1993 WL 557652
United States District Court, N.D. California.

Nancy J. STENDER, Diane Skillsky, Julie Valentine–Dunne, Reba Barber–Money, Irma Hernandez, Anita Martinea and Jon Gold on behalf of themselves and all others similarly situated, Plaintiffs,
v.
LUCKY STORES, INC., Defendant.

No. C–88–1467 MHP.
|
Dec. 15, 1993.

MEMORANDUM AND ORDER

PATEL, District Judge.

***1** Plaintiffs brought this class action against Lucky Stores, Inc. ("Lucky") on behalf of Black and female employees working in retail stores within Lucky's Northern California Food Division. Claims were brought pursuant to Title VII of the 1964 Civil Rights Act, 42 U.S.C. § 2000e *et seq.,* 42 U.S.C. § 1981; and the California Fair Employment and Housing Act ("FEHA"), Government Code §§ 12900–12996. Plaintiffs alleged discrimination on the basis of race and sex in initial job placement, allocation of work hours, movement of part-time to full-time positions, and promotions.

The parties have entered into a consent decree settling the plaintiffs' claims as to racial discrimination and now ask this court to determine whether, or to what extent, the payments to those covered by the consent decree are excludable from gross income under section 104(a)(2) of the Internal Revenue Code.

Having considered the parties' submissions, the court hereby enters the following memorandum and order.

BACKGROUND

On July 27, 1992, the parties entered into a "Consent Decree Regarding Injunctive Relief, Monetary Relief and Notice for Race Claims" (hereafter "Race Decree"). The Race Decree states that its purpose is "[t]o provide injunctive and monetary relief with finality to all class members in regard to race claims." Race Decree ¶ III.B. Compliance with the decree is to "constitute compliance with Title VII, 42 U.S.C. § 1981, and FEHA...." *Id.* ¶ V.B.

As part of that consent decree, the parties agreed to submit jointly to the Internal Revenue Service ("IRS") a neutral request for a private letter ruling on the issue of the taxability of the payments under the consent decree. *See* Race Decree ¶ XVII.B.6. On August 28, 1992, a request for a ruling was submitted by Lucky's attorneys alone. In that letter, Lucky argued that the consent decree awards should not be taxable. Lucky contends that when it submitted this letter to the IRS, it was with the agreement of plaintiffs that the letter articulated plaintiffs' position and not Lucky's. Plaintiffs dispute that there was any such agreement.

At any rate, the IRS declined to issue a ruling. The parties were unable to reach an agreement on the issue, and therefore, in accordance with the consent decree, the matter was submitted to the court for determination. *See* Race Decree ¶ XVII.B.6.

LEGAL STANDARD

Gross income under the Internal Revenue Code is defined broadly, as "all income from whatever source derived." 26 U.S.C. § 61(a). Gross income is subject to taxation unless it falls within a specifically enumerated exclusion elsewhere in the Code. Section 104(a) provides one such exclusion, exempting the following from taxation:

> (2) the amount of damages received (whether by suit or agreement and whether as lump sums or periodic payment) on account of personal injuries or sickness....

26 U.S.C. § 104(a)(2).

As the Supreme Court has recently pointed out in *United States v. Burke,* 504 U.S. 229, 112 S.Ct. 1867 (1992), neither the text nor the legislative history of this provision offers guidance as to how to interpret the term "personal injuries." *See id.* at 1870. IRS regulations, however, have since 1960 identified "personal injuries" by reference to traditional tort principles. *See* 26 C.F.R. § 1.104–1(c) (1991) ("The term 'damages received (whether by suit or agreement)' means an amount received ... through prosecution of a legal suit or action based upon tort or tort type rights, or through settlement entered into in lieu of such prosecution.").

***2** In *Burke,* the Court confirmed that the proper focus for purposes of section 104(a)(2) is on the nature of the claim underlying the award or settlement, and specifically on whether the claim "redresses a tort-like personal injury." *Burke,* 112 S.Ct. at 1872. If so, then the award or settlement is properly excluded from gross income under section 104(a)(2); otherwise, it is not. *Id.* The Court stated that to determine whether a particular claim is sufficiently tort-like in nature, it is critical to examine the remedies available under that cause of action, since "the concept of a 'tort' is inextricably bound up with remedies." *Id.* at 1872 n. 7; *see also id.* at 1871. The Court emphasized that "one of the hallmarks of a traditional tort liability is the availability of a broad range of damages...." *Id.* at 1871.

The specific issue in the *Burke* case was the taxability of settlement awards under Title VII as that provision existed before the passage of the Civil Rights Act of 1991, Pub.L. 102–166, 105 Stats 1071 (codified as amended at 42 U.S.C. § 2000e–2). Because the pre-Act Title VII provided only the remedies of backpay, injunctions, and other equitable relief, the *Burke* Court held that it was not a sufficiently tort-like claim to fall under the exclusion provisions of the IRS Code. *Burke,* 112 S.Ct. at 1872–74. The Court contrasted pre-Act Title VII with other types of claims, such as 42 U.S.C. § 1981, that provide compensatory and punitive damages as well. *Id.*

DISCUSSION

The consent decree at issue in this action provides for monetary relief for two named plaintiffs and for the class members through the establishment of a settlement fund. These sums are paid in settlement of plaintiffs' and class members' claims that Lucky violated Title VII, 42 U.S.C. § 1981, and FEHA by discriminating against them because of their race.

It is clear that settlement awards under 42 U.S.C. § 1981 and FEHA are excludable from gross income, as awards derived from tort-like causes of action. Following *Burke,* an examination of the remedies available under those provisions reveals that they each afford plaintiffs a wide range of remedies. Plaintiffs suing under section 1981 can seek injunctive relief and damages, including compensatory and punitive damages. They are also entitled to a jury trial. *Burke,* 112 S.Ct. at 1873–74. In fact, the *Burke* Court specifically noted section 1981 as an example of a cause of action that provides the broad range of remedies that signals a tort-like cause of action. *See id.* Plaintiffs suing under FEHA are also afforded compensatory and punitive damages, as well as attorneys' fees and costs. *See Commodore Home Systems, Inc. v. Superior Court,* 32 Cal.3d 211 (1982). As Lucky even now appears to concede, settlement awards under section 1981 and FEHA are therefore excludable under section 104(a)(2) of the IRS Code.

It also follows from *Burke* that settlement awards under post-Act Title VII must be excluded from gross income. The Civil Rights Act of 1991 added the remedies of compensatory and punitive damages to the range of remedies available to Title VII plaintiffs. *See* 42 U.S.C. § 1981a(a)(1). Under the Act, Title VII plaintiffs are also now entitled to a jury trial if they seek compensatory or punitive damages. *Id.* § 1981a(c). The *Burke* Court recognized that the 1991 Civil Rights Act "signals a marked change in [Congress'] conception of the injury redressable by Title VII...." *Burke,* 112 S.Ct. at 1874 n. 12. With the addition of these new remedies, Title VII remedies now mirror those available for other types of claims that the *Burke* Court indicated were sufficiently tort-like to exempt awards under that provision from gross income under section 104(a)(2).

***3** This court has already determined that the provisions of the Civil Rights Act of 1991 apply retroactively to plaintiffs' claims in this case. *See Stender v. Lucky Stores, Inc.,* No. 88–1467 (N.D.Cal. Jan. 7, 1992). Therefore, this case is governed by Title VII law as it currently exists, subsequent to the 1991 Act. Since it is clear that settlement awards under the post-Act Title VII are excludable from gross income, it follows that the awards in this case are excludable.[1]

The above analysis is entirely consistent with the position that Lucky articulated in its August 28, 1992 letter to the IRS requesting a ruling on this issue. Lucky now seeks to backtrack from its position, which it claims was not really its position at the time. Even placing aside the fact that Lucky's position now is diametrically opposed to the one it appeared to take in its August 28, 1992 letter to the IRS, Lucky has put forth no compelling arguments for finding these awards to be non-excludable.

It must be emphasized that the settlement of these claims took place after the court's decision on retroactivity. Thus, Lucky was fully aware of the range of damages available under Title VII. Nonetheless, Lucky argues that the settlement was primarily motivated by a desire to settle plaintiffs' Title VII claims. They point out that where the express terms of a settlement do not allocate between claims the intent of the payor is of paramount importance. *See, e.g., Stocks v. Commissioner,* 98 T.C. 1 (1992). In this case, the court need not determine the intent of the payor, since, as explained above, all three types of claims settled are excludable as tort-type claims. If a claim is tort-like, as the claims are here, then "any damages received on account of that claim are excludable." *Downey v. Commissioner,* 100 T.C. No. 40 (June 29, 1993), *as corrected,* 100 T.C. No. 40 (July 20, 1993), 1993 WL 231740, 1993 U.S. Tax Ct. LEXIS 40, at *7.

The court notes, however, that the evidence Lucky presents to show its intent in settling is less than compelling. Defendants argue that plaintiffs have focussed their attention throughout litigation on their Title VII claims. Regardless of whether or not this is true, all three claims remained viable at the time the Race Decree was entered into, all three claims require the same kinds of proof to establish discrimination, and all three types of claims were covered by the consent decree. *Cf. Bent v. Commissioner,* 87 T.C. 236 (1986), *aff'd,* 835 F.2d 67 (3d Cir.1987) (settlement after court has rejected two of three claims necessarily is premised on third claim).

Lucky's other evidence in support of its contention that it intended the settlement to represent Title VII backpay alone is an unsworn statement purporting to represent Lucky's position during negotiations. This evidence is singularly unhelpful to the court. As plaintiffs point out, settlements of this type often involve a great deal of back-and-forth negotiations. Lucky cannot now produce one statement from two months before the consent decree was signed and claim that the document represents its intent in settling the case. Indeed, plaintiffs have produced a later negotiation memorandum by Lucky indicating that the issue of the taxability of the settlement was an element of the negotiations. *See* Borgen Declaration in Support of Plaintiffs' Motion to Strike ¶ 2, Exhibit 1. Notably, although it had ample opportunity, Lucky has submitted no declaration stating that the motivating force behind settlement was to settle the Title VII claims.

***4** In sum, there is nothing in the record of any evidentiary weight that reflects Lucky's intent in settling these claims. As noted above, the question of which claim motivated Lucky's settlement is not strictly relevant, since all three claims are tort-like claims. However, even if this court had not ruled that the Civil Rights Act of 1991 was retroactive, the dearth of evidence as to Lucky's intent in settlement would make it impossible to determine that Lucky intended that the settlement be allocated to the Title VII claims alone.

Lucky appears to make the further argument that the payment in the Race Decree actually was intended primarily as a payment for only a portion of the Title VII claim—namely the backpay portion. As has been pointed out, there is scant evidence in the record to support this claim. More importantly, to the extent Lucky means to imply that this court should parse a particular cause of action to determine the payor's intent, it is mistaken about the precedent in this area. The analysis as to whether a particular claim is "tort-like" or not looks to the nature of the injury, as reflected in the remedies *available* under that type of claim. *See Downey,* 1993 WL 231740, 1993 U.S. Tax Ct. LEXIS, at *4–*8. Once it is determined that a particular claim is tort-like, "*any* damages received on account of that claim are excludable." *Id.* at *7 (emphasis supplied).

Courts have emphasized that it is the nature of the injury, and not its consequences, that determines whether or not an injury is tort-like. The fact that the consequences of an injury may be most reflected in, say, loss of wages does not mean that the nature of the injury itself is not personal. *Id.; see also Roemer v. Commissioner,* 716 F.2d 693, 699 (9th Cir.1983) ("The nonpersonal consequences of a personal injury ... are often the most persuasive means of proving the extent of the injury that was suffered. The personal nature of an injury should not be defined by its effect."). The remedies available under Title VII reflect Congress' conception of discrimination as a tort-like injury; the fact that a particular plaintiff may best be able to demonstrate the consequences of that injury through demonstrating lost wages does not change the nature of the action.[2]

Lucky's primary argument in favor of non-exclusion appears to be that the IRS may disagree with a court ruling that plaintiffs' awards are not taxable, and that the risk of this event should not fall solely on Lucky. Lucky points out that if this occurs, then it will be liable for the amounts that should have paid to the IRS by the plaintiffs. On the other hand, Lucky contends, if the court were to rule that the awards *were* taxable and they later turned out not to be, then the plaintiffs could apply for refunds and would be no worse off. The short answer to this argument is that if the parties wanted to allocate a portion of the award as taxable and a portion as non-taxable, they could have done so. Instead, each party apparently decided to assume the risk that the I.R.S. or this court might rule against it. In this case, it is clear from the facts and from the relevant caselaw that Lucky must pay the price for assuming that risk.

CONCLUSION

***5** For the foregoing reasons, it is hereby ORDERED that:

1) Paragraph 4 of the Declaration of Tony M. Edwards in Support of Lucky's Memorandum Re Tax Allocation is stricken from evidence;

2) the payments made pursuant to the Consent Decree Regarding Injunctive Relief, Monetary Relief and Notice for Race Claims (July 29, 1992) are excludable from gross income under 26 U.S.C. § 104(a).

IT IS SO ORDERED.

All Citations

Not Reported in F.Supp., 1993 WL 557652, 63 Fair Empl.Prac.Cas. (BNA) 981, 64 Empl. Prac. Dec. P 43,009, 62 USLW 2431

Footnotes

1 Plaintiffs assert that no portion of the settlement payments are allocated to punitive damages or prejudgment interest. *See* Seligman Declaration in Support of Plaintiffs' Memorandum Re Tax Treatment ¶ 9, Exhibit G. Defendants do not contest this fact.

2 Lucky asserts that the IRS is considering treating all backpay awards as taxable income, regardless of the nature of the underlying claim. Lucky's support for this assertion is a declaration from an attorney for Lucky who states that he spoke with unnamed IRS attorneys who told him that the IRS might take this stance. *See* Edwards Declaration in Support of Lucky's Memorandum Re Tax Allocation ¶ 4. Obviously, this statement is pure hearsay. The court therefore strikes this paragraph pursuant to Local Rule 220–7 (declarations that do not conform to Federal Rule of Civil Procedure 56(e) must be stricken), Federal Rule of Civil Procedure 56(e) (limiting declarations to statements that would be admissible in evidence), and Federal Rules of Evidence 801 and 802 (hearsay).