AUTHORIZING GROSS-UP COMPENSATION: MAKING RECOVERING PLAINTIFFS WHOLE BY ACCOUNTING FOR THE ADDITIONAL TAX CONSEQUENCES THAT ACCOMPANY LUMP-SUM BACK PAY AWARDS

Few courts have recognized that victims of employment discrimination face heightened tax burdens when they receive back pay awards following litigation or settlement. While antidiscrimination statutes allow for equitable remedies in order to make plaintiffs whole, only four circuits currently include compensation protecting plaintiffs from the additional tax consequence they will face as a result of bunching wages. Various laws in the past allowed plaintiffs to mitigate the impact of this tax burden, but none are currently in effect to universally protect the victimized party. However, antidiscrimination laws allow gross-up as an available remedy to shift this burden from the victim to the liable defendant. Gross-up is permissible within the current landscape without placing a burden on taxpayers or necessitating congressional involvement as other solutions would require. After analyzing past and potential solutions, this Comment recommends gross-up as the most reasonable and effective solution to the heightened tax burden currently impacting recovering employment discrimination victims.

I. INTRODUCTION

Employees who experience workplace discrimination that leads to constructive discharge or wrongful termination often file suit against former employers seeking a variety of damages. Most antidiscrimination statutes follow the remedial structure of Title VII of the Civil Rights Act of 1964 ("Title VII"), allowing for back pay as

one of many remedies available.[1] In today's legal landscape, the amount of time that lapses between termination of employment and resolution of suit, by either settlement or trial disposition, can vary from less than a year to more than a decade.[2] Extended timelines cause accumulation, or "bunching," of due compensation, including back pay from prior years, into singular lump sums paid out to successful plaintiffs following negotiations or trial.[3] This bunching effect leads to plaintiffs, many of whom have seen little income throughout the adversarial process, receiving a disproportionately large award in a single year and facing the tax burden that accompanies this increased income in equally disproportionate amounts. This Comment supports the growing number of federal circuit courts authorizing "gross-up" of back pay awards to account for the additional tax consequences that accompany lump-sum back pay awards. Gross-up is the process of increasing an award "to offset [the] tax burden" caused by reporting the damages awarded as income in a single year when the income would have otherwise been spread over multiple tax years, resulting in a lower tax burden had the cause of the suit never occurred.[4] Judge Sweeney at the U.S. Court of Federal Claims summarized the issue:

> Plaintiff[s] contend[] that [their] overall tax liability would be significantly greater with the receipt of a one-time lump-sum damages award compensating for all past and future lost . . . income than it would have been with the receipt of periodic . . . payments over the course of [multiple years] . . . . [Plaintiffs assert the] additional tax burden as a specific element of damages and seek[] compensation to neutralize the disparity.[5]

Most courts accept this additional tax burden as part of the plaintiff's claimed damages and remedy it through the court's

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1. 42 U.S.C. § 2000e-5(g)(1); *see also* Rehabilitation Act of 1973, 29 U.S.C. § 794a(a)(2) (incorporating the "remedies, procedures, and rights set forth in Title VII of the Civil Rights Act of 1964").

2. *See* TERENCE DUNGWORTH & NICHOLAS M. PACE, STATISTICAL OVERVIEW OF CIVIL LITIGATION IN THE FEDERAL COURTS 20 (1990) (reviewing the duration of cases from 1971 to 1986 and discovering about 60 percent of private civil cases were disposed in less than one year, but nearly 10 percent lasted more than three years). More complex litigation, as illustrated by *Sears v. Atchison, Topeka & Santa Fe Railway*, can last up to seventeen years before plaintiffs see any recovery. 749 F.2d 1451, 1456 (10th Cir. 1984).

3. *See* Michael K. Hulley, Jr., *Taking Your Lump Sum or Just Taking Your Lumps? The Negative Tax Consequences in Employment Dispute Recoveries and Congress's Role in Fashioning a Remedy*, 2012 MICH. ST. L. REV. 171, 181 (2012).

4. Sonoma Apartment Assocs. v. United States, 127 Fed. Cl. 721, 724 (2016). The Court of Federal Claims referred to the additional award as a "tax neutralization payment." *Id.*

5. *Id.*

equitable power to increase the amount awarded, though the D.C. Circuit stands alone in arguing for absolute prohibition of gross-up.[6] Gross-up compensation is used in many areas of law to create solutions for issues similar to increased tax liability, but this Comment focuses on the gross-up application of lump-sum back pay awards for reasons discussed later.[7]

In Part II of this Comment, Subpart II.A explains the overlap of tax law and employment discrimination litigation, which led to the current question of tax implication on awards. It also addresses the question of whether courts can remedy the resulting additional tax consequences that arise where this overlap exists through their equitable powers. Subparts II.B and II.C summarize the past and current jurisprudence of the federal circuit courts on this issue, identifying a trend toward courts authorizing gross-up compensation. Part III reviews the possible advantages and disadvantages of the alternatives to gross-up compensation, ultimately supporting a unanimous adoption of gross-up as the most effective solution to additional tax burdens on lump-sum back pay awards. Subpart III.A analyzes gross-up, the discretion given to trial courts with regard to gross-up application, and the factors involved in calculating gross-up compensation. Subpart III.B evaluates comparable solutions used in other tax contexts and their shortcomings in the employment discrimination litigation context. Part IV recommends the consistent use of gross-up compensation to account for the negative tax burden on bunched back pay awards.

II. BACKGROUND

A. The Tax Issues and Employment Litigation

It is important to start with a fundamental understanding of tax implications on settlements and awards in general. The U.S. Constitution authorizes Congress to "lay and collect taxes."[8] Through the Internal Revenue Code ("IRC") § 61(a), Congress permits taxation on "all income from whatever source derived."[9] This includes income from any compensation for labor (i.e., salaries or wages from an employer), as well as rent, interest, or dividends collected from other sources.[10] The list of taxable income sources is not exhaustive and therefore extends to compensation received through settlement and

6. *Compare* Eshelman v. Agere Sys., 554 F.3d 426, 442 (3d Cir. 2009) (authorizing gross-up compensation), *and Sears*, 749 F.2d at 1456 (same), *with* Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994) (rejecting gross-up compensation completely).

7. *See infra* notes 17–19, 24 and accompanying text.

8. U.S. CONST. art. I, § 8.

9. I.R.C. § 61(a).

10. *Id.*

litigation awards.[11] All income that is received in a tax year must be reported and taxes due must be paid within that same year.[12] The U.S. federal tax rates are adjusted on an annual basis but follow a marginal, progressive rate schedule.[13] This means that taxpayers pay more tax on their last dollars of income than their first, based on a bracketed schedule.[14]

For example, under the 2021 tax rate schedules, an unmarried taxpayer earning $50,000 of taxable income would pay 10 percent on her first $9,950, 12 percent on her next $30,575, and 22 percent on her last $9,475.[15] Her total tax liability would be $6,748.50 (disregarding any available deductions). While her marginal tax rate, the highest bracket at which a portion of her income is taxed, is 22 percent, her average tax rate is only 13.5 percent in 2021.

This progressive system, taxing later dollars at higher rates, leads to higher marginal and average tax rates on larger sums of income.[16] Thus, when a successful plaintiff is awarded a lump-sum back pay award compensating her for multiple years of lost income from an adverse employment action, she is taxed at a higher marginal rate than she would have been had she been paid the income she was entitled to on a yearly basis; this tax phenomenon is known as "bunching."[17] For example, if the above taxpayer was wrongfully terminated in January 2018 but did not receive an award of back pay until January 2021, the award would account for her lost income from 2018, 2019, and 2020. Her tax burden for 2021 would be calculated from $150,000 of gross income following the same rate schedule discussed above, even though her salary was only $50,000 per year. In this situation, the taxpayer would reach a marginal tax rate of 24 percent and an average tax rate of 20 percent, totaling $30,021 in tax liability. On each $50,000 earned, or each year's income, she now owes just over $10,000 in federal taxes rather than the $6,748.50 previously calculated on a single year's income. This amounts to over 45 percent more in due taxes, compensating the plaintiff with 7.5 percent less after-tax net income than she would have earned over

11. Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). The test used for determining whether a payment is income is whether it was an "accession[] to wealth, clearly realized, over which the taxpayer[] ha[s] complete dominion." *Id.* at 431. Compensation from litigation awards surely satisfies this test.

12. I.R.C. § 451(a) ("The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer.").

13. *See* I.R.C. § 1(j)(3)(B). For a list of the current tax tables, see Rev. Proc. 2020-45 § 3.01, 2020-46 I.R.B. 1018–19.

14. *See* I.R.C. § 1(j).

15. I.R.C. § 1(j)(2)(C); Rev. Proc. 2020-45 § 3.01, 2020-46 I.R.B. 1018–19.

16. *See* Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. REV. 1421, 1430 (2018).

17. *Id.* at 175–76, 181, 207.

three years but for her wrongful termination.[18] This discrepancy in tax consequences begs the question of whether the award actually accomplishes the intent of making the successful plaintiff whole.

The tax code provides some protections for recipients of substantial awards. IRC § 104, for example, excludes "any damages . . . received . . . on account of personal physical injury or physical sickness," by settlement or award from the recipient's taxable income.[19] Similarly, IRC § 62 authorizes a deduction for attorneys' fees in employment discrimination cases.[20] This protects award recipients by only taxing the amount they receive as actual income after paying attorneys' fees rather than the full award.

In other areas of law, courts have looked favorably upon the gross-up procedure for tax or similar purposes. For example, tort cases have considered the tax implications for wrongful death and personal injury awards since the 1980s.[21] These cases are often considered more complex due to estimations of future income, life expectancy, investment potential, and other factors, yet the negative tax consequences of bunching awards are still accounted for.[22] Some federal circuits have also considered the tax implications in breach of contract claims and the accumulation of consequential damages.[23] These examples showcase the equitable nature of gross-up and the fact that increased complexity has not been a barrier to its use.

In contrast, the area of employment law has failed to implement gross-up procedures to address similar needs. The objective of antidiscrimination laws, including Title VII, the Americans with Disabilities Act ("ADA"), and the Age Discrimination in Employment Act ("ADEA"), is to make an injured plaintiff whole by compensating

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18. This example does not factor in the present value of money because the impact would be minimal on a three-year time period. *CPI Inflation Calculator*, U.S. BUREAU OF LAB. STAT., https://www.bls.gov/data/inflation_ calculator.htm (last visited Apr. 25, 2021). Any change would slightly reduce, but not resolve, the significant change in total tax owed and therefore constitute an unnecessary complexity for the purpose of this Comment.

19. I.R.C. § 104(a)(2).

20. *Id.* § 62(a)(20).

21. *See* Sosa v. M/V Lago Izabal, 736 F.2d 1028, 1033–34 (5th Cir. 1984) (increasing a lost income award "by the amount of income tax that would have to be paid on the earnings of the award"); *see also* De Lucca v. United States, 670 F.2d 843, 844 (9th Cir. 1982) (adding "an amount to compensate for income taxes on the investment earnings of the lump sum award").

22. *See* Brian C. Brush & Charles H. Breedon, *A Taxonomy for the Treatment of Taxes in Cases Involving Lost Earnings*, 6 J. LEGAL ECON. 1, 7–9 (1996).

23. *See* Oddi v. Ayco Corp., 947 F.2d 257, 268 (7th Cir. 1991) (reasoning that a tax award was appropriate because the tax consequence from the breach of contract was foreseeable); *see also* Paris v. Remington Rand, Inc., 101 F.2d 64, 68 (2d Cir. 1939) (rejecting a "tax differential" approach on a breach of contract claim on the basis of "wide speculation," implying it allows tax gross-up when calculations can be more accurate).

her for monetary and other losses suffered as a result of the discriminatory action of an employer.[24] These statutes follow the remedial scheme of Title VII, allowing courts to order, among other things, reinstatement, back pay, "or any other equitable relief as the court deems appropriate."[25] Courts have used this wide discretion in equitable relief to authorize the monetary "mak[ing] whole" of plaintiffs in various ways, but they arguably fall short of this goal by not addressing the tax implications that accompany the awards.[26]

With the objective of returning plaintiffs to the position they would have been in had the discriminatory action not occurred, some federal circuits found that accounting for the increased tax burden placed on plaintiffs is necessary to fully accomplish this objective.[27] This would mean mitigating the 45 percent increased tax burden placed on the plaintiff in the above illustration.

Likewise, front pay damage awards lead to a similar question of tax implications. Front pay awards experience the same issue from a different lens, which is bunching of future compensation with a comparable tax consequence. While front pay and back pay share many characteristics and have overlapping applications as discussed later, this Comment focuses on the tax implications of bunching back pay. The issue of compensating for additional tax consequences on bunching back pay lies in the equitable nature of its application and legal considerations, while front pay requires discretionary consideration of future amount earned, duration, and present value reduction.[28]

Prejudgment interest similarly intends to mitigate that impact and has a comparable objective of accounting for bunching after extended litigation and plaintiffs' past and continuing loss. Unlike

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24. Albemarle Paper Co. v. Moody, 422 U.S. 405, 418 (1975) (explaining the purpose of antidiscrimination statutes to be "to make persons whole for injuries suffered on account of unlawful employment discrimination").

25. 42 U.S.C. § 2000e-5(g)(1); *see also* Eshelman v. Agere Sys., Inc., 554 F.3d 426, 442 (3d Cir. 2009) ("Our conclusion is driven by the 'make whole' remedial purpose of the antidiscrimination statutes.").

26. *See In re* Cont'l Airlines, 125 F.3d 120, 135 (3d Cir. 1997) (noting that discretion is necessary to return employees to the "economic status quo" that existed prior to illegal employer conduct); Roy L. Brooks, *A Roadmap Through Title VII's Procedural and Remedial Labyrinth*, 24 SW. L. REV. 511, 521–22 (1995).

27. *Eshelman*, 554 F.3d at 441–42 ("We hold that a district court may, pursuant to its broad equitable powers . . . award a prevailing employee an additional sum of money to compensate for the increased tax burden a back pay award may create. . . . Without this type of equitable relief in appropriate cases, it would not be possible 'to restore the employee to the economic status quo that would exist but for the employer's conduct.'" (quoting *In re* Cont'l Airlines, 125 F.3d at 135)); *see* Sears v. Atchison, Topeka & Santa Fe Ry., 749 F.2d 1451, 1456 (10th Cir. 1984).

28. 45C AM. JUR. 2D *Job Discrimination* § 2593 (2020).

gross-up, prejudgment interest awards are widely accepted by most courts, even if their calculations rely on considerable estimation.[29] The Third Circuit recognized the need for gross-up compensation and prejudgment interest by noting that "the harm to a prevailing employee's pecuniary interest may be broader in scope than just a loss of back pay."[30] These solutions are intended to solve a simple problem: how to return injured plaintiffs back to their prior "economic status quo."[31] The difference lies in the complexity of the harm each attempts to alleviate. Prejudgment interest compensates a plaintiff for both the opportunity lost and the respective inflation experienced due to a delayed award; it is calculated differently for each year of loss based on many external factors.[32] Tax gross-up awards alleviate the additional tax burden from the bunching of multiple years that results from the large award rather than the lack thereof.

B. The History of Gross-Up Compensation

Before exploring the current circuit split on gross-up authorization, it is worth noting the historic changes that have influenced this issue. Two notable changes to tax law in the last century demonstrate potential solutions that have already been rejected. The result of these rejections left victims of discrimination unprotected from the harms gross-up prevents. Both ended with affirmative congressional decisions to close off these protections for victims of discrimination.

The first was the process of income averaging, repealed in 1986.[33] This process allowed taxpayers to amass up to four years of prior income and average their tax liability over that time period.[34] This law provided recipients of lump-sum back pay awards—especially those who may have been out of work over the course of litigation or settled for nonequivalent work to mitigate their loss—the chance to spread their tax liability across at least a few prior years.[35] This lessened the impact from the progressive rate schedule. However, this option was repealed by the Tax Reform Act of 1986.[36] Critics of this method raised concerns about its equitable use for all taxpayers, the burden on the U.S. Treasury to implement and manage such a

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29. Eirik Cheverud, *Increased Tax Liability Awards After* Eshelman*: A Call for Expanded Acceptance Beyond the Realm of Anti-Discrimination Statutes*, 56 N.Y L. SCH. L. REV. 711, 730 (2011/12).

30. *Eshelman*, 554 F.3d at 442.

31. *See* Hulley, *supra* note 3, at 202.

32. Cheverud, *supra* note 29, at 727–38.

33. I.R.C. § 1305 (repealed 1986).

34. D. Mark Collins & Patrick Goetzinger, *Individual Income Tax Provisions of the Tax Reform Act of 1986*, 32 S.D. L. REV. 415, 447 (1987).

35. *See id.* at 446–47.

36. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, 2117 (1986) (codified as amended at I.R.C. § 1).

program, and the resulting loss of revenue for the Internal Revenue Service ("IRS"), which was estimated near $4 billion in a single year when income averaging was available.[37] While income averaging provided a benefit to recovering plaintiffs for a few decades, its assistance was limited to a four-year distribution of liability (even when litigation lasted longer), and it put the monetary burden on the IRS instead of the liable defendant.[38]

The second was a broader version of the exclusion of any personal injury, not just physical injury, from income. When first litigated, courts agreed with plaintiffs' interpretation of IRC § 104, which excluded compensation for "tort-like" injuries from taxable income.[39] Employment discrimination awards were placed in the same category as other "injuries" and were treated the same as personal injury claims under the tax code.[40] This resulted in no taxation of back pay and other damages awarded. However, in the 1992 case *United States v. Burke*,[41] the Supreme Court narrowed the exclusion by holding that Congress's intent was to exclude physical injury damages because they compensated plaintiffs for medical bills already incurred or recovery costs, which the court stated should not be "taxable" income.[42] Congress agreed and in 1996 amended the language to what we see today.[43]

Both laws, while providing benefits to employment discrimination plaintiffs, did so at the expense of the general taxpaying public. In both instances, no taxes were paid on the money changing hands.[44] Similar to other faulty solutions discussed in Subpart III.B, placing the tax burden on the taxpaying public, instead of the liable defendant, results in a substantial negative impact on society as a whole; such remedies should not be considered viable solutions.

C. Current Circuit Split

To date, only a handful of federal circuit courts have decided issues of gross-up compensation for back pay awards in the context of

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37. *See* Richard Schmalbeck, *Income Averaging After Twenty Years: A Failed Experiment in Horizontal Equity*, 1984 DUKE L.J. 509, 510–11 (1984).

38. Cheverud, *supra* note 29, at 723.

39. *See, e.g.*, Rickel v. Comm'r, 900 F.2d 655, 661 (3d Cir. 1990).

40. J. Martin Burke & Michael K. Friel, *Tax Treatment of Employment-Related Personal Injury Awards: The Need for Limits*, 50 MONT. L. REV. 13, 23–24 (1989).

41. 504 U.S. 229 (1992).

42. *Id.* at 241–42.

43. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, sec. 1605(a)–(c), § 104(a), 110 Stat. 1755, 1838–39 (codified as amended at I.R.C. § 104) (adding "physical" as a limiting requirement on the damages to be excluded from taxable income).

44. *See* Cheverud, *supra* note 29, at 13; Schmalbeck, *supra* note 37, at 511.

employment discrimination or wrongful termination cases. Since 1984, and most recently in 2017, four federal circuits have accepted gross-up compensation to fit within the equitable powers of courts authorized by the antidiscrimination statutes.[45] Only one circuit, in 1994, rejected gross-up application, and another rejected its application specifically against government employers without considering its application in the private sector.[46] Within circuits yet to speak on awarding gross-up compensation, district courts have generally decided in favor of authorizing gross-up compensation.[47]

In *Sears v. Atchison, Topeka and Santa Fe Railway*,[48] the Tenth Circuit became the first to hold that gross-up compensation is an acceptable equitable remedy for plaintiffs who suffer negative tax consequences based on lump-sum back pay awards.[49] There, the court affirmed a lower court's discretionary award of a "tax component in the back pay award to compensate [plaintiffs] for their additional tax liability as a result of receiving over seventeen years of back pay in one lump sum."[50] The court qualified its holding and limited its scope by claiming that gross-up is "not appropriate in a typical Title VII case"; however, this "protracted" case deserved consideration of a tax component.[51] Earlier that same year, the Tenth Circuit denied gross-up in *Blim v. Western Electric*[52] because the current law allowed five-year averaging, which protected the plaintiffs from "nearly all of any [tax] penalty that would otherwise result from receipt of a lump sum payment."[53] However, as noted earlier, the income averaging approach was not ubiquitously effective and certainly would have been inadequate in comparison to the gross-

45. *See* Clemens v. CenturyLink, Inc., 874 F.3d 1113, 1116 (9th Cir. 2017); EEOC v. N. Star Hosp., Inc., 777 F.3d 898, 904 (7th Cir. 2015); Eshelman v. Agere Sys., Inc., 554 F.3d 426, 441–42 (3d Cir. 2009); Sears v. Atchison, Topeka & Santa Fe Ry., 749 F.2d 1451, 1456 (10th Cir. 1984).

46. *See* Dashnaw v. Peña, 12 F.3d 1112, 1116 (D.C. Cir. 1994); *see also* Arneson v. Callahan, 128 F.3d 1243, 1247 (8th Cir. 1997).

47. *See, e.g.*, EEOC v. Joe's Stone Crab, Inc., 15 F. Supp. 2d 1364, 1380 (S.D. Fla. 1998) ("[A] district court . . . may include a tax component in a lump sum back pay award to compensate prevailing Title VII plaintiffs. This accords with a prevailing practice . . . which commonly include[s] an amount to offset the plaintiff/taxpayer's increased liability."); Pham v. City of Seattle, 151 P.3d 976, 979, 981 (Wash. 2007) (affirming the trial court's award of additional damages for adverse tax consequences); *see also* King v. CVS Health Corp., 198 F. Supp. 3d 1277, 1291 (N.D. Ala. 2016) ("An award of additional sums to offset that increased tax burden makes logical sense. However, the Eleventh Circuit has not spoken on this question.").

48. 749 F.2d 1451 (10th Cir. 1984).

49. *See id.* at 1453, 1456.

50. *Id.* at 1456.

51. *Id.*

52. 731 F.2d 1473 (10th Cir. 1984).

53. *Id.* at 1480.

up compensation awarded in *Sears*. Income averaging in the *Sears* plaintiffs' case would still result in taxation on almost three and a half years of income during each of the five years over which the total sum could be spread.[54]

More recently, a defendant-employer attempted to rely on *Blim* for support to reject gross-up because the plaintiff's "tax burden would not be 'significant'" enough to warrant it.[55] On review, the Tenth Circuit made clear that *Blim* rejected gross-up compensation because other means of mitigating additional tax consequences were available to the plaintiff and without those means, any tax-disadvantaged plaintiff could be entitled to gross-up at the district court's discretion.[56] In the final words of its 2015 decision, the Tenth Circuit rescinded the *Sears* limitation on gross-up for "typical" cases by clarifying that its holding did not require "atypical cases" to entitle plaintiffs to gross-up compensation, leaving this call to the discretion of the district court as well.[57]

While the Tenth Circuit did not define which cases *would* entitle plaintiffs to gross-up compensation, there is an opportunity for the court to make gross-up compensation available in any case where it *could* be beneficial to recovering plaintiffs. Arguably, this could apply to any case that results in additional tax liability, any case that takes more than a year or two to settle or reach judgment, or any case with an award that places a plaintiff in a tax bracket above the one that she would be in but for the employment discrimination.

The Third Circuit, in contrast, took a few decades to solidify the availability of gross-up as an equitable remedy. In 1987, the Third Circuit authorized gross-up compensation for an employment discrimination plaintiff solely because the defendant-employer did not challenge its application and chose only to dispute the dollar amount requested.[58] As such, the holding only addressed the calculation of that amount and not whether gross-up compensation was allowable as a preliminary matter.[59] Following this decision, district courts within the Third Circuit consistently applied gross-up strictly to lump-sum back pay awards, presuming that the Third Circuit would find this to be within their equitable powers.[60]

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54. *See Sears*, 749 F.2d at 1456.

55. EEOC v. Beverage Distribs. Co., 780 F.3d 1018, 1024 (10th Cir. 2015).

56. *Id.*

57. *Id.*

58. Gelof v. Papineau, 829 F.2d 452, 455–56 (3d Cir. 1987).

59. *Id.* at 455 n.2 ("In light of [defendant's] concession that the judgment should properly include the negative tax impact of a lump sum payment as an element of damages, we do not address the question of whether such an award should be made in all back pay cases.").

60. *See* O'Neill v. Sears, Roebuck & Co., 108 F. Supp. 2d 443, 447 (E.D. Pa. 2000) ("[W]e anticipate that the Third Circuit would likewise compensate the

In 2006, the Third Circuit heard the preliminary issue while reviewing a decision out of the Eastern District of Pennsylvania where a plaintiff successfully sued her employer for discriminating against her based on her disability.[61] The jury awarded the plaintiff-employee, among other damages, back pay with additional compensation to cover the tax consequences accompanying her lump-sum award.[62] The Third Circuit affirmed the lower court's presumption toward gross-up application, deciding that based on the "'make whole' remedial purpose of the antidiscrimination statute[]" and the "broad equitable powers" granted by those statutes, district courts could award gross-up compensation.[63]

In 2015, the Seventh Circuit followed the same reasoning as the Third Circuit and agreed that gross-up was available as an equitable remedy within antidiscrimination statutes to supplement lump-sum back pay awards.[64] In that case, the Western District of Wisconsin applied gross-up to a back pay award for a Title VII retaliation claim, recognizing that the plaintiff "will have to pay taxes on a lump sum award that he would not have had to pay had he received the money spread out over the more than three years since he was terminated improperly."[65] The Seventh Circuit affirmed the 15 percent increase to the back pay award and the underlying reasoning but explicitly set guidelines for district courts, and therefore indirectly for plaintiffs, to "show their work if and when they adjudge similar tax-component awards in the future."[66] In subsequent decisions, district courts within the Seventh Circuit have regularly used this caveat to deny plaintiffs gross-up compensation when they failed to show careful, or sometimes any, calculations to their requested gross-up sum.[67] This expectation aligns with the equitable nature of gross-up, as well as the logic that some calculation is required in order for plaintiffs or

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claimant for the depletion of that money due to the increased taxes to which the award is subject on account of its being received in a single tax year, rather than being spread out over time."); *see also* Loesch v. City of Philadelphia, No. 05-CV-0578, 2008 U.S. Dist. LEXIS 48757, at *27–29, 33 (E.D. Pa. June 25, 2008).

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

62. *See* Eshelman v. Agere Sys., Inc., 397 F. Supp. 2d 557, 561 (E.D. Pa. 2005).

63. *Eshelman*, 554 F.3d at 441–42.

64. *See* EEOC v. N. Star Hosp., Inc., 777 F.3d 898, 904 (7th Cir. 2015).

65. EEOC v. N. Star Hosp., Inc., No. 12-CV-214-bbc, 2014 U.S. Dist. LEXIS 10084, at *10 (W.D. Wis. Jan. 27, 2014).

66. *N. Star Hosp., Inc.*, 777 F.3d at 904.

67. *See, e.g.*, Smith v. Farmstand, No. 11-CV-9147, 2016 U.S. Dist. LEXIS 140460, at *79–81 (N.D. Ill. Oct. 11, 2016) (finding that because "[p]laintiff provides no guidance as to how the Court might go about calculating an appropriate tax-component," he was not entitled to such compensation); *see also* Arroyo v. Volvo Grp. N. Am., LLC, No. 12-CV-6859, 2017 U.S. Dist. LEXIS 108507, at *43–45 (N.D. Ill. July 13, 2017) (coming to a similar conclusion).

their experts to make an accurate request for gross-up compensation in the first place.

Finally, in *Clemens v. CenturyLink, Inc.*,[68] the Ninth Circuit became the most recent circuit to officially permit district courts "to award a gross up—and the appropriate amount of any such gross up—[at] the sound discretion of the district court."[69] Unlike the previous circuit decisions, the Ninth Circuit offered a hint of guidance as to when gross-up would be appropriate or inappropriate.[70] It developed factors of calculability and stated the necessity of gross-up compensation as prerequisites to awarding it.[71] However, rather than setting a clear threshold for fulfilling these standards, this holding permits courts to evaluate demands for gross-up along a sliding scale, allowing a greater degree of one factor and a lesser degree of another to result in the propriety of gross-up compensation.[72] In doing so, the Ninth Circuit seemed to be aware of its imprecise rulemaking, referencing the Third Circuit's similarly ambiguous guidance that the "nature and amount of relief . . . var[y] from case to case" without saying how they vary or why it would be relevant.[73]

Conversely, in *Dashnaw v. Peña*,[74] the D.C. Circuit became the only federal circuit to reject gross-up for lump-sum back pay awards across the board for victims of discrimination.[75] In a four-page decision, it offered one paragraph to explain that with a "complete lack of support in existing case law for tax gross-ups," it saw no reason to allow such compensation for a plaintiff who was discriminated against based on his age.[76] More than a decade later, in *Fogg v. Gonzales*,[77] the D.C. Circuit stood by its original ruling and overturned the lower court's decision to award a 14 percent gross-up on top of a back pay award.[78] The lower court agreed with the plaintiff that he could distinguish his case from *Dashnaw* based on the greater

68. 874 F.3d 1113 (9th Cir. 2017).

69. *Id.* at 1117.

70. *See id.*

71. *Id.* ("[T]here may be cases where a gross up is not appropriate for a variety of reasons, such as the difficulty in determining the proper gross up or the negligibility of the amount at issue.").

72. *See id.*

73. *Id.* (quoting Eshelman v. Agere Sys., Inc., 554 F.3d 426, 443 (3d Cir. 2009)).

74. 12 F.3d 1112 (D.C. Cir. 1994).

75. *See id.* at 1116.

76. *Id.* While the D.C. Circuit had no binding precedent on the issue, the Tenth Circuit had ten years prior considered and allowed gross-up for similarly situated victims of employment discrimination. *See* Sears v. Atchison, Topeka & Santa Fe Ry., 749 F.2d 1451, 1456 (10th Cir. 1984).

77. 492 F.3d 447 (D.C. Cir. 2007).

78. *Id.* at 455–56.

tax burden he would endure.[79] On review, the D.C. Circuit steadfastly rejected this decision, stating that the size and delay of the award were irrelevant to its unqualified ban on "'gross-ups' of back pay to cover tax liability."[80]

In a narrower decision, the Eighth Circuit took the position that gross-up compensation was unavailable for government employees in the case of employment discrimination.[81] The plaintiff was a federal employee whose termination for symptoms relating to a neurological disorder affecting his productivity violated the Rehabilitation Act of 1973.[82] The Eighth Circuit affirmed a judgment for the plaintiff but denied gross-up to compensate for his additional tax burden.[83] In support of its denial of gross-up, the court relied on sovereign immunity and the fact that at no point had the government waived such immunity for a "tax enhancement remedy against the federal government" as it did for liability on employment discrimination.[84] The Eighth Circuit looked further than the low-hanging fruit of precedent and the antidiscrimination statutes for support of its denial of gross-up compensation. In a sense, one could deduce that analysis of the antidiscrimination statutes inadequately supported the court's denial of gross-up, requiring a rule specific to government employers.[85] Since its rejection was limited to government protection, it seems likely that if an employee who was discriminated against in the private sector requested gross-up for consequential tax liability, the Eighth Circuit would find it within the court's equitable power to award it.

III. ANALYSIS

This Part analyzes why gross-up is the best solution to address the negative tax consequences of lump-sum back pay awards and argues that it should be universally affirmed. First, it will discuss the benefits and consequences of gross-up and the factors that need to be accounted for when calculating gross-up compensation. It will then compare alternative solutions and conclude by recognizing gross-up as the most effective and accurate solution to this issue.

A. Gross-Up and Means of Calculation

While there may not be a perfect solution to handling the negative tax consequences that accompany back pay bunching, gross-

79. *See* Fogg v. Gonzales, 407 F. Supp. 2d 79, 91 (D.D.C. 2005), *rev'd*, 492 F.3d 447 (D.C. Cir. 2007).

80. *Fogg*, 492 F.3d at 455 (quoting *Dashnaw*, 12 F.3d at 1116).

81. *See* Arneson v. Callahan, 128 F.3d 1243, 1247 (8th Cir. 1997).

82. *Id.* at 1244–45.

83. *Id.* at 1247.

84. *Id.*

85. *See id.*

up is the most efficient and reasonably accurate solution available. The public policy concerns, ease of calculations using hindsight information, and availability of equitable monetary remedies from the court outweigh the minor disadvantages of gross-up. It is also important to note that the disadvantages of gross-up are not exclusive to this solution because they also occur while implementing any comparable alternatives.

There are two notable concerns that accompany gross-up compensation. One downfall of gross-up is that employers carry the additional burden of payment beyond what they would have owed the plaintiff but for the adverse employment action. However, this additional cost is not dissimilar to punitive damages, which could be reduced based on this additional noncompensatory award. The deterrence purpose of the antidiscrimination statutes supports this burden being placed on an employer found liable for employment discrimination rather than on a recovering victim.[86] The second notable concern is that the computation process for gross-up is complex because it factors in potential deductions, filing status, and other tax considerations.[87] However, the complexity is not insurmountable and can be deciphered by economic and tax experts, at least to a threshold of reasonable accuracy for a court to feel confident relying on such calculations.[88] This process has been analyzed both in the courts and by economic experts, who offer a variety of ways to handle this uncertainty, including denying gross-up where it cannot be easily calculated, accepting simple calculations on low award amounts, or following complex economic formulas for optimal accuracy when larger sums are at stake.[89] Since gross-up is a form of equitable compensation, courts have been given discretion to determine the most reasonable approach on a case-by-case basis.

Generally, back pay and gross-up compensation calculations must use specific mathematical calculations and therefore benefit from the accuracy of hindsight rather than future estimations.[90] This

86. *See* Albemarle Paper Co. v. Moody, 422 U.S. 405, 417–18 (1975); *see also* Gregg D. Polsky & Stephen F. Befort, *Employment Discrimination Remedies and Tax Gross Ups*, 90 IOWA L. REV. 67, 106 (2004).

87. *See* Barber v. Cal. State Pers. Bd., 247 Cal. Rptr. 3d 474, 484 (Cal. Ct. App. 2019).

88. *See* Tim Canney, *Tax Gross-Ups: A Practical Guide to Arguing and Calculating Awards for Adverse Tax Consequences in Discrimination Suits*, 59 CATH. U. L. REV. 1111, 1135 (2010) (citing Argue v. David Davis Enter., No. 02–9521, 2009 WL 750197, at *26–27 (E.D. Pa. Mar. 20, 2009)) (noting the reasonable expectation trial judges place on plaintiffs to provide "detailed accounting calculations and records supporting a specific figure or estimate").

89. *See id.* at 1135–36, 1136 n.222.

90. *See* Sonoma Apartment Assocs. v. United States, 939 F.3d 1293, 1298 (Fed. Cir. 2019) (comparing the complexity of calculating gross-up on breach of contract awards to the more accurate calculation of gross-up on back pay awards because "the applicable tax rates and lost income [are] known").

reduces the likelihood of overestimating or undervaluing. The burden to calculate award requests and to show evidence of the calculations and conclusions rests with the plaintiff.[91] Many courts agree that *complete failure* to show calculations of the additional tax consequence faced by plaintiffs equates to failing to carry the burden of proving such consequence exists.[92] This aligns with the Third Circuit's warning that plaintiffs are not "presumptively entitled to an additional award to offset tax consequences" simply because they are awarded back pay.[93] Additionally, courts already address the issue of complexity by not requiring perfectly accurate calculations to authorize recovery due to a vast number of unavoidable variables.[94]

District courts vary in their acceptance and skepticism of gross-up calculations. The Eastern District of Pennsylvania has denied gross-up compensation in two cases where plaintiffs used the same expert.[95] Both decisions cite a lack of accuracy as justification for the denial of gross-up. In *Loesch v. City of Philadelphia*,[96] the expert ignored the plaintiff's filing status and specific deductions, overestimating hypothetical calculations rather than using the proper and readily available information.[97] The plaintiff requested $87,330 for tax coverage based on the expert's calculation.[98] The court recognized the inaccuracies and ease of the proper calculation and submitted the below chart as its own calculation, awarding $46,746 to the plaintiff in gross-up compensation to offset his additional tax burden.

91. *See* Eshelman v. Agere Sys., Inc., 554 F.3d 426, 443 (3d Cir. 2009).

92. *See* Hukkanen v. Int'l Union of Operating Eng'rs, 3 F.3d 281, 287 (8th Cir. 1993); *Argue*, 2009 WL 750197, at *26–27; Loesch v. City of Philadelphia, No. 05-CV-0578, 2008 WL 2557429, at *11 (E.D. Pa. June 25, 2008).

93. *Eshelman*, 554 F.3d at 443.

94. "Plaintiffs must provide *some* measure of substantiation to show the reasonableness of their calculations," *Sonoma Apartment Assocs.*, 939 F.3d at 1299, but "absolute exactness or mathematical precision" is not required, Bluebonnet Sav. Bank v. United States, 266 F.3d 1348, 1355 (Fed. Cir. 2001).

95. *See Argue*, 2009 WL 750197, at *26–27; *Loesch*, 2008 WL 2557429, at *11.

96. No. 05-CV-578, 2008 WL 2557429 (E.D. Pa. 2008).

97. *Id.* at *11.

98. *Id.* at *11–12.

FIGURE 1: COURT'S CALCULATION TO ADJUST PLAINTIFF'S AWARD IN *LOESCH*[99]

Lump Sum Award	$345,542
Deductions	$16,806
Taxable Income	$328,736
Tax	$82,863
Effective Tax Rate (married filing jointly)	26.67%
Normal Tax Rate on "normal salary of $51,925"	12.45%
Tax Increase	14.22%
Additional tax on lump sum	$46,746

In a subsequent case, the same expert used the tax rates from the incorrect year as to when the plaintiff would receive the lump-sum back pay award and estimated the plaintiff's past taxes when they were available in the plaintiff's prior tax returns for complete accuracy.[100] The court not only found the calculations to be inaccurate but also that the plaintiff failed to offer support that he was even entitled to an equitable gross-up at all, consequently denying any additional recovery to offset tax liability.[101] Other courts within the Third Circuit have agreed that without a presumption toward gross-up entitlement, requests for additional compensation will be denied when there is a "lack of reliable evidence in the record to allow the Court to make a non-speculative negative tax implication award."[102]

In the above cases, the same court aided the plaintiff by resolving inaccurate calculations to award gross-up in one instance and denied compensation due to inaccuracy in another, while other courts in the same circuit have denied compensation for lack of proof behind awarding gross-up compensation. This variance is due to the equitable nature of gross-up as a remedy and the level of discretion given to trial courts in awarding it. Some plaintiffs may argue that the discrepancy between decisions (specifically, the district court's assistance to one plaintiff in an effort to find a reasonable award but not to others) is evidence of abuse of discretion if their inaccurate calculations are not aided in the same way.[103] In any case, this string

99. *Id.* at *11.

100. *See Argue*, 2009 WL 750197, at *26–27.

101. *Id.*

102. Supinski v. United Parcel Serv., Inc., No. 3:06-CV-00793, 2012 WL 2905458, at *6 (M.D. Pa. July 16, 2012); *see also* Vega v. Chi. Park Dist., 351 F. Supp. 3d 1078, 1096 (N.D. Ill. 2018) ("[I]n the relevant portion of [plaintiff's] brief, she points to nothing other than a federal withholding table. Perhaps plaintiff can calculate an appropriate tax-component award based on this document alone, but the Court is at a loss. Based on this meager showing, the Court declines to award plaintiff a tax offset.").

103. *See, e.g.*, Porter v. U.S. Agency for Int'l Dev., 293 F. Supp. 2d 152, 156 (D.D.C. 2003) (denying gross-up in part because plaintiff could not establish a

of decisions shows a check on awarding gross-up compensation for additional tax consequences and an effort toward accuracy, protecting employers from paying undue awards.

However, some courts simply accept the plaintiff's request and calculation of gross-up where defendants do not object to plaintiff's right to gross-up at all. In 2015, the Northern District of Illinois awarded plaintiff her requested sum in less than a paragraph:

> [Plaintiff] maintains that the back pay award would place her in the 25% tax bracket, as opposed to the 15% tax bracket under her current salary, and she requests a 10% tax-component award on the back pay . . . to account for the difference. [Plaintiff] will be awarded $6,203.60 (10% x $62,036.01) to offset [her] back pay award.[104]

Any calculation accepted without an adversary to scrupulously critique its methodology has the potential to be less accurate than that of the Pennsylvania court's in *Loesch*. However, courts have agreed that the "nature and amount of relief needed to make an aggrieved party whole" are relevant to the discretionary decision of awarding gross-up.[105] It may be appropriate in the Illinois case and similar cases—with less money at stake and a lack of pushback from a defendant-employer—to accept the simplified calculation and ignore issues of deductions, marginal tax rates, and the tax then required on the additional income. The Seventh Circuit accepted a similarly simplified calculation in *EEOC v. Northern Star Hospitality*,[106] the seminal case in which it affirmed gross-up.[107] While the Seventh Circuit warned district courts and plaintiffs to show their work in the future, it affirmed a $6,495 award because it was a "modest, equitable remedy," even without clear evidence to support the calculation.[108] An equitable award that does not need to be exact is an appropriate one as long as the court does not abuse its discretion in compensating the plaintiff.[109]

Without clear requirements for accuracy and specificity, courts may simply reject gross-up for lack of certainty. Conversely, for the purposes of consistency and fairness noted above, there should be clear guidance as to which factors must always be considered in

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"precise calculation"); Josifovich v. Secure Computing Corp., No. CIV. 07-5469FLW, 2009 WL 2390611, at *6 (D.N.J. July 31, 2009) (disagreeing with the plaintiff's contention that "she is entitled to have [her settlement proceeds] 'equitably grossed up'").

104. Sheils v. Gatehouse Media, Inc., No. 12-CV-2766, 2015 WL 6501203, at *12 (N.D. Ill. Oct. 27, 2015).

105. Eshelman v. Agere Sys., 554 F.3d 426, 443 (3d Cir. 2009).

106. 777 F.3d 898 (7th Cir. 2015).

107. *Id.* at 904.

108. *Id.*

109. *Id.* at 901, 903–04.

calculating gross-up compensation and which may be discretionary depending on context. For example, filing status is almost always predictable and has major implications for tax rates; therefore, it should be an absolute requirement that the plaintiff offer this accurate information in order to request gross-up.[110] Additionally, although all taxpayers may choose between the standard deduction and itemizing their deductions, it is reasonable to at least account for the standard deduction in all gross-up calculations;[111] this could be a minimum amount all taxpayers would deduct from their gross income prior to calculating tax liability.[112] It would also protect the employer from paying for the tax burden on an amount of income that the taxpayer herself would not pay taxes on. If the taxpayer is able to itemize her deductions with some level of accuracy, she should be expected to do so in order to inform the court's decision as accurately as possible and not overburden the defendant. Finally, if the tax rates notably change from year to year, gross-up on each year of back pay should be calculated according to the actual rate applied in hindsight, as opposed to applying a blanket percentage gross-up.

A recent article by Michael Nieswiadomy and Thomas Loudat offers an insightful economic analysis and function for calculating gross-up compensation.[113] Nieswiadomy and Loudat recommend accounting for "Social Security and Medicare taxes" on top of "both federal and state (if applicable) income taxes and their progressive rate structure; the deductibility of state income taxes in some state jurisdictions; payroll taxes; and investment income."[114] Such mathematical gymnastics are not expected of courts, but they should be expected of plaintiffs and their experts if these values are known and can be accounted for. As noted earlier, perfect accuracy is not required because all unknowns and presumptions cannot be eliminated, but the ultimate goal of compensating plaintiffs and making them whole should always be weighed against fairly burdening the defendant in order to reach a just result.

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110. *See* I.R.C. § 1(j) (identifying the rate schedules per designated filing status); *see also* § 7703(a)(1) (defining married filing jointly filing status); § 2(b) (defining head of household filing status).

111. *See* I.R.C. § 63. This would presume that any taxpayer seeking an additional award to offset their tax liability would also take advantage of the available deductions, which would include the greater of their itemized deductions or the standard deduction, implying that, at minimum, the taxpayer would claim the standard deduction.

112. *Id.* §§ 63(b)(2), 63(c)(7) (listing the standard deduction values before inflation adjustments); Rev. Proc. 2020-45 § 3.16, 2020-46 I.R.B. 1022 (listing the 2021 inflation-adjusted standard deduction values).

113. Michael Nieswiadomy & Thomas Loudat, *Neutralizing the Adverse Effect of State and Federal Income Taxes on Lump Sum Awards in Employment Cases*, 25 J. LEGAL ECON. 53, 54 (2019).

114. *Id.*

B. Comparable Solutions

Two solutions are used in other areas of tax law for the purpose of aiding taxpayers with complex, and often burdensome, tax liability: amending prior tax returns and preferential tax treatment. These could both be viable options to handle the additional consequences that accompany lump-sum back pay awards. Below, both are carefully considered in an effort to find the best and most accurate protection for recovering plaintiffs. Accordingly, the positive attributes of these alternatives do not outweigh the downfalls for either to be recommended as a more effective solution than gross-up.

Allowing plaintiffs to amend prior tax returns and then allocate portions of a lump-sum award to the years in which that income would have otherwise been earned is one possible alternative solution. IRC § 441 computes annual tax liability based on income received within each tax year, starting January 1 and ending December 31.[115] For this reason, any award is taxed in its entirety in the year it is received at the tax rates of that year. Allowing amended returns would permit recovering plaintiffs to apportion a back pay award over the years for which it is recovered and appropriately allocate the tax liability to mitigate additional tax consequences of bunching. This process would allow each year's income to be separated and taxed individually based on the respective year's tax laws and rates as it would have been but for the unlawful discriminatory practice. This solution would require action by Congress to allow amended returns based on the monies received in a lump sum in one year.

Currently, IRC § 1312 offers an enumerated list of the reasons for which a return can be amended, which includes accounting for errors or previously excluded income items but not the allocation of back pay awards.[116] In the 1960s, a plaintiff attempted to amend eight years of tax returns based on a back pay award and allocate his earnings and attorneys' fees across the time period.[117] The Tax Court rejected this attempt to mitigate his tax burden, explaining that the IRC did not allow amendment in his situation.[118] This holds true today under the current language of § 1312.[119] Congress could authorize amendment as an additional circumstance under § 1312 in order to distribute or remove the additional tax burden placed on lump-sum back pay awards. However, the benefits of such a change are not significant enough to outweigh the difficulties and limitations it presents, which include a lengthy and risky run at getting Congress to pass legislation to make this change.

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115. I.R.C. § 441(a)–(b).
116. *See* I.R.C. § 1312.
117. *See* Smith v. Comm'r, 26 T.C.M. (CCH) 1017, 1018, 1020 (1967).
118. *Id.*
119. *See* I.R.C. § 1312.

However, there are two main benefits to amending tax returns that gross-up compensation does not offer. Most importantly, amending tax returns provides a more accurate alternative to gross-up. Amendment would require a reconsideration and recalculation of all circumstances of each amended tax year. This detailed review would inevitably make the conclusion more precise. Although the amendment of prior tax returns removes one financial burden that is placed on liable defendants, three additional burdens make this solution less satisfactory: additional administrative burdens on recovering plaintiffs to amend and refile years of prior tax returns, the limited scope of when this process would be appropriate, and the potential for misuse by plaintiffs. Overall, this alternative is infeasible and unrealistic at the scale that lump-sum back pay awards often reach.[120]

Despite these shortcomings, amending prior tax returns is a reasonable alternative to gross-up for short-lived litigation. Currently, the limitation for most amendments is three years.[121] This means that in most instances, taxpayers can only amend their prior three years of returns, with a few exceptions. *Sears* is a great example of the potential difficulties that could arise from litigation in today's court system.[122] Amending seventeen years of tax returns would require an extended window for amendments, which at this time is only available for amending fraudulent returns and filing returns that were never filed in the first instance.[123] Litigation spanning more than five years could lead to large margins of error on account of many "what if" situations. Therefore, this option would only be helpful in simpler cases and is not a universal solution.

Additionally, the burden for calculating and filing so many returns would be exponentially enlarged and carried by recovering plaintiffs.[124] This may seem fair as a tradeoff for accurate compensation, especially when compared to the financial burden it saves liable defendants over gross-up. However, when considered side by side, most would argue the financial burden on liable defendants in the gross-up solution is more appropriate than the

120. *See Remedies for Employment Discrimination*, EEOC, https://www.eeoc.gov/remedies-employment-discrimination (last visited Apr. 25, 2021).

121. *See* I.R.C. § 6511(a)–(b).

122. Sears v. Atchison, Topeka & Santa Fe Ry., 749 F.2d 1451, 1455 (10th Cir. 1984) (noting the "cruel effect of litigation delays" on the class members).

123. Although the normal limitation for amendments is three years, there are some exceptions that extend this limit as far as seven years for bad debts and worthless securities. *See* I.R.C. § 6511(d)(1).

124. *See* Robert W. Wood, *IRS Can Audit for Three Years, Six, or Forever: Here's How to Tell*, BUS. L. TODAY, August 2017, at 2–3 (highlighting the complexity of amending prior returns successfully and recommending taxpayers keep records for as long as possible in case amendment is required).

administrative burden on plaintiffs in the amendment solution. While not overly burdensome, the IRS would also play an administrative role in handling the additional refiled amendments, requiring government time and resources to effectively administer this solution.

Further tipping the scales against amending prior tax returns is the potential for misuse by plaintiffs based on annual changes. Fluctuating tax rates could incentivize recovering plaintiffs to manipulate their allocation of income toward years with lower tax rates and shift deductions to years with more liberal tax breaks.[125] In the earlier example, a taxpayer was entitled to $50,000 of income for each of three consecutive years. However, if tax schedules fluctuated over the course of litigation, the taxpayer may attempt to allocate $40,000 to a year with higher rates or $60,000 to a year with lower rates, claiming potential salary adjustments or bonuses to further mitigate tax obligations. This risk of misuse would be at the expense of the U.S. citizenry, who deserve to benefit from fairly distributed tax burdens. However, the potential burden shift to taxpayers at large is an even greater downfall in the following alternative.

The second potential alternative for removing the additional tax burden for plaintiffs recovering lump-sum back pay would be to allow preferential tax treatment on lump-sum awards. Capital gains, or income from the sale of certain property held for over a year, is one category of income that receives preferential tax treatment in the year it is earned.[126] This preferential treatment limits the tax rates on capital gains to no more than 20 percent in 2021 compared to the highest tax rate of 37 percent on ordinary income.[127] There are a few reasons for this incentivizing treatment, including accounting for inflation and protecting taxpayers from burdensome tax bills on bunched gains, both of which align with the goals of offering preferential treatment to lump-sum back pay awards.[128] However, capital gains receive preferential treatment to incentivize long term investment and mitigate any burdens upon profit transferees.[129] These reasons obviously do not align with the goals of applying preferential treatment to any settlements or awards.

Furthermore, Congress could offer another exception to the ordinary tax rates applied to lump-sum awards. Arguably, this

125. *See, e.g.*, I.R.C. § 1(j)(1)–(2) (modifying the tax brackets as part of the 2017 Tax Cuts and Jobs Act, but only for a "taxable year beginning after December 31, 2017, and before January 1, 2026").

126. I.R.C. § 1(h); *see also id.* § 1221(a) (defining properties that are considered capital assets, the sale of which may be taxable as capital gains).

127. *See* § 1(h); Rev. Proc. 2020-45 § 3.03, 2020-46 I.R.B. 1020.

128. *See* Noël B. Cunningham & Deborah H. Schenk, *The Case for Capital Gains Preference*, 48 TAX L. REV. 319, 328 (1993).

129. Deborah M. Weiss, *Can Capital Tax Policy be Fair? Stimulating Savings Through Differentiated Tax Rates*, 78 CORNELL L. REV. 206, 247 (1993).

protection could be justified by the reasons supporting the exceptions already in the IRC for deductions for attorneys' fees of discrimination victims,[130] as well as rules to exclude damages collected "on account of personal physical injury" from gross income.[131] However, these tax provisions also have support that reach beyond the tax concerns of lump-sum back pay awards. The deduction for attorneys' fees protects plaintiffs from paying income tax on the portion of their award that they will use to compensate their attorneys.[132] The income exclusion for physical injury damages exists due to the need for medical expense coverage more than compensation.[133] Both are still examples of a willingness by Congress to offer exceptions to the general taxability rule. One purpose of all these exceptions, including the one proposed, has been described as "return-of-capital."[134] This refers to returning money that may have been lost to injury.[135] Whether it be required attorneys' fees, physical injury expenses, or additional tax liability, the argument is that the recovering plaintiffs would not have been burdened with these expenses but for the injury caused by the defendants.

On the other hand, back pay is a collection of past income. As discussed earlier, there is no question that it is income and should be included as ordinary taxable income. If it was given preferential treatment at a lower rate, it would have the potential to reduce plaintiffs' tax burden below what would have been owed but for the employment action. Additionally, the burden would shift onto taxpayers who would then see less tax collected overall on income that should be taxed in some year at ordinary rates. This could be mitigated by a similarly progressive tax rate but would likely not be accurate in every situation. The tax rate could also be set higher than the capital gains rates of 0, 15, and 20 percent progressively; however, it would still be impossible to set an equitable schedule that does not overburden some and over-benefit others due to the taxpayers' varying awards and original tax brackets. Total tax liability under preferential rates would inaccurately, and possibly inadequately, compensate plaintiffs because their prediscrimination tax rates would be standardized.[136] This standardization inaccurately calculates plaintiffs' tax-to-income ratio relative to their share of U.S. taxpayer total liability. For these reasons, preferential treatment is

130. I.R.C. § 62(a)(20).
131. *Id.* § 104(a)(2).
132. *See id.* § 62; *supra* text accompanying note 20.
133. *See supra* notes 37–42 and accompanying text.
134. Burke & Friel, *supra* note 40, at 41–42.
135. *Id.*
136. *Compare* I.R.C. § 1(j)(5)(B)(ii) (providing progressive rates based on filing status), *with id.* § 1(h) (providing progressive rates without regard to filing status).

not an appropriate solution to resolve the additional tax burden of recovering plaintiffs.

After reviewing the numerous pitfalls which come with other alternatives to lump-sum payments, it is evident that the minor consequences of gross-up, including calculation requirements and burdening the liable defendant, are outweighed by the overall accuracy, efficiency, and reasonableness of gross-up.

IV. CONCLUSION

While all large awards result in unusual tax burdens on their recipients, employment discrimination and wrongful termination plaintiffs experience an unfair tax burden attached to income they should have received in the past at lower intervals. Receiving back pay in lump sums in order to make plaintiffs whole can only be successful if the amount of money they take home at the end of the day is at least equal to what they were owed in years past. While four federal circuit courts have appreciated this need and affirmed gross-up as a solution to protect plaintiffs from additional damage as well as place them back in the position they would have held but for the discrimination, it has taken decades just to get this handful of courts to authorize such a solution. This Comment finds that gross-up compensation offers the most accurate compensation for additional tax liability as well as the most reasonable means to do so. Compared to amending prior tax returns and preferential tax treatment, gross-up places the additional burden with the liable defendant rather than the U.S. taxpaying public or the recovering plaintiff. Gross-up also appropriately rests in the currently available equitable powers of the courts under the antidiscrimination statutes being administered while benefiting from hindsight and formulaic calculation. It is time that the Supreme Court set a precedent stating two distinct interpretations of antidiscrimination statutes. First, the equitable powers of district court judges laid out by antidiscrimination statutes allow for gross-up. Second, where a plaintiff suffers an additional tax liability from the receipt of a lump-sum back pay award due to employment discrimination or wrongful termination, additional compensation is required to make the plaintiff whole and return her to the financial position she would have occupied but for the employer's wrongdoing. With these two holdings, all plaintiffs should be able to fully recover for additional tax liability as necessary at the discretion of the courts and within reasonably calculated parameters.

Corinne Spencer[*]

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