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THE SUPREME COURT ADOPTS A COMMON SENSE APPROACH FOR DEFINING ADVERSE EMPLOYMENT ACTION

By J. Edward Hollington

On June 22, 2006, the United States Supreme Court addressed the definition of *adverse employment action* in Title VII retaliation cases. *Burlington Northern v. White*, 126 S.Ct. 2405, 165 L.Ed. 2d 345, 2006 U.S. Lexis 4895 (2006). This article analyzes the decision and its potential impact on employment law cases.

DAMAGE AWARDS FOR EMOTIONAL DISTRESS ARE NOT TAXABLE INCOME ACCORDING TO D.C. CIRCUIT COURT OF APPEALS

By Gregory P. Williams

In a ruling that may have significant impact on employment litigation, the U.S. Court of Appeals for the D.C. Circuit has held that damage awards for emotional distress unrelated to lost wages are not taxable income. This article discusses the August 22, 2006 decision of the D.C. Circuit in *Murphy v. I.R.S.*, 2006 WL 2411372 (C.A.D.C.) and its potential impact on employment law cases.

THE SUPREME COURT ADOPTS A COMMON SENSE APPROACH FOR DEFINING ADVERSE EMPLOYMENT ACTION

By J. Edward Hollington

On June 22, 2006, the United States Supreme Court broadened the definition of *adverse employment action* in Title VII retaliation cases. Burlington Northern v. White, 126 S.Ct. 2405, 165 L.Ed. 2nd 345, 2006 U.S. Lexis 4895 (2006). The opinion brings uniformity in the standards to be utilized for determining an adverse employment action. Various circuits have applied differing standards such as “materially adverse change in terms and conditions of employment,” “ultimate employment decisions,” and “challenged action would have been material to a reasonable employee.” *Id.* Lexis 13-15.

The Court pointed out that § 704 (anti-retaliation) provision of Title VII does not contain the limiting language of § 703(a) (anti-discrimination provision).

Definition of Adverse Employment Action

The Court stated “...that the anti-retaliation provision, unlike substantive provision, is not limited to discriminatory actions that affect terms and conditions of employment.” *Id.* 20. The anti-retaliation provisions prohibit any adverse treatment that is based on a retaliatory motive and is *reasonably likely to deter the charging party or others from engaging in protected activity*. *Id.* 23. The scope of anti-retaliation provisions extends beyond workplace related or employment related retaliatory acts and harm. *Id.* 26.

Plaintiff’s Burden

1. Engaged in protected activity.
2. **That a reasonable employee would have found the challenged action materially adverse.**
3. That a causal connection exists between the protected activity and the materially adverse action. Mickelson v. New York Life Insurance, 2006 U.S. App. Lexis 21944 (10th Cir., Aug. 28, 2006) citing Burlington Northern v. White.

The Facts of the White Case

This unanimous opinion (8-0) which contains dramatic and emphatic support for anti-retaliation provisions of Title VII arises from a Sixth Circuit case involving Sheila White, a track laborer with Burlington Northern Railroad. Ms. White reported that her immediate supervisor complained about women working in the maintenance department, and made other insulting and inappropriate remarks in front of her. Burlington suspended the supervisor for 10 days and ordered him to attend sexual harassment training. A few days later Ms. White was transferred from forklift duties to standard track labor work. She then filed a complaint with the EEOC claiming the reassignment of her duties amounted to unlawful gender based discrimination and

retaliation. A few days after filing a second retaliation charge she was suspended without pay for insubordination. She filed an internal grievance in which Burlington reinstated her to her position and awarded her back pay for 37 days she had been suspended. Ms. White filed an additional retaliation charge based on the suspension.

Burlington asserted that no adverse employment action had occurred because she had lost no income and was reinstated as a result of the internal grievance. Burlington also asserted that reassignment of duties cannot constitute retaliation. The Court answered, “**Common sense suggests that one good way to discourage an employee such as Ms. White from bringing discrimination charges would be to insist that she spend more time performing the more arduous duties and less time performing those that are easier or more agreeable.**” Id. 32. The Court also explained, “Many reasonable employees would find a month without a paycheck to be serious hardship.” A reasonable employee facing the choice between retaining a job and a paycheck, and filing discrimination complaint might well choose the former. Id. 35-36.

Summary Judgments Less Likely

Any time a legal standard includes references to a “reasonable employee,” and references to “common sense,” such usually indicates factual questions. Whether an employer’s actions might dissuade a reasonable worker from making or supporting a charge of discrimination establishes a standard that will make it unlikely summary judgments will be entered except where employer actions are trivial or nothing more than a petty slight. White at 29-30; Michelson (2006 U.S. App. Lexis 21944 citing White, concluding that a curt, impolite e-mail does not meet the standard because “a lack of good manners will not create a deterrence to a reasonable employee from engaging in protected activity) Employment actions such as transfers, reassignments, office locations, working hours, job assignments and the like will no longer provide employers an opportunity to argue in summary judgments that such do not constitute adverse employment action.

The Reasonable Employee Standard Likely to Go Beyond Title VII Retaliation

Many commentators anticipate the standard announced in White will be utilized in other retaliation cases, such as 1983 (1st Amendment), whistleblower statutes, and Sarbanes-Oxley. (See, *A New World for Retaliation Claims*, National Law Journal, June 26, 2006)

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In a ruling that may have significant impact on employment litigation, the U.S. Court of Appeals for the D.C. Circuit has held that damage awards for emotional distress unrelated to lost wages are not taxable income.

On August 22, 2006, the D.C. Circuit ruled in *Murphy v. I.R.S.*, 2006 WL 2411372 (C.A.D.C.) that emotional distress awards were not income within the meaning of the Sixteenth Amendment of the U.S. Constitution. As a result, the federal law that had allowed taxation of such awards was unconstitutional.

To understand the ramifications of the decision, some history is in order. As a general rule, awards for personal injury tort claims are not taxable under §104(a)(2) of the tax code, which excludes from taxation money received on account of "personal physical injuries or physical sickness." Before 1996, lawyers generally tried to treat employment discrimination awards the same way. However, in 1996, Congress changed the tax code to state that "emotional distress shall not be treated as a physical injury or physical sickness." This change affected taxation of awards in employment cases, which often have an emotional distress element but no physical injury or sickness. Under the new law, awards for emotional distress were now taxable income.

In *Murphy*, plaintiff Marrita Murphy sued her employer in 1994 alleging that she was treated unlawfully under various "whistle-blower" statutes after she complained about environmental hazards in the workplace. An administrative law judge awarded her \$70,000 in compensatory damages, which included \$45,000 for "emotional distress or mental anguish" and \$25,000 for injury to her professional reputation. None of the award was for lost wages or diminished earning capacity.

On her federal tax return for 2000, Murphy included the \$70,000 award in her "gross income" and, as a result, paid \$20,665 in taxes on the award. Murphy later filed an amended return in which she sought a refund of the \$20,665 based upon § 104(a)(2) of the Internal Revenue Code, which provides that "gross income does not include . . . damages . . . received . . . on account of personal physical injuries or physical sickness." The Internal Revenue Service (IRS) denied her request for a refund. Murphy then sued the IRS and the United States in the district court, seeking a refund of the \$20,665, plus applicable interest, pursuant to the Sixteenth Amendment, as well as other relief. She argued her compensatory award was in fact for "physical personal injuries" and therefore excluded from gross income under § 104(a)(2). In the alternative Murphy asserted § 104(a)(2) as applied to her award was unconstitutional because the award was not "income" within the meaning of the Sixteenth Amendment. The district court rejected all Murphy's claims on the merits and granted summary judgment for the United States and the IRS. Murphy appealed to the Court of Appeals for the D.C. Circuit.

The D.C. Circuit reversed the trial court. The Court noted that the Sixteenth Amendment gave Congress the right to “lay and collect taxes on incomes,” and consequently, to be constitutional, a tax could not be levied on that which did not constitute “income.” The Court ruled that the damages Murphy received were awarded to make her emotionally and reputationally “whole” and not to compensate her for lost wages or taxable earnings of any kind. The emotional well-being and good reputation she enjoyed before they were diminished by her former employer were not taxable as income. Therefore, the compensation she received in lieu of what she lost cannot be considered income and, thus the Sixteenth Amendment did not empower the Congress to tax her award. As a result, § 104(a)(2) was unconstitutional insofar as it permitted the taxation of an award of damages for mental distress and loss of reputation. The Court remanded the case to the district court to enter an order and judgment instructing IRS to refund the taxes Murphy paid on her award plus applicable interest.

Note that this decision is limited to cases filed within the D.C. Circuit, and thus is not automatically applicable elsewhere, including in New Mexico. In fact, other circuits have held that emotional distress damages are not excluded from income. See, e.g., *Lindsey v. Comm’r*, 422 F.3d 684 (8th Cir. 2005); *Rivera v. Baker W., Inc.*, 430 F.3d 1253 (9th Cir. 2005). However, should other circuits follow the lead of the D.C. Circuit, the ruling could have significant impact on the litigation of employment discrimination cases. For example, the likelihood of settlement of such cases may be increased if the tax burden on the plaintiff is decreased. As a practical matter, the cost of settlement goes down as the tax burden goes down.

Murphy’s holding may be limited in application due to its own unique facts. As stated above, the *Murphy* plaintiff’s award was not related to lost wages. It is not clear whether or not, in a situation where a damage award includes both lost wages and emotional damages, the entire award would be taxable as income. The *Murphy* decision does not address this issue.

The *Murphy* decision has received some criticism in tax law circles. The criticism stems not from the narrow holding in this case, but from the D.C. Circuit’s apparent willingness to use historical and constitutional grounds to limit Congress’ taxation powers. Those critics have argued that *Murphy* may be used in other contexts as a way of attacking federal income taxation. For that reason, it is foreseeable that *Murphy* may be reexamined by the D.C. Circuit or other courts.