does not include . . . the amount of any damages . . . received . . . on account of personal physical injuries or physical sickness . . . For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness." It appears that the addition of only a few words significantly changed the exclusion.

84. Notwithstanding the IRS's proposed regulations announced on September 15, 2009, the Tax Court has consistently held that the two-prong test defined in Schleier remains the same, except that "physical" was added to the second prong. See Goode v. Comm'r, 91 T.C.M. (CCH) 901, 903 (2006). But see Prop. Treas. Reg. § 1.401-1, 75 Fed. Reg. 47,152, 47,153 (Sept. 15, 2009) (reversing the outcome of Burke and "eliminating the requirement that 'personal injuries or sickness' be 'based upon tort or tort type rights'" (internal citation omitted)).


86. Presidential Statement on Signing the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, reprinted in 1996 U.S.C.C.A.N. 1862, 1864. As President Clinton stated, finally, I have reservations about a provision in the Act which makes civil damages based on nonphysical injury or illness taxable. Such damages are paid to compensate for injury, whether physical or not, and are designed to make victims whole, not to enrich them. These damages should not be considered a source of taxable income. Id. Despite his opposition to the § 104(a)(2) amendment, the law increased the minimum wage base, an important part of his agenda. Id. at 1862.

87. GENERAL EXPLANATION OF TAX LEGISLATION, supra note 85; see also Wolff, supra note 29, at 1346.

88. GENERAL EXPLANATION OF TAX LEGISLATION, supra note 85.

89. Id. at 224.

90. I.R.C. § 104(a) (2006) (emphasis added). Although damages on account of emotional distress are not included in the gross-income exclusion, the last sentence of § 104(a) provides that damages paid for emotional distress are excluded from gross income only to the extent the taxpayer paid for medical expenses. I.R.C. § 104(a) (2006); see also Prasil v. Comm'r, 85 T.C.M. (CCH) 1124, 1125-28 (2003). In other words, if the damages paid to the taxpayer are reimbursement for amounts the taxpayer personally paid for medical expenses associated with emotional distress, then those reimbursements are not taxable. Robert W. Wood, Tax Aspects of Settlements and Judgments, 522-3rd TAX MGMT. PORTFOLIO (BNA) § III.3.E.b. (2009).

91. See infra Part I.C.
Unfortunately, there is very little legislative history that supports or explains the 1996 congressional amendment to § 104(a)(2). Requiring an injury or sickness to be “physical” would reign in courts’ broad and conflicting interpretations of personal injury.92 The House Committee report states:

Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness. For example, some courts have held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits.93

Based on this excerpt from the House Committee report, several inferences can be drawn. First, the expanded interpretation of personal injury or sickness by courts resulted in backpay, lost profits, or lost wages being excluded from gross income.94 Congress never intended these items to be excluded from gross income.95 Second, excluding awards for damage to reputation and discrimination from gross income does not comport with the human-capital doctrine96 because, absent a physical injury, the taxpayer has not lost human capital.97 Finally, Congress intended to decrease litigation “for cases that do not involve physical injury or physical sickness.”98

92. See General Explanation of Tax Legislation, supra note 85, at 223 (stating that the “confusion . . . has led to substantial litigation”). In repealing the gross-income exclusion for punitive damages, the Senate reasoned that “[p]unitive damages are intended to punish the wrongdoer and are not intended to compensate the claimant (e.g., for lost wages or pain and suffering). Thus, they are a windfall to the taxpayer and appropriately should be included in taxable income.” S. Rep. No. 104-281, at 115 (1996) (Conf. Rep.), reprinted in 1996 U.S.C.C.A.N. 1474, 1589–90; see also O’Gilvie v. United States, 519 U.S. 79, 83 (1996).

93. H.R. Rep. No. 104-737, at 300 (emphasis added); see also General Explanation of Tax Legislation, supra note 85.

94. General Explanation of Tax Legislation, supra note 85.


96. See supra Part I.A.

97. See supra Part I.A.

98. Hennessey v. Comm’r, 97 T.C.M. (CCH) 1756, 1758 (2009); see also General Explanation of Tax Legislation, supra note 85, at 223 (“The confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation . . . .”). Litigation under § 104(a)(2) did not decrease as Congress predicted, however, because the line between what is physical versus what is emotional distress is unclear. See 2009 Annual Report, supra note 1, at 446–47.

Some suggest other motives behind the 1996 amendment. One scholar has suggested that the real reason for the amendment was to “limit the benefit and effectiveness of the newly extended Civil Rights Act remedies.” Spitz, supra note 29, at 441. But see Prop. Treas. Reg. § 1.401-1, 75 Fed. Reg. 47,152, 47,153 (Sept. 15, 2009) (concluding that the tort and remedy requirement was eliminated with the 1996 amendment). Another has suggested that an “unconscious legislative
C. Section 104(a)(2) After 1996: Analyzing the Physical Injury or Sickness Exclusion with an Emotional Distress Exception

Three areas provide insight into the definition of and distinction between physical injury or sickness and emotional distress: (1) the SBJPA 2006 legislative history, (2) IRS pronouncements, and (3) Tax Court and circuit court decisions.

1. With Little Discussion of What Physical or Emotional Distress Means, Congress Provided Footnote 56

In describing emotional distress, Congress stated that “[i]t is intended that the term emotional distress includes symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress.” This one sentence, a footnote in the legislative history of the SBJPA, is the sum and substance of Congress’s definition of emotional distress. This footnote is usually the only piece of legislative history cited by courts to understand what Congress meant by physical injury or sickness versus emotional distress.

Aside from this footnote, the House Conference Report states that “[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness.” Without specifically defining either term, if the injury or sickness is considered physical, then both physical and emotional distress damages “that flow
therefrom” are excluded. But, if the injury or sickness is considered emotional distress, then the personal injury damages are not excluded.

2. Not to Be Outdone by Congress, the IRS Remains Quiet and Elusive with Respect to the Physical Injury Exclusion and the Emotional Distress Exception

The IRS has largely remained silent on what exactly a physical sickness or physical injury is and how it is different from emotional distress. Because the regulations have not changed since the 1996 amendment, they are of no help. The most informative guidance comes in the form of two Private Letter Rulings (PLRs) issued in 2000 and 2001, and a Chief Counsel Advisory Memorandum issued in 2008.

The 2000 PLR, known as the “bruise” ruling, responded to a taxpayer’s question of whether damages received under a settlement agreement were excluded under §104(a)(2). The letter to the IRS explained that A was not.

102. Id.; see Hawkins, 89 T.C.M. (CCH) at 1472 (“[L]egislative history make[s] clear that damages for emotional distress and resultant symptoms are not excluded . . . .”). But “[o]nce the ‘physical’ threshold is reached, compensation for a broad range of psychological and emotional damages can be excluded from the taxpayer’s income.” Volz & Tazian, supra note 29, at 285.

103. Hawkins, 89 T.C.M. (CCH) at 1472; see also Prop. Treas. Reg. §1.401-1, 75 Fed. Reg. 47,152, 47,153 (Sept. 15, 2009); I.R.S. Pub. 17, at 93 (2009). Additionally, it would seem that Congress’s intent was to tax discrimination awards where no physical injury or sickness was present. As the House Report states, “some courts have held that the exclusion applies to damages in cases involving . . . employment discrimination . . . where there is no physical injury or sickness.” H.R. REP. No. 104-586, at 142-43 (1996). The report concludes that the “exclusion from gross income does not apply to . . . a claim of employment discrimination . . . accompanied by a claim of emotional distress.” Id. at 144. Taken together, a reasonable reading of the legislative history would suggest that damages for discrimination that are accompanied by a physical injury or physical sickness are still excluded under §104(a)(2). Hawkins, 89 T.C.M. (CCH) at 1472.


106. A letter ruling is a response from the IRS to a written request by a taxpayer asking for guidance on how the IRS will treat a particular set of facts. Rev. Proc. 2009-1, 2009-1 I.R.B. 6, available at http://www.irs.gov/pub/irs-irsbs IRB09--01.pdf. It is binding on the IRS with respect to the taxpayer who requested the PLR, and may not be used by other taxpayers. Id. at 47. Letter rulings are helpful because they provide an indication of how the IRS might interpret the Tax Code under a given set of facts. See Byrne v. Comm’r, 84 T.C.M. (CCH) 704, 710 n.14 (2002) (“Although private letter rulings are not precedent, . . . they do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws.”).


sexually harassed by C via physical touching and "lewd remarks." A, however, experienced no "observable bodily harm (e.g. cuts, bruises, etc.)." C also assaulted A, causing "extreme pain." The IRS concluded that the damages associated with these contacts were not excludable under § 104(a)(2) because they were a "pain incident"; the implication being that even though there was physical pain, the taxpayer suffered no physical injury.

After the "First Pain Incident," C assaulted A again, "cutting her and biting her." The IRS excluded from gross income all damages associated with this incident as well as those emotional damages "properly allocable to [it]." In defense of its conclusion, the IRS noted that "[t]he term 'personal physical injuries' is not defined in either § 104(a)(2) or the legislative history of the 1996 Act" and concluded that the fourth edition of Black's Law Dictionary, which "defines the term 'physical injury' as 'bodily harm or hurt, excluding mental distress, fright, or emotional disturbance,'" was the appropriate definition. Therefore, "physical contacts resulting in observable bodily harms such as bruises, cuts, swelling, and bleeding are personal physical injuries under § 104(a)(2)."

The 2001 PLR concluded that damages received from a settlement for lung cancer attributed to asbestos were related to a physical disease and were therefore excluded from gross income under § 104(a)(2). The taxpayer contracted lung cancer from inhaling asbestos fibers. Even though asbestos fibers are invisible to the naked eye, the IRS still found that the taxpayer suffered a physical sickness. By implication, therefore, a person can have physical injuries or physical sickness even though there are no visible contacts or touchings.

111. Id.
112. Id.
113. Id.
114. Id.
115. Id.
116. Id. (quoting BLACK'S LAW DICTIONARY 1304 (rev. 4th ed. 1968)). Black's has revised its definition, however. See, e.g., BLACK'S LAW DICTIONARY 789 (7th ed. 1999) ("bodily injury. Physical damage to a person's body. - Also termed physical injury.").
117. I.R.S. Priv. Ltr. Rul. 200041022. The "bruise ruling" left unanswered whether "observable bodily harms" are sufficient or necessary to have a physical injury or sickness. Wood, supra note 104, at 1389.
119. Id.
122. See Wood, supra note 27, at 31 ("While there was no physical contact or touching between the taxpayer's husband and the manufacturers, Letter Ruling 200121031 upholds the exclusion.").
In the 2008 CCA, the facts indicated that C continued to suffer trauma from a physical injury sustained when C was a minor. The IRS concluded that the inability of C to “establish[] the extent of his physical injuries” did not defeat C’s exclusion under § 104(a)(2).

The inferences from these three IRS rulings that observable bodily harms are sufficient to constitute physical injury or sickness under § 104(a)(2). Unobservable bodily sicknesses, objectively identified through the use of medical technology, are also sufficient to constitute physical sickness. The ability to establish the magnitude of a physical injury is not necessary to fall within the definition of “physical” under the statute.

3. Federal Courts Attempt to Distinguish Between Physical Injury or Sickness and Emotional Distress: Clear as Mud

Courts, predominantly the Tax Court, have struggled with the definition of and distinction between physical injury or sickness and emotional distress under § 104(a)(2). Most of the Tax Court’s decisions with respect to the definition of “physical” or “emotional distress” are conclusory. They conclude that a taxpayer’s injury or sickness is not physical, or that it is emotional distress, without first defining those terms.


124. Id.

125. Id. This conclusion “can perhaps be read as admitting of the possibility that the observable bodily harm standard the IRS has informally adopted is too tough.” Wood, supra note 104, at 1390.

126. Usually, the court refers to either the legislative history or Black’s Law Dictionary. See, e.g., Prasil v. Comm’r, 85 T.C.M. (CCH) 1124, 1127 (2003) (referring to the legislative history of the SBIPA). Interestingly, none of the cases surveyed in this section discuss the basic rules of statutory construction for revenue acts. See Malat v. Riddell, 383 U.S. 569, 571 (1966) (per curiam) (“[T]he words of statutes—including revenue acts—should be interpreted where possible in their ‘ordinary, everyday senses.’” (quoting Crane v. Comm’r, 331 U.S. 1, 6 (1947))).

127. In most instances, the Tax Court does not even consider the “everyday meaning of [the] words” physical or emotional, but instead resorts immediately to footnote 56 of the SBIPA congressional record, which defines emotional distress as “insomnia, headaches, and stomach disorders.” H.R. REP. NO. 104-737, at 301 n.56 (1996) (Conf. Rep.); see, e.g., Johnson v. Comm’r, 97 T.C.M. (CCH) 1860, 1861 n.5 (2009); Phelps v. Comm’r, 95 T.C.M. (CCH) 1336, 1340 n.6 (2008); Goode v. Comm’r, 91 T.C.M. (CCH) 901, 903 (2006); Amos v. Comm’r, 86 T.C.M. (CCH) 663, 666 n.4 (2003); Venable v. Comm’r, 86 T.C.M. (CCH) 254, 256 (2003), aff’d, 110 F. App’x 421 (5th Cir. 2004).

On the other hand, where the statute is ambiguous, the court can and often will look to legislative history, as well as other non-statutory sources, to understand Congress’s intent. See J.M. Huber Corp. v. United States, 27 Fed. Cl. 659, 664 (1993) (“Statutory interpretation of Internal Revenue Code provisions in particular involves looking at the plain meaning first, then examining legislative history to discern the intent of Congress where there is ambiguity in the statute”). Given the often immediate reference to § 104(a)(2)’s legislative history, one can infer that courts consider § 104(a)(2) patently ambiguous.
One attempt by the Tax Court to provide a cogent definition came from Judge David Laro in *Hawkins v. Commissioner.* Hawkins received a settlement payment because of race discrimination. In concluding that the payor did not pay the damages because of physical injury or sickness, the Tax Court referred to the definition of emotional distress in *Black's Law Dictionary:* “emotional distress’ denotes ‘A highly unpleasant mental reaction (such as anguish, grief, fright, humiliation, or fury) that results from another person’s conduct; emotional pain and suffering.’” Because the Tax Court found that the taxpayer’s settlement payment was for emotional distress, the payment was not excluded from gross income.

a. Fatigue, Sleeplessness, and Indigestion

In most cases, the courts do not define emotional distress, but take the approach that “[they will] know it when [they] see it.” In *Lindsey v. Commissioner,* Lindsey received a $2,000,000 settlement. Lindsey tried to exclude the settlement from his gross income under § 104(a)(2), asserting that he suffered physical injuries and sicknesses during the settlement negotiations. At trial, Lindsey’s physician testified that Lindsey suffered from hypertension, fatigue, and loud snoring. The Tax Court held that “fatigability, occasional indigestion, and difficulty sleeping—are the types of injuries or sicknesses that Congress intended to be encompassed within the definition of emotional distress.” Accordingly, the Tax Court included

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129. *Id.* at 311.
130. *Id.* at 312 (quoting BLACK'S LAW DICTIONARY 542 (7th ed. 1999)).
131. *Id.*
133. *Lindsey v. Comm'r* (*Lindsey 1*), 87 T.C.M. (CCH) 1295, 1296 (2004), *aff'd,* 422 F.3d 684 (8th Cir. 2005). Lindsey was the CEO of Empire Gas Corporation (EGC), “a company engaged in the liquefied petroleum business.” *Id.* Northwestern Growth Company was another petroleum company, and the two companies “entered into an agreement . . . to acquire Synergy, a propane company.” *Id.* A dispute arose between the two companies that led to a termination agreement that would pay Lindsey $2,000,000. *Id.* The settlement agreement stated the payment was for “tortious interference with contracts . . . injury to Mr. Lindsey’s personal and professional reputation and emotional distress, humiliation and embarrassment.” *Id.*
134. *Id.* at 1297–98.
135. *Id.* at 1298.
136. *Id. ; see also Sanford v. Comm'r,* 95 T.C.M. (CCH) 1618, 1620 (2008) (finding that sexual harassment and subsequent physical symptoms of stress were properly classified as emotional distress); Bond v. Comm'r, 90 T.C.M. (CCH) 445, 446–47 (2005) (analyzing depression under the emotional-distress exclusion provision in § 104(a)(2) and inferring that Bond’s depression was emotional distress).

Similarly, mental anguish is not a physical injury. In *Venable v. Commissioner,* Venable filed suit on behalf of her late husband, Hubbard. Venable v. Comm'r, 86 T.C.M. (CCH) 254, 255 (2003), *aff'd,* 110 F. App’x 421 (5th Cir. 2004). Hubbard ran a software company, and one of his investors accused him of theft of accounts receivable. *Id.* Hubbard was criminally prosecuted, but the charges were later dismissed. *Id.* Venable sued the investor for malicious prosecution,
Lindsey’s settlement in his gross income.\textsuperscript{137}

\textit{b. Physical Restraint Through False Imprisonment: Still Deemed Not Physical}

Meeting the physical-injury test is difficult. In \textit{Stadnyk v. Commissioner}, Stadnyk, a resident of Kentucky, received damages based on a claim of false imprisonment.\textsuperscript{138} A mediation agreement resulted in a $49,000 settlement.\textsuperscript{139} At trial, the IRS argued that the settlement was not paid for “physical restraint and detention,” but rather for emotional distress.\textsuperscript{140} The Tax Court agreed and held that “[p]hysical restraint and physical detention are not ‘physical injuries’ for purposes of [exclusion under] section 104(a)(2).”\textsuperscript{141}

In support of its decision, the Tax Court referred to the definition of false imprisonment under Kentucky law and found that injury for false imprisonment was “one where the plaintiff c[ould] recover for mental suffering and humiliation.”\textsuperscript{142} Having found that Stadnyk’s award was compensation for a nonphysical injury, the court concluded that her award was taxable.\textsuperscript{143}

and a jury awarded her $437,300. \textit{Id.} The bulk of the award was for mental anguish and loss of reputation. \textit{Id.} Concluding that these damages were exactly the type no longer excluded under the statute, the court held for the Commissioner. \textit{Id.} at 259. Therefore, Venable’s jury award was not excluded from her gross income. \textit{Id.}

\textsuperscript{137.} \textit{Lindsey I}, 87 T.C.M. (CCH) at 1298. The Eighth Circuit affirmed the Tax Court’s decision that “stress-related symptoms, including periodic impotency, insomnia, fatigue, occasional indigestion, and urinary incontinence[ ]” are all symptoms related to emotional distress. \textit{Lindsey v. Comm’r (Lindsey II),} 422 F.3d 684, 688 (8th Cir. 2005). The court concluded that these “nonphysical . . . damages . . . are no longer excludable as gross income following the enactment of the 1996 amendment.” \textit{Id.} at 689.

\textsuperscript{138.} \textit{Stadnyk v. Comm’r,} 96 T.C.M. (CCH) 475, 476 (2008), aff’d, 367 F. App’x 586 (6th Cir. 2010). Stadnyk purchased an automobile that stopped working shortly after she drove it off the lot. \textit{Id.} at 475. The dealer was elusive and unresponsive to her complaints, so she directed her bank to put a stop payment on her check for the car payment. \textit{Id.} A bank error resulted in the check being marked “NSF” for insufficient funds. \textit{Id.} The dealer, believing that Stadnyk intentionally passed a bad check, contacted the police and had her arrested. \textit{Id.} She was handcuffed in front of her family, transported to the county jail, strip-searched, and made to wear an orange jump suit. \textit{Id.} After the criminal charges were dropped, she filed suit against the bank for breach of fiduciary duty. \textit{Id.} at 475–76. Stadnyk also filed suit against the auto dealer and its owner for “[m]alicious prosecution . . . false imprisonment, defamation, and outrageous conduct.” \textit{Id.} at 476. This suit was settled and dismissed. \textit{Id.} The terms of the settlement were not reported. \textit{Id.}

\textsuperscript{139.} \textit{Id.} at 476.
\textsuperscript{140.} \textit{Id.} at 477.
\textsuperscript{141.} \textit{Id.} at 478.

\textsuperscript{142.} \textit{Id.} \textit{But see Wood, supra note} 27, at 41 (“[T]here is nothing mental about being locked behind bars and subjected to the physical confinement it entails . . . the primary thrust of a false imprisonment claim is not mental.”).

\textsuperscript{143.} \textit{See Stadnyk,} 96 T.C.M. (CCH) at 478.
c. Physical Manifestation of Emotional Distress

Even more confusing than the holding in *Stadnyk* is the Tax Court’s guideline regarding physical manifestation of emotional distress. In *Goode v. Commissioner*, Goode received $135,000 from a settlement agreement with the District of Columbia.\(^{144}\) In his complaint against the District of Columbia, Goode asserted “physical pain and physical upset.”\(^{145}\) However, he alleged at trial that the settlement payment was compensation for “migraine headaches, stomachaches, and hand numbness.”\(^{146}\) The Tax Court found for the Commissioner, holding that Goode did not suffer a physical injury or sickness, but rather suffered physical manifestations of emotional distress.\(^{147}\) Therefore, his award was taxable.\(^{148}\)

d. Aggravation of Existing Physical Sickness

In a 2010 decision, *Domeny v. Commissioner*, the Tax Court found that damages paid due to aggravation of an existing physical sickness fell within the § 104(a)(2) definition of a physical injury or sickness and was not taxable.

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145. *Id.*

146. *Id.* at 904.

147. *Id.; see also Shaltz v. Comm'r*, 85 T.C.M. (CCH) 1489, 1490 (2003) (inferring that mental anguish, humiliation, and embarrassment caused by sexual harassment are not considered physical injuries or sickness). In *Shaltz v. Commissioner*, the issue for the Tax Court was whether $30,000 that Shaltz received in settlement of her complaint against General Motors (GM) for sexual harassment was for physical injury or sickness, and therefore excluded from gross income. *Id.* The court held that Shaltz’s $30,000 receipt was taxable because her complaint did not assert any physical injuries. *Id.* at 1491–92 & n.6. Additionally, although Shaltz provided a letter from her physician stating that she suffered from “depression, anxiety, stress, and recurrent past stressors,” the court noted that the facts provided did not “link [her] disability . . . with the sexual harassment complaint or, more importantly, to GM’s settlement of that complaint.” *Id.* at 1492 n.6. Although it is not clear whether the court’s use of the term “disability” in reference to Shaltz’s depression means that depression is a physical sickness under § 104(a)(2), the court could have easily dismissed the importance of the letter by concluding that depression was emotional distress. See *Goode*, 91 T.C.M. (CCH) at 904–05 (holding that Goode’s award was taxable because he suffered only from physical manifestations of emotional distress).

148. *Goode*, 91 T.C.M. (CCH) at 905. The court also noted that even if he suffered a physical injury or sickness, the settlement was not because of physical injuries; the District of Columbia’s representative at trial did not “recall requesting, receiving, or reviewing any medical documentation corroborating petitioner's illness.” *Id.* at 904. Further, the language of the settlement agreement was contrived. *Id.* at 904–05.
Domeny suffered from Multiple Sclerosis (MS). Upon starting a new job with a nonprofit organization that performed fundraising and community outreach, tension between Domeny and her supervisor caused her MS "symptoms to flare up." After Domeny discovered and reported that her supervisor was embezzling funds, the supervisor fired her. Subsequent to Domeny’s discharge, her attorney negotiated a settlement between Domeny and her employer. Although the agreement provided that a portion of it was for backpay, about fifty percent of the amount paid lacked any specific language indicating the employer’s intent in making the payment.

The Tax Court had to decide whether the amounts were “received on account of” Domeny’s physical sickness. In concluding that the amounts were paid for Domeny’s physical sickness, and thus excluded from gross income under § 104(a)(2), the Tax Court noted that “[Domeny’s] work environment exacerbated her existing physical illness . . . . [H]er MS flareup . . . was intense and long lasting.”

D. Damages that Are Not Paid on Account of Physical Injuries Are Not Excluded from Gross Income by § 104(a)(2), Even if the Taxpayer Suffered a Physical Injury or Sickness

To be excluded from gross income, the payor’s payment of damages to the taxpayer must be primarily to compensate the taxpayer for physical injuries.
When a court finds that the payment was not for physical injury or sickness, the damage award will be taxable.\textsuperscript{159}

The District of Columbia Circuit emphasized this requirement in \textit{Murphy v. IRS}.\textsuperscript{160} Murphy received a $70,000 award for damage to her "vocational reputation" and "past and future emotional distress" based on a claim of employment discrimination.\textsuperscript{161} Murphy presented evidence, through the testimony of her psychologist, indicating that she suffered from "'bruxism,' or teeth grinding ... [and] other 'physical manifestations of stress' including 'anxiety attacks, shortness of breath, and dizziness.'"\textsuperscript{162} She argued that § 104(a)(2) does not require the physical injuries to result from a physical stimulus.

Amos sought to exclude this payment from his gross income under § 104(a)(2). \textit{Id.} at 665. The issue was whether Rodman paid the $200,000 because of Amos's physical injuries. \textit{Id.} at 666. The IRS asserted that very little of the amount paid was for physical injuries because "Rodman was skeptical about the extent of [Amos's] physical injuries." \textit{Id.} The Tax Court rejected this argument and held that "it is the nature ... of the claim settled, and not its validity, that determines the exclusion" under § 104(a)(2); in this instance, "Rodman's dominant reason" for settling was Amos's physical injuries from getting kicked. \textit{Id.}

There are also instances where courts question the causal link between the payment for damages and the injury asserted in the complaint. As required by \textit{O'Gilvie}, the test is more than a "but for" test; the payments must be made because of the taxpayer's physical injury. \textit{O'Gilvie v. United States, 519 U.S. 79, 83 (1986).} In \textit{Johnson v. United States}, the Tenth Circuit affirmed the district court's holding that Johnson's settlement payment was taxable. \textit{Johnson v. United States, 76 F. App'x 873, 877-78 (10th Cir. 2003).} Citing \textit{O'Gilvie} and concluding that the award was taxable, the court rejected Johnson's argument that "but for" his physical injury he would never have a claim that ultimately resulted in a damage award. \textit{Id.} at 877.

\textit{Murphy II}, 493 F.3d 170 (D.C. Cir. 2007). This case is known more for the District of Columbia Circuit's original holding that § 104(a)(2) was unconstitutional, a highly criticized decision that the court vacated and reversed. \textit{See Murphy v. IRS (Murphy I), 460 F.3d 79, 92 (D.C. Cir. 2006), vacated, 493 F.3d 170 (D.C. Cir. 2007); see also Gregory L. Germain, Taxing Emotional Injury Recoveries: A Critical Analysis of Murphy v. Internal Revenue Service, 60 ARK. L. REV. 185, 187 n.80 (2007) ("The decision caused an uproar in the tax community.").}

\textit{Murphy II}, 493 F.3d at 172.

The psychologist based this on dental and medical records, noting "'somatic' and 'emotional' injuries." \textit{Id.} Murphy also referred to the \textit{American Heritage Dictionary} for the definition of "somatic" as "'relating to, or affecting the body, especially as distinguished from a body part, the mind, or the environment.'" \textit{Id.} at 174 (internal citation omitted).

In her reply brief, Murphy argued that "[i]f the amended statute is to have any meaningful purpose, there must be a distinction between 'physical injuries or physical sickness' and the term 'physical symptoms' as used in the legislative history." Reply Brief of Appellants at 14, \textit{Murphy v. Internal Revenue Service, 493 F.3d 170 (D.C. Cir. 2007) (No. 05-5139).} Additionally, Murphy argued in her initial brief that she "need[] [only] to show ... she received damages on account of physical injuries or physical sickness to qualify for the exclusion." Appellant's Brief at 44, \textit{Murphy v. Internal Revenue Service (D.C. Cir. 2007) (No. 05-5139).} One flaw, however, with Murphy's analysis of the statute is found in her initial brief when she referred to her expert's conclusion that "emotional distress is always a physical injury or physical sickness just like physical problems with other parts of the body." \textit{Id.} at 10.
The Commissioner avoided addressing Murphy's argument and instead argued that Murphy failed to show that she was compensated "because of her physical injuries." The District of Columbia Circuit agreed with the Commissioner and noted that although Murphy "no doubt suffered from certain physical manifestations of emotional distress," these injuries were not the basis for her award. The origin of Murphy's claim was not her bruxism, but her emotional distress.

To exclude compensatory damages from gross income under § 104(a)(2), the taxpayer's complaint must request damages because of an injury, assert that this injury is a physical injury or sickness, and finally ensure that the physical injury or sickness serves as the basis for any payments received.

Accepting this conclusion would make the language regarding emotional distress in § 104(a) surplusage. The plain language of § 104(a) excepts emotional distress from the definition of "physical" under the statute. I.R.C. § 104(a) (2006).

164. Murphy II, 493 F.3d at 175. But see Germain, supra note 160, at 189 (stating that "physical manifestations of emotional distress, absent physical impact, [were not meant] to be excluded from taxation").

165. Murphy II, 493 F.3d at 176; see also Hellesen v. Comm'r, 97 T.C.M. (CCH) 1810, 1811–12 (2009) (reasoning that "physical problems" following termination did not exclude damages because the complaint did not allege physical injury); Shelton v. Comm'r, 97 T.C.M. (CCH) 1592, 1593–94 (2009) (declining to exclude damages for sexual harassment that resulted in physical injuries because the class-action settlement mentioned only emotional and mental anguish); Moulton v. Comm'r, 97 T.C.M. (CCH) 1151, 1155 (2009) (refusing to exclude damages because the mediation agreement made no mention of physical injury or sickness); Goode v. Comm'r, 91 T.C.M. (CCH) 901, 904 (2006) (noting that damages did not "emanat[e] from a physical manifestation of emotional distress"); Bond v. Comm'r, 90 T.C.M. (CCH) 445, 446 (2005) (noting that a settlement payment was not excluded because it "was not intended to compensate petitioner for her carpel tunnel and back injuries"); Lindsey v. Comm'r, 87 T.C.M. (CCH) 1295 (2004), aff'd, 422 F.3d 684 (8th Cir. 2005) (reasoning that even if the petitioner suffered physical injuries or sickness, they were not the basis for the settlement agreement, and the award was not paid because of physical injury or sickness); Cates v. Comm'r, T.C. Summ. Op. 2003-15, 2003 WL 716270, at *3 (Feb. 28, 2003) ("Moreover, assuming that hypertension is a physical injury (a point that we specifically do not decide) we cannot find that Rockford intended to compensate petitioner for her hypertension.").

166. See Murphy II, 493 F.3d at 175. Similar to Murphy II, though a much more egregious case of physical injury, is Longoria v. Commissioner, a case in which Longoria alleged race discrimination that directly resulted in physical injuries; however, the settlement agreement for $156,667 did not mention those physical injuries. Longoria v. Comm'r, 98 T.C.M. (CCH) 11, 13 (2009). Despite his numerous physical injuries, Longoria's complaint "[d]id not allege that he experienced physical injuries . . . as a result of his discrimination," but requested damages only for "severe mental anguish; anxiety; stomach problems; sleep disorder; [and] stress." Id. Because these are considered symptoms of emotional distress, his entire award was taxable. Id. at 15–16.

167. See, e.g., Volz & Tazian, supra note 29, at 278 ("In order for damages to be excludable, the commission of sexual harassment must result in psychological trauma sufficient to cause personal physical injury or physical sickness.").
E. Changes in Law and Medicine Reflect a Changing Distinction Between the Physical, the Mental, and the Emotional

1. Advances in Medical Science Moot the Distinction Between Physical and Mental

As one commentator has stated, "A decade of unusually collaborative research . . . illustrates that chronic major depression is as physical as diabetes or heart disease." This statement summarizes the paradigm shift that has occurred over the past twenty years in the field of major psychological disorders: no longer are those with persistent, debilitating feelings of sadness considered weak and expected to recover on their own. Rather, these feelings are emotional manifestations of physical impairments to the brain's structure. Modern medical treatment and technology demonstrate that brain-based sicknesses, such as PTSD and chronic major depression, have a biological basis affecting the brain's structure and activity.

Notably, this fact was affirmed by the United States Surgeon General when he also "conclude[d] [that] mental illnesses are biological brain disorders that can be helped by medical treatment." Even the Diagnostic and Statistical Manual of Mental Disorders (DSM-IV) acknowledges that "the term mental disorder . . . implies a distinction between ‘mental’ disorders and ‘physical’ disorders that is a reductionistic anachronism of mind/body dualism . . . and . . . the term persists in the title of DSM-IV because we have not found an appropriate substitute." These views are consistent with the Journal of the American Medical Association finding that chronic major depression is "as


169. Brian Vastag, Decade of Work Shows Depression Is Physical, 287 JAMA 1787, 1787 (2002); see also AARON T. BECK & BRAD A. ALFORD, DEPRESSION CAUSES AND TREATMENT xix, (2d ed. 2009) (noting that "depression research is vibrant and ever-changing," and detailing the physical aspects of depression).

170. Vastag, supra note 169, at 1787.


173. Gardner, supra note 168, at 682. Mental illnesses, such as major depression, panic disorder, and PTSD, are "now considered physical, or biological, rather than 'mental.'" id. at 682-85.

These findings provide a logical basis for concluding that brain-based illnesses are physical sicknesses.\(^{176}\)

2. The Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 Acknowledges the Physical Sickness of the Brain

Congress also understands that brain-based injuries and mental illnesses constitute physical impairments.\(^{177}\) Although the current Congress’s definition of a physical injury or sickness is not binding on the 104th Congress’s amendment to § 104(a)(2),\(^{178}\) where an earlier Congress’s meaning is unclear, as is the case with the 1996 amendment to § 104(a)(2), a later Congress’s understanding is relevant.\(^{179}\) By passing the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (MHPAEA), Congress conveyed its current opinion regarding “physical” sickness. The MHPAEA requires insurance companies to treat mental illness no differently than traditional physical illness.\(^{180}\) This requirement

175. Vastag, supra note 169, at 1787; see also Gardner, supra note 168, at 686 (“Science continues to provide evidence that serious mental illnesses are actually physical diseases of the brain.”).

176. See Dawn Capp & Joan G. Esnayra, It’s All in Your Head—Defining Psychiatric Disabilities as Physical Disabilities, 23 T. JEFFERSON L. REV. 97, 99 (2000) (“An overwhelming amount of scientific data proves that psychiatric disabilities are physical in nature.”). The physical and psychosomatic disabilities differ because medical treatments have “actual or potential effectiveness” in treating disabilities. Id. at 102; see also id. at 105 (“[B]ecause mental impairments result from disorders of the brain, a physical organ, the line between physical and mental impairments is gray.”). The authors conclude that “the signs and symptoms which characterize psychiatric disabilities correspond with broad anatomical regions of the brain and are therefore ‘physical disabilities.’” Id. at 110-11.

177. See Robert Pear, House Approves Bill on Mental Health Parity, N.Y. TIMES, Mar. 6, 2008, at A14 (reporting that the “biological causes” of mental illness was one of several reasons Congress cited in support of this bill).

178. See Seatrain Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572, 596 (1980) (“While the views of subsequent Congresses cannot override the unmistakable intent of the enacting one, such views are entitled to significant weight, and particularly so when the precise intent of the enacting Congress is obscure.” (internal citations omitted)).

179. Id.

demonstrates Congress's recognition that mental illnesses are physical illnesses, at least in the context of insurance.  

3. Characteristics of a Physical Injury in a Non-Tax Context

The Tax Code is not the only body of law in which the definition of physical injury has caused uncertainty and thereby forcing federal courts to define the term physical injury. In Turturro v. Continental Airlines, for example, Turturro had to prove a sufficient bodily injury to recover damages for emotional distress caused by Continental’s unwillingness to let him disembark the plane.182 Citing the Supreme Court’s decision in Eastern Airlines, Inc. v. Floyd, the district court noted that “bodily injury encompasses ‘a change in the structure of an organ,’ and the brain’s physical architecture can transform during PTSD . . . fall[ing] within the . . . definition of bodily injury.”183 The court’s approach adopted a broader definition of physical injury than the IRS’s “bruise” ruling.184

4. The Restatement (Third) of Torts: A Better Attempt to Distinguish Between Physical Injury or Sickness and Emotional Distress

Courts relying on the common law and Restatement approaches have recognized a better way of defining physical injury or sickness.185 Tentative draft number five of the Restatement (Third) of Torts defines physical harm as “physical impairment of the human body.”186 Recognizing the increasing footing means that insurance companies must treat mental illness and physical illness equally. See Pear, supra note 177, at A14.

181. See, e.g., 154 CONG. REC. H1287 (daily ed. Mar. 5, 2008) (statement of Rep. Patrick Kennedy) (“[U]nfortunately . . . the brain is still relegated to that part of the world where people think of it as something that should be in your controls . . . that even though you might have a biochemical imbalance in your brain . . . it is your fault . . . .”); id. at H1288 (statement of Rep. John Sullivan) (“[Mental illness] is a chemical imbalance of the brain, and I think it should be treated like any other illness, and it is high time in this country that we do that.”); id. at H1291 (statement of Rep. Carolyn Maloney) (“We all know that mental illness is just like any physical illness . . . . So it’s amazing to me that some people still see mental illness as different and separate from physical illness.”); id. at H1301 (statement of Rep. Mark Udall) (“[T]here remains no scientific justification for treating mental health as separate and inferior to physical health.”).


183. Id. at 179 (emphasis added) (quoting E. Airlines Inc. v. Floyd, 499 U.S. 530, 541 (1991)).

184. See supra Part I.C.2.

185. See United States v. Burke, 504 U.S. 229, 234 (1992) (“[C]ommon law tort law concepts are helpful in deciding whether a taxpayer is being compensated for a ‘personal injury.’” (quoting Threlkeld v. Comm’r, 87 T.C. 1294, 1305 (1986), aff’d, 848 F.2d 81 (6th Cir. 1988))). The court recognized that damages for “emotional distress and pain and suffering” could be recovered under state law. Id. at 235; cf. Connolly v. Comm’r, 93 T.C.M. (CCH) 1138, 1139 (2007) (referencing the Restatement (Second) of Torts).

difficulty in distinguishing between physical injuries and sicknesses and emotional distress, the draft Restatement provides, "[t]he essential difference [between bodily harm and emotional disturbance] is that bodily harm usually provides objective evidence of its existence and extent while the only evidence of both the existence and severity of emotional disturbance is usually the report of the person suffering it." In its attempt to further distinguish between bodily harm and emotional distress, the draft Restatement specifically rejects recovery under the physical-harm provisions for such conditions as "nausea, headaches, and hysterical attacks," reasoning that these conditions "dilute[e] the definition of bodily harm." This conclusion is very similar, almost identical, to the House Conference Committee’s definition. Fortunately, the draft Restatement further distinguishes bodily harm from emotional harm: "An actor who negligently causes bodily harm through the mechanism of emotional disturbance is subject to liability for the bodily harm."

This definition corresponds to the contextual framework of § 104(a)(2). Section 104(a)(2) focuses on whether the taxpayer suffered a "personal physical injur[y] or physical sickness." Whether the source of the physical injury is a shock to the taxpayer’s nervous system or a kick to the face should not matter.

emotional distress as “a highly unpleasant mental reaction (such as anguish, grief, fright, humiliation, or fury) that results from another person’s conduct; emotional pain and suffering . . . Also termed emotional harm; mental anguish; mental distress; mental suffering.” Id. at 563. Although combining the two definitions from Black’s provides a useful starting point, the draft Restatement (Third) of Torts provides a more succinct understanding of physical injury and emotional distress.

187. RESTATEMENT (THIRD) OF TORTS, supra note 186, § 4 cmt. b.
188. Id.
189. Id. cmt. d.
190. See supra note 99 and accompanying text; see also RESTATEMENT (THIRD) OF TORTS, supra note 186, § 4 cmt. b. The Illustration provided by the draft Restatement is helpful:

Liz Labs negligently tests a sample from Dr. Kate and reports, erroneously, that the test reveals that Dr. Kate had recently used illegal drugs. Upon being informed of this, Dr. Kate suffers significant emotional harm, experiences several nights of troubled sleep, the inability to eat very much for a couple of weeks, and occasional nausea during that period. Recovery for Dr. Kate’s emotional disturbance is subject to the requirements of Chapter 8 [Liability for Emotional Disturbance].

191. Id. § 47 cmt. b.
II. DIFFERENT DEFINITIONS OF PHYSICAL INJURY OR SICKNESS AND EMOTIONAL DISTRESS

A. Reference to State Law?

Drawing from the Tax Court’s opinions, perhaps the distinction between physical injury or sickness and emotional distress should be made with reference to the state law where the taxpayer litigated the issue. The Tax Court adopted this approach in Stadnyk v. Commissioner and referenced Kentucky law to determine if Stadnyk’s injury was physical or nonphysical.

However, if the determination of taxability relied on varying state laws, then this approach might lead to disparities in horizontal equity. Moreover, any determination of whether an injury or sickness is physical according to state law would violate the long-standing rule reiterated in Greer that although “state law creates legal interests, . . . the federal statute determines when and how [those interests] shall be taxed.” Thus, any classification of whether an injury or sickness is physical under § 104(a)(2) should not require a reference to state law.

B. Physical Impact Requirement?

One author’s critique of the Murphy decision suggests that the legislative history of § 104(a)(2) requires not only a physical injury or sickness, but also that the injury or sickness be caused by a physical impact. The author

193. See Greer v. United States, 207 F.3d 322, 328 (6th Cir. 2000) (“[S]tate law creates legal interests, but the federal statute determines when and how they shall be taxed.” (quoting Burnet v. Harmel, 287 U.S. 103, 110 (1932))); see also Knoll v. Comm’r, 86 T.C.M. (CCH) 396, 400 (2003) (referring to Illinois tort law); Bland v. Comm’r, 79 T.C.M. (CCH) 1713, 1716 (2000) (referring to Oklahoma law for the tort of intentional infliction of emotional distress); Dana L. Kaplan, Can Legislation Alone Solve America’s Mental Health Dilemma? Current State Legislative Schemes Cannot Achieve Mental Health Parity, 8 QUINNIPIAC HEALTH L.J. 325, 353 (2005) (“Many state statutes narrowly define mental illness to include only those illnesses that are ‘biologically-based’ or ‘serious.’”).

194. See Stadnyk v. Comm’r, 96 T.C.M. (CCH) 475, 477 (2008), aff’d, 367 F. App’x 586 (6th Cir. 2010).

195. See James P. Angelini & Tracy Noga, Equity, Cost of Living, and the Internal Revenue Code, 28 A.B.A. SEC. OF TAX’N NEWS Q., Summer 2009, at 1 (explaining that “[a] tax system is considered horizontally equitable if it treats all taxpayers in the same economic situation in the same fashion”).

196. Greer, 207 F.3d at 327 (quoting Burnet, 287 U.S. at 110).

197. See Germain, supra note 160, at 203–05 (“[T]here must be a proximate physical impact causing an immediate physical injury or sickness (although not necessarily to the plaintiff) in order to have a ‘physical injury or physical sickness’ from which excludable damages could flow.”). The author’s phrase “not necessarily to the plaintiff” should not be interpreted to allow the taxpayer to exclude damages paid where only the defendant suffered physical injury but not the plaintiff taxpayer. See H.R. REP. NO. 104-737, at 301 (1996) (Conf. Rep.) (providing an example in which damages from loss of consortium (a form of emotional distress) were excludable because the taxpayer’s spouse suffered a physical injury).
suggested that Murphy did not have a physical injury under § 104(a)(2) because her bruxism was not the result of a physical impact.198

Although a physical-impact requirement might provide more clarity in the statute, neither the plain language of § 104 nor the legislative history supports such a narrow reading.199 The statute specifically covers “damages . . . received . . . on account of personal physical injuries or physical sickness.”200 Inferring a physical-impact requirement does not fit with the plain language of § 104(a)(2). Indeed, the statute’s only requirement is that the physical injury be personal.201

C. Bruises and Cuts Required?

In the years that have passed since the IRS’s bruise ruling,202 Tax Court decisions and IRS PLRs have offered a much broader view of what constitutes a physical injury or sickness under § 104(a)(2).203 In interpreting the IRS letter rulings and Tax Court decisions, an injury or sickness does not need to be visible to the naked eye for the taxpayer to be given an exclusion under § 104(a)(2); the injury can be demonstrated, for example, by an x-ray or other objective evidence.204 The rulings imply that visible personal contact and visible marks are not requirements; rather, the question is whether the injury or sickness is a bodily one, and whether the taxpayer can offer objective evidence demonstrating as much.

This conclusion is supported by the Tax Court’s decision in Domeny.205 Domeny demonstrates that a taxpayer can meet the statute’s physical requirement without a showing of personal contact.206 Second, it demonstrates that an emotional mechanism that triggers a physical response, like a hostile work environment, will not automatically place the injury or sickness within the emotional distress exception.207 Lastly, the court’s emphasis on the “intens[ity]” and “long-lasting” nature of Domeny’s sickness provides the distinction that keeps her sickness out of the emotional distress exception.208

198. See supra Part I.D.
201. Id. The word "personal" is the only modifier behind "physical injury or sickness."
202. See supra note 125 and accompanying text.
203. See Wood, supra note 104, at 1388; see also Cory, supra note 158, at 248.
204. See I.R.S. Priv. Ltr. Rul. 200121031 (Feb. 16, 2001); see also Amos v. Comm’r, 86 T.C.M. (CCH) 663, 664 (2003) (noting that x-rays were used to recognize an unidentifiable injury).
205. See supra text accompanying note 149.
208. Id. at *5.
The court needed a way to differentiate physical manifestations of emotional distress and a hostile work environment that exacerbated an existing sickness.

**D. The Confusing Mantra: Physical Manifestations of Emotional Distress**

The concept of physical manifestations of emotional distress, as articulated in *Murphy* and *Goode*, has created more problems than it has solved. The Tax Court considers headaches, nausea, fatigue, and sleeplessness to be physical manifestations of emotional distress, fear, or embarrassment. These “symptoms” of emotional distress are indeed physical, but usually do not injure, or produce sickness in any part of the human body.

A person’s nervous system is not normally injured or impaired, for example, because a dog barked, and he felt fear. Indeed, there is no more bodily injury involved when a person feels fear than when a person feels happiness. On the other hand, suppose that same dog’s bark that shocked the man’s nervous system resulted in that man suffering a heart attack. It would seem absurd to conclude that the taxpayer who suffered a heart attack had not suffered a physical injury or sickness under § 104(a)(2), but instead a physical manifestation of emotional distress. This absurd result, however, is the logical

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209. See supra Part I.C.3.b (discussing Goode); see also supra Part I.D (discussing Murphy).

210. See 2008 ANNUAL REPORT, supra note 1, at 474–75.


212. See Stephen S. Hall, Fear Itself, N.Y. TIMES MAG., Feb. 28, 1999, at 42 (“For more than a century, scientists have pondered the nature of fear and anxiety, and how they cause the physical symptoms that contribute to so much human suffering.”); see also Understanding the Biology of Fear, ARTICLE ALLEY (Nov. 10, 2007), http://www.articlealley.com/article_244638_23.html. Headaches are biologically based, but the congressional history specifically excludes headaches from the definition of physical injury or sickness. See H.R. REP. No. 104-737, 301 n.56 (1996) (Conf. Rep.); see also JONATHAN M. BORKUM, CHRONIC HEADACHES: BIOLOGY, PSYCHOLOGY, AND BEHAVIORAL TREATMENT 102 (2007).

213. In a claim for emotional distress, there is generally no requirement for demonstration of physical injury; rather, it is the tortfeasor’s conduct that forms the basis for recovery. See Betsy J. Grey, Neuroscience, Emotional Harm, and Emotional Distress Tort Claims, 7 AM. J. OF BIOETHICS, Sept. 2007, at 66; see also 38 A.L.R. 4th 998 (“To prevail on a claim of intentional infliction of emotional distress, a plaintiff must prove that the defendant’s conduct was reckless, intentional, and so outrageous to such an extreme degree that it exceeds the bounds of decency and, thus, is not tolerated by a civilized community.” (citing Robinson v. Hill City Oil Co., 2 So. 3d 661, 668 (Miss. Ct. App. 2008), cert. denied, 999 So. 2d 1280 (Miss. 2009))).

214. See RESTATEMENT (THIRD) OF TORTS, supra note 186, § 4 cmt. b (“[I]f the defendant’s negligent conduct (for example, negligent driving) frightens the plaintiff (for example, a pedestrian crossing the street), the disturbance of the plaintiff’s nerve centers caused by this fear does not constitute physical harm.”).

215. See Keith Kendrick, Address at Gresham College: The Future Biology of Happiness: Lifestyle Changes or Recreational Drugs? (June 29, 2006), available at http://www.gresham.ac.uk/event.asp?PageId=45&EventId=374 (“Happy people show strong activation in their left prefrontal cortex whereas people experiencing negative emotions tend to have stronger activation in the right prefrontal cortex.”).
conclusion to the Tax Court's "physical manifestation of emotional distress" interpretation.\textsuperscript{216} It should be abandoned.

Instead, emotional distress under § 104(a)(2) must be interpreted in light of the emotional distress symptoms provided in the House Conference Report: insomnia, headaches, and stomach disorders.\textsuperscript{217} To have meaning, this group must consist of similar afflictions.\textsuperscript{218} The afflictions in this group are all ephemeral with little or no permanent impairment to the body.\textsuperscript{219} Therefore, the symptom group should only be expanded according to the characteristics of the group; brain-based sicknesses and injuries do not fit within this group.\textsuperscript{220}

III. ADOPTING A DEFINITION THAT FITS WITH THE LEGISLATIVE HISTORY, IRS PRIVATE LETTER RULINGS, AND THE DRAFT RESTATEMENT (THIRD) OF TORTS

Charles Allen's PTSD injury is unlike any other case presented and analyzed thus far. Allen's PTSD, traditionally considered an intangible illness, was caused by a physical impact, with no outward signs of cuts or bruises, yet determined by a state court to be a bodily injury because of changes in the internal structure of his brain.\textsuperscript{221} In light of the statute's language, purpose, and legislative history,\textsuperscript{222} the court should adopt the definition of "physical" articulated by the draft Restatement (Third) of Torts. It would provide an objective measure for determining whether human capital has been lost and would advance a workable solution to the problem.

\textsuperscript{216} See supra Part I.C.3.c.
\textsuperscript{218} United States v. Burke, 504 U.S. 229, 243 (1992) (Scalia, J., concurring) ("[A] word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress." (quoting Jarecki v. G. D. Searle & Co., 367 U.S. 303, 307 (1961))).
\textsuperscript{219} Volz & Tazian, supra note 29, at 285. Although in Murphy the taxpayer provided objective evidence of permanent damage to her teeth, her damages were not excluded from gross income because the damages were paid to compensate for her emotional distress, not her bruxism. Murphy I, 460 F.3d 79, 84 (D.C. Cir. 2006), vacated, 493 F.3d 170 (D.C. Cir. 2007). Had her complaint asserted her physical injuries, and had she received damages for them, she should have prevailed.
\textsuperscript{220} Volz & Tazian, supra note 29, at 285. As Volz and Tazian have stated,

The statutory requirement that the injury or sickness be 'physical' implies that claims of psychological trauma or disorder be substantiated by medical examinations

... [that] establish a medical record substantiating the presence of an enduring or persistent condition .... Congress intended that psychological damage[s] ... must rise above the short-lived distress of a headache or upset stomach to a level of persistence or permanence more akin to a broken bone or a scar.

\textit{Id.} For example, after the first occurrence of a major depressive episode, the likelihood of permanent brain damage increases. Vastag, supra note 169, at 1788.
\textsuperscript{222} See supra Part I.B.
A. Adopting the Draft Restatement (Third) of Torts Approach: Objective, Identifiable Physical Injury or Sickness Excludes the Ephemeral and Conforms to Congress’s Intent

The draft Restatement (Third) of Torts adopts the proper balance between physical injury or sickness and emotional distress. Objective evidence of bodily impairment, such as evidence of change in the structure of internal organs, will maintain the distinction between physical injury or sickness and symptoms of emotional distress, such as headaches and indigestion, that do not result in any identifiable “long-lasting” impairment to the body.

A distressful disturbance that causes the injury or illness, such as a hostile work environment brought about by the tortfeasor’s conduct, should not preclude the injury or illness from being physical under § 104(a)(2). The question is not how the taxpayer received the injury, but rather whether the injury is indeed physical and whether the claim “ha[s] its origin in [that] physical injury or sickness.”

B. Brain-Based Injuries and Sicknesses Are Physical

As shown by advances in medical technology, brain-based illnesses, like chronic major depression and PTSD, are physical sicknesses of the brain. The brain-based injury or sickness that is observed via changes in the brain’s structure proves that part of the taxpayer’s body has been impaired. Thus, a recovery for impairment of the taxpayer’s brain fits squarely within the human-capital theory. It also fits within the plain language of § 104(a)(2), the

224. For example, a brain injury or illness may be identified through the use of brain-imaging technology, such as Magnetic Resonance Imaging (MRI) or functional Magnetic Resonance Imaging (fMRI). Through the use of PET scans and brain-imaging technology, this objective evidence is available. An fMRI is a form of neuromaging that measures brain activity. An MRI is also a form of neuroimaging, but it measures the brain’s structure. Anthony R. McIntosh, fMRI v. MRI, WWW.BIO.NET, http://www.bio.net/bionet/mm/neur-sci/1993-October/012506.html (last visited Nov. 10, 2010).
226. See RESTATEMENT (THIRD) OF TORTS, supra note 186.
227. See Domeny v. Comm’t, No. 6975-08, 2010 WL 114287, at *5 (T.C. Jan. 13, 2010) (emphasizing that Domeny’s MS flare-ups were “intense and long-lasting”).
228. See RESTATEMENT (THIRD) OF TORTS, supra note 186, § 47 cmt. b (explaining that an actor who negligently causes physical harm via an emotional disturbance could be liable for physical harm).
230. RESTATEMENT (THIRD) OF TORTS, supra note 186, § 4 cmt. b.
231. H.R. REP. NO. 104-737, at 301 (1996) (Conf. Rep.). This comports with the conclusion in Murphy as well. See supra Part I.D.
234. See Leeper, supra note 29, at 1046.
legislative history describing the reasons for the 1996 amendment, and the historical reasons for excluding physical injury or sickness from the definition of gross income.

There is no logical basis in law or medicine to conclude that lung cancer caused by asbestos exposure, or an MS flareup caused by a stressful work environment, is a physical injury or sickness that is in conformity with Congress’s intent under § 104(a)(2), but that brain sicknesses like chronic major depression and PTSD are nonphysical injuries or symptoms of emotional distress.

IV. CONCLUSION

Assuming Allen receives his damage award, his award should be excluded from taxation under § 104(a)(2) because “[e]ach element of [his claim] satisfies the requirements”: objectively identified bodily injury, damages paid “on account of” that bodily injury, and a causal link between the accident and the bodily injury.235 And while he might have suffered anxiety and other emotional disturbances, the physical changes in his brain precipitated the anxiety and emotional disturbance; it was not stress or anxiety that manifested itself via headaches, insomnia, or other temporary nuisances.

Although physical injury or sickness and emotional distress under § 104(a)(2) are not defined by the statute, the regulations, or case law, a workable definition of and distinction between both is available based on the statute’s legislative history, the IRS letter rulings, the draft Restatement (Third) of Torts, and medical science. Brain-based illnesses like Allen’s are physical sicknesses or injuries. These injuries or sicknesses are not part of the group of emotional-distress symptoms such as headaches, insomnia, or stomach disorders; they are characteristically different. Objective evidence of the illness provides a basis for determining that an impairment to the body has occurred. Consequently, damages paid “because of” these sicknesses should be excluded from gross income under § 104(a)(2).236
