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What Effect Should State Law Have in Defining “Personal Injury” Damages for Purposes of I.R.C. Section 104(a)(2) Exclusion?

In Roemer v. Commissioner, the Ninth Circuit turned to California law to locate the meaning of “personal injury” as used in section 104(a)(2) of the Internal Revenue Code. This Comment analyzes that court’s decision and compares the use of state law within the tax code with its use in certain other federal statutory schemes. Although state law can be useful and perhaps accurate in deciphering Congressional intent, this Comment considers a key policy behind the tax code—namely uniformity—and concludes that the sole use of state law in defining terms within the tax code is incompatible with the congressional object.

I. INTRODUCTION

The United States federal income tax is embodied in title 26 of the United States Code. The courts and the Internal Revenue Service (IRS) utilize a broad definition of income; most realized accessions to wealth are presumed to be taxable income, unless the taxpayer can demonstrate that an exclusion or deferral applies.

2. “[G]ross income means all income from whatever source derived . . . .” I.R.C. § 61(a) (1991). The authority to tax individual income derives from the 16th Amendment, U.S. Const. amend. XVI.
Congress has legislated such an exclusion in section 104(a)(2) of the Internal Revenue Code (I.R.C.)\(^4\) and has excluded damages received on account of personal injuries from taxable income.\(^6\) This code section has presented many interpretative problems for the courts, the IRS, and taxpayers alike. This Comment will focus on only one of these problems, namely the definition of "personal injury" damages by resorting to state tort law classifications. The earliest predecessor of section 104(a)(2),\(^6\) section 213(b)(6),\(^7\) was passed by Congress in 1918 and provided for the exclusion of damages from income.\(^8\) At that time, it was questioned whether Congress believed tort damages were income.\(^9\) The legislative history of section 213(b)(6)\(^10\) suggests that Congress was inconclusive about classifying damages as income.\(^11\) Nonetheless, the exclusion was codified, and the Supreme Court subsequently concluded that punitive damages in a business context are income in *Commissioner v. Glenshaw Glass.*\(^12\)

Personal injuries have been held to include both physical and non-physical injuries.\(^13\) In 1989, Congress amended section 104(a) and declared that the exclusion "shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness."\(^14\) Notwithstanding the amendment, numerous tax cases have involved questions of nonphysical injuries,\(^15\) and compensatory damages for nonphysical injuries remain viable for section 104(a)(2)

\(^4\) I.R.C. § 104(a)(2) (1991). "[G]ross income does not include . . . (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness . . . ."

\(^5\) Id. See *infra* notes 268-92 and accompanying text for a discussion of the reasons for this exclusion.


\(^8\) Id. Gross income does not include "[a]mounts received . . . as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness." *Id.* For a comprehensive history, see Stuart M. Schabes, Comment, *Roemer v. Commissioner*, 12 *HOFSTRA L. REV.* 211 (1983).


\(^10\) See *supra* note 7.

\(^11\) H.R. 767, 65th Cong., 2d Sess. 9-10 (1918), *reprinted in* 1939-1 (Part 2) C.B. 86, 92 (doubtful that amounts received for personal injuries or sickness are required to be included in gross income).


exclusion.\textsuperscript{16} This area of nonphysical injuries has plagued the courts with difficulties in defining "personal injury."\textsuperscript{17} "[N]either the Code nor the regulations explain what a taxpayer must show in order to prove that he has received damages 'on account of personal injuries.'"\textsuperscript{18} The courts have addressed this problem by focusing on the nature of the underlying claim.\textsuperscript{19}

In 1983, the Ninth Circuit adopted an approach in \textit{Roemer v. Commissioner}\textsuperscript{20} that resolved this definitional problem by turning to state law.\textsuperscript{21} The effects of this approach are yet to be felt; however, at least one case has utilized this method.\textsuperscript{22}

This Comment will question the \textit{Roemer} rationale\textsuperscript{23} by inquiring into the theories behind the tax code exclusion, the inherent necessities of turning to state law in some situations, and the potential for abuse and national inconsistencies that could result from following the Ninth Circuit's approach.\textsuperscript{24} This Comment will show that the sole use of state law to define "personal injury" is questionable and inconsistent with federal tax exclusion policy.

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\textsuperscript{16} The 1989 amendment only addressed the issue of punitive damages for non-physical injuries. See \textit{supra} note 14 and accompanying text.

\textsuperscript{17} See \textit{supra} note 15 and accompanying text.

\textsuperscript{18} See \textit{Raytheon Prod. Corp. v. Commissioner}, 144 F.2d 110, 113 (1st Cir.), \textit{cert. denied}, 323 U.S. 779 (1944) (the question to be asked is "In lieu of what were the damages awarded?"); \textit{Swastika Oil & Gas Co. v. Commissioner}, 123 F.2d 382 (6th Cir. 1941), \textit{cert. denied}, 317 U.S. 639 (1943) (recoveries of lost profits are income and not excludible); \textit{Agar v. Commissioner}, 290 F.2d 283, 284 (2d Cir. 1961) (basic reason for payment); \textit{Knuckles v. Commissioner}, 349 F.2d 610, 613 (10th Cir. 1965) (actual reason for making payment); \textit{Seay v. Commissioner}, 58 T.C. 32, 37 (1972) (depends on nature of the claim); \textit{United States v. Garber}, 589 F.2d 843, 847 (5th Cir. 1979) (must derive from some sort of tort claim); \textit{Threlkeld v. Commissioner}, 87 T.C. 1294, 1297 (1986) (must look to the origin and character of the claim).


\textsuperscript{21} \textit{Id. at 697}.

\textsuperscript{22} \textit{See infra} note 77.

\textsuperscript{23} See \textit{supra} notes 20-21 and accompanying text.

\textsuperscript{24} See \textit{infra} notes 317-35 and accompanying text.
II. WHAT IS "PERSONAL INJURY?"

As noted above,25 "personal injury" definition has presented problems for the Tax Court. Most courts addressing the issue have concluded that the inquiry must focus on the nature of the claim.26 Since "personal injury" is not defined in the Code, courts exercise discretion in addressing the problem.27 However, the IRS and the courts have not agreed on how this definition should be made.28

Three recent cases have addressed this definitional issue,29 two of them utilizing state tort law in their analyses.30 The IRS has also taken a position,31 one that conflicts with the Ninth Circuit's approach in Roemer.32 A discussion of these cases and the IRS's position will introduce this unsettled area of federal income tax law.

A. Roemer v. Commissioner

In 1952, Paul F. Roemer started his own insurance business in Oakland, California.33 "By the mid-1960's, he enjoyed an excellent personal and professional reputation in the community."34 In 1965, Roemer decided to apply for an agency license from Penn Mutual Life Insurance Company, which subsequently requested a credit report from Retail Credit.35 The credit report was grossly defamatory, and a purported retraction contained further defamatory remarks.36 Roemer was denied agency licenses from Penn Mutual and other insurance companies, and his general reputation in the community suffered.37

Roemer brought suit in a California court for libel under section 45 of the California Civil Code.38 Under section 45, "[l]ibel is a false and unprivileged publication by writing [or] printing ... which exposes any person to hatred, contempt, ridicule, or obloquy, or which causes him to be shunned or avoided, or which has a tendency

25. See supra notes 17-22 and accompanying text.
26. See supra note 19 and accompanying text.
27. See supra notes 4, 18 and accompanying text.
28. See infra notes 72-90 and accompanying text.
30. Roemer, 716 F.2d at 693; Threlkeld, 87 T.C. at 1294.
31. See infra notes 72-82 and accompanying text.
32. See supra notes 20-21 and accompanying text.
33. Roemer, 716 F.2d at 694.
34. Id.
35. Id. at 694-95.
36. Id. at 695.
37. Id.
38. Id. See Schabes, supra note 8, at 215 (discussing the procedural history of the defamation suit).
to injure him in his occupation." Roemer alleged that the defamatory report was done "with intent to damage his reputation, and to injure him in his business profession and occupation." The jury awarded Roemer $40,000 in compensatory damages and $250,000 in punitive damages. The jury was not asked to specify whether the damages were for injury to Roemer's personal or professional reputation and did not allocate the award between personal and business loss.

On his 1975 federal tax return, Roemer reported $16,020 of the damages as income. The Commissioner of the IRS determined that the entire award was gross income, less a deduction for costs and attorney fees. The Tax Court with three dissenting judges upheld the Commissioner's determination, concluding that 1) the compensatory damages were not excludible because Roemer failed to establish they were for injury to his personal reputation, and 2) the punitive damages were includable in gross income. In reaching its decision, the Tax Court majority found the conclusive factor in determining when an award was for personal injury was the nature of the claim settled. The Tax Court concluded that the damages represented compensation for lost income. The court focused on the allegations contained in the pleadings, along with the issues and evidence presented at trial. The majority concluded that the nature of Roemer's claims involved damages to his professional reputation as an insurance broker. In 1983, the Court of Appeals for the Ninth Circuit unanimously reversed.

The Ninth Circuit maintained that the Tax Court confused "a personal injury with its consequences and illogically distinguished physical from nonphysical personal injuries." The Ninth Circuit held that "[t]he relevant distinction that should be made is between

39. CAL. CIV. CODE § 45 (West 1982).
40. 716 F.2d at 695.
42. 716 F.2d at 695.
43. Id. How Roemer arrived at this figure is unclear, and Roemer later admitted that the amount was incorrect. 79 T.C. 398, 404 (1982).
44. 716 F.2d at 695.
45. 79 T.C. at 407-08.
46. Id. at 405. See supra note 19 and accompanying text.
47. 79 T.C. at 406.
48. Id.
49. Id.
50. 716 F.2d at 695.
51. Id. at 697.
personal and nonpersonal injuries, not between physical and nonphysical injuries. In so ruling, the Ninth Circuit turned to the text of section 104(a)(2) and applied an "ordinary meaning" analysis to the term "personal injury." Citing Woodward v. Commissioner and Raytheon Production Corp. v. Commissioner, the Ninth Circuit said it must look to the nature of the tort of defamation to determine whether the exclusion applied. In determining the underlying nature of the claim, the court declared that it "must look to state law." The court proceeded to discuss California’s legislative history of defamation and concluded that since the tort of defamation appeared under the California Civil Code at "Division 1. Persons. Part 2. Personal Rights.," the code recognizes a personal right to be protected from defamation. The Ninth Circuit further recognized that California law provides for the related torts of disparagement or trade libel, these being seen as business injuries. Realizing that an attack such as Roemer sustained could affect both personal and business character, the Ninth Circuit stated that Roemer had a choice of actions in California. The court went on to hold that since defamation of an individual is a personal injury under California law, the compensatory damages were excludible from gross income under section 104(a)(2). The court also held that the punitive damages were excludible.

52. Id.
53. See supra note 4 and accompanying text.
54. 716 F.2d at 697.
57. 716 F.2d at 697.
58. Id. "Since there is no general federal common law of torts nor controlling definitions in the tax code, we must look to state law to analyze the nature of the claim litigated." Id. (citing United States v. Mitchell, 403 U.S. 190, 197 (1971) (quoting Burnet v. Harmel, 287 U.S. 103, 110 (1932)) (other citation omitted).
59. 716 F.2d at 697-99. See generally CAL. CIV. CODE §§ 43-46 (West 1982). "[E]very person has ... the right of protection from ... defamation ... " CAL. CIV. CODE § 43 (West 1982). Under section 44, "(a) Libel. (b) Slander." CAL. CIV. CODE § 44 (West 1982).
60. 716 F.2d at 699. See Gudger v. Manton, 21 Cal. 2d 537, 541, 134 P.2d 217, 220 (1943) (utilizing Restatement of Torts section 624 for slander of title); Erlich v. Etner, 224 Cal. App. 2d 69, 73, 36 Cal. Rptr. 256, 258 (1964) (defining trade libel as "an intentional disparagement of the quality of property, which results in pecuniary damage" by resorting to Restatement of Torts sections 626 and 627); Shores v. Chip Steak Co., 130 Cal. App. 2d 627, 630, 279 P.2d 595, 597 (1955) ("The distinction between libel and trade libel is that the former concerns the person or reputation of plaintiff and the latter relates to his goods.").
61. 716 F.2d at 699.
62. Id. at 700.
63. Id. Since section 104(a) has been amended, this Comment will not address the punitive damages holding. See supra note 14 and accompanying text. For a comprehensive analysis of Roemer v. Commissioner, see Schabes, supra note 8.
B. Church v. Commissioner

Prior to the Ninth Circuit's reversal in Roemer,64 the Tax Court confronted a factually similar situation in Church v. Commissioner.65 There, the Attorney General of Arizona had received a jury award of $250,000 compensatory and $235,000 punitive damages in a defamation suit brought against a Phoenix newspaper.66 The Tax Court distinguished Roemer67 and held the $250,000 compensatory damages excludible from gross income.68 Though the results of Church69 and Roemer70 are consistent, the analyses applied by the Ninth Circuit and the Tax Court varied considerably.71

C. Subsequent IRS Reaction

1. Revenue Ruling 85-143

Shortly after the Ninth Circuit's decision in Roemer,72 the Commissioner announced in Revenue Ruling 85-143 that the IRS would not follow the approach taken by the Ninth Circuit in Roemer.73 The IRS rejected the Ninth Circuit's approach because the nature of the libel, not the definition of libel under state law, should determine whether the libel produced a personal injury.74 That announcement by itself may not persuade a court.75

64. See supra notes 33-63 and accompanying text.
65. 80 T.C. 1104 (1982).
66. Id. at 1104-05. The newspaper had labelled Church as a communist. Id.
68. 80 T.C. at 1108-09 (declaring that Roemer said little about how the credit report hurt him personally, while the entire thrust of Church's case presentation was personal effects of being labelled a communist).
69. 80 T.C. at 1104.
70. 716 F.2d at 693.
71. The Ninth Circuit focused on the nature of the claim and utilized California's state law "label," whereas the Tax Court in Church seems to have focused on the effects of the defamation as presented, something condemned by the Ninth Circuit. See infra note 100 and accompanying text.
72. 716 F.2d 693 (9th Cir. 1983).
74. Id. at 56.
75. See Dixon v. United States, 381 U.S. 68, 73 (1965) (stating that Revenue Rulings do not have the force of law). A Revenue Ruling is not entitled to the deference accorded a statute or treasury regulation. Threlkeld v. Commissioner, 87 T.C. 1294 (1986), aff'd, 848 F.2d 81, 84 (6th Cir. 1988); Brook, Inc. v. Commissioner, 799 F.2d 833, 836 n.4 (2d Cir. 1986). But cf. Udall v. Tallman, 380 U.S. 1, 16-17 (1965) (stating that Revenue Rulings may be helpful in interpreting the law).
may “disregard a Ruling if [it] conflicts with the statute it suppos-
edly interprets or with that statute’s legislative history or if the Rul-
ing is otherwise unreasonable.” However, if the Tax Court follows Roemer, and the IRS insists upon Revenue Ruling 85-143, many taxpayers will be inconvenienced by having to litigate their positions in court.

2. Revenue Ruling 84-108

The Ninth Circuit in Roemer held that since the compensatory damages were received on account of personal injuries, the punitive damages were also excludible. The court relied on the Commissioner’s interpretation as declared in Revenue Ruling 75-45. In 1984, the IRS in Revenue Ruling 84-108 changed its position and held that punitive damages received in a wrongful death suit were taxable. In 1985, the IRS strengthened its position in Revenue Ruling 85-98. Burford v. United States dealt with the IRS’s problematic position concerning Revenue Ruling 84-108. The Burford court held that damages received for a wrongful death, though punitive in nature, were excludible under section 104(a)(2). The court stated that “[o]nly a contorted reading of Section 104(a)(2) could lead to the interpretation that wrongful death proceeds are not received on account of a personal injury.” The IRS had taken the position that since wrongful death actions in Alabama were characterized as punitive, the damages so received were punitive and non-excludible. It

76. Brook, 799 F.2d at 836 n.4.
77. The Tax Court may be bound to follow Roemer under the Golsen Rule. See Golsen v. Commissioner, 54 T.C. 742, 756-57 (1970), aff’d on other grounds, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971). “[I]t is our best judgment that better judicial administration. [sic] requires us to follow a Court of Appeals decision which is squarely in [sic] point where appeal from our decision lies to that Court of Appeals and to that court alone.” 54 T.C. at 757 (footnotes omitted).
79. 716 F.2d 693, 700 (9th Cir. 1983).
80. Rev. Rul. 75-45, 1975-1 C.B. 47. Any damages received under section 104(a)(2), whether compensatory or punitive, received on account of personal injuries or sickness are excludible from gross income. Id. at 48.
82. Rev. Rul. 85-98, 1985-2 C.B. 51, 52 (stating that the amount of a libel claim settlement must be allocated into compensatory and punitive elements, with the punitive damages not being excludible).
83. 642 F. Supp. 635 (N.D. Ala. 1986) (holding that settlement proceeds received under Alabama wrongful death act were received on account of personal injuries and excludible).
85. 642 F. Supp. at 636.
86. Id. at 637.
is interesting to note that the IRS's position in Revenue Ruling 84-10888 and Revenue Ruling 85-1439 are inconsistent. With Revenue Ruling 85-143, the IRS will disregard state law, but with Revenue Ruling 84-108, the IRS relies heavily on state law even if inconsistent with the exclusion policy.90

D. Threlkeld v. Commissioner

In 1979, James Threlkeld filed a diversity action against J.B. Williams in U.S. District Court for the Western District of Tennessee for malicious prosecution.91 Williams had contracted to purchase real estate from Threlkeld and another and attempted unsuccessfully to rescind the contract.92 Threlkeld alleged that Williams' action subjected him to "indignity, humiliation, inconvenience, and pain and distress of mind, . . . prevented [him] from attending to his usual professional pursuits, . . . injur[ed] his professional reputation, and . . . injur[ed] his credit reputation."93 Threlkeld settled his malicious prosecution suit in 1980 for $300,000.94 Threlkeld excluded most of the settlement from gross income on his 1980 tax return, and the Commissioner assessed a deficiency, later conceding that all but the $21,500 representing damages for injury to professional reputation was excludible.95 In 1986, the Tax Court, with one judge dissenting, held that there was no valid distinction between injury to personal and professional reputation for purposes of section 104(a)(2).96 The Tax Court held that, under Tennessee law, damages received in settlement of a malicious prosecution civil action

89. See supra notes 72-74 and accompanying text.
90. See infra notes 268-92 and accompanying text on exclusion policy.
92. Id.
93. Id.
94. Id. at 82. The $300,000 was allocated as follows:
   - $75,000 for damage to his professional reputation
   - $75,000 for damage to his credit reputation
   - $74,980 for indignity, humiliation, inconvenience, and pain and distress of mind
   - $20 for release of the fraudulent conveyance action claim
   - $75,000 for the assignment of judgment by Threlkeld
Threlkeld received $86,000 in 1980 and the remaining $214,000 in 1981. Id.
95. Id.
96. Id.
were received on account of personal injuries. The IRS appealed to the Sixth Circuit Court of Appeals, claiming the Tax Court erred.

The Sixth Circuit noted that the Tax Court relied heavily on the Ninth Circuit's opinion in *Roemer.* It also noted the Ninth Circuit's declaration that "nonpersonal consequences of a personal injury" are often the most persuasive means of proving the extent of injury, and that "the personal nature of an injury should not be defined by its effect." The Sixth Circuit disagreed with Revenue Ruling 85-143 and, quoting *Brook, Inc. v. Commissioner,* found the ruling unreasonable. The Sixth Circuit held that the nature of the underlying injury determines section 104(a)(2) excludibility and concluded that in this case, the taxpayer's injury to reputation was personal despite its effects on professional pursuits.

By affirming the Tax Court, it appears the Sixth Circuit agreed with the *Roemer* approach of defining personal injury. Yet, the Tax Court had reservations about using the *Roemer* analysis and discussed its shortcomings.

These shortcomings, when combined with precedent holding against state law "control" of words in a federal statute, suggest that the Ninth Circuit's approach is unique. As a starting point, this Comment will first discuss the various precedents and introduce analogous areas where state law is used. Then, after a brief discussion on exclusion policy, the analysis will proceed by applying two separate approaches to the "use of state law" question. This Comment will demonstrate that the Ninth Circuit's approach in *Roemer* is questionable and should be reconsidered.

97. *Id.*  
98. *Id.*  
99. *Id.* at 83.  
100. *Id.*  
101. *See supra* notes 72-74 and accompanying text.  
103. *Threlkeld,* 848 F.2d at 84.  
104. *Id.*  
105. *See supra* notes 51-62 and accompanying text.  
106. *Threlkeld,* 87 T.C. at 1306. Quoting the Tax Court:  
   State law may be of limited assistance where, in a settlement, the claim settled is itself unclear. Similarly, State law is of little help where there are several claims, only some of which are for personal injuries. The State law classification . . . will be of no assistance identifying the claim . . . or in carving up the damage recovery.  
107. *Estate of Steffke,* 538 F.2d 730, 732 (7th Cir.), *cert. denied,* 429 U.S. 1022 (1976) (holding that federal law controls the meaning of words in federal revenue statute in the absence of language evincing a different purpose).  
108. *See supra* notes 51-62 and accompanying text.  
109. 716 F.2d 693 (9th Cir. 1983).
III. STATE LAW EFFECTS ON FEDERAL INCOME TAX

A. Guiding Principles

In one paragraph consisting of two sentences, the Ninth Circuit in Roemer justified its sole reliance on state law.\textsuperscript{110} By relying on a quote in Burnet v. Harmel,\textsuperscript{111} the Ninth Circuit proposed a novel approach in dealing with the question: "What is a personal injury?" Though this method was supported by the precedent quoted,\textsuperscript{112} its invocation in terms of section 104(a)(2) exclusion was unpredicated.\textsuperscript{113} The Ninth Circuit could have possibly warded off some criticism\textsuperscript{114} by advocating its position more thoroughly, but its underlying proposition is dubious.

One need only look to the Burnet\textsuperscript{115} opinion itself to conclude the Ninth Circuit was taking a big step. As stated in Burnet,

Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation.\textsuperscript{116}

The Court further stated, "State law may control only when the federal taxing act, by express language or necessary implication, makes its own operation dependent upon state law."\textsuperscript{117} In the case of personal injury damage exclusion under section 104(a)(2),\textsuperscript{118} Congress certainly did not expressly provide for state law control.\textsuperscript{119} Whether

\textsuperscript{110} 716 F.2d at 697. "Since there is no general federal common law of torts nor controlling definitions in the tax code, we must look to state law to analyze the nature of the claim litigated. In order to determine the nature of Roemer's claim, we must analyze the defamation action as it developed in state law." \textit{Id.} (citations omitted).

\textsuperscript{111} Burnet v. Harmel, 287 U.S. 103, 110 (1932) (stating that state law creates legal interests; federal law determines when and how to tax).

\textsuperscript{112} \textit{Id.}

\textsuperscript{113} \textit{See supra} notes 19-21 and accompanying text.

\textsuperscript{114} \textit{See generally} Schabes, \textit{supra} note 8, at 211 (criticizing the Ninth Circuit's resort to California law).

\textsuperscript{115} 287 U.S. at 103.


\textsuperscript{119} I.R.C. § 104(a)(2) (1991). "[G]ross income does not include . . . (2) any damages received . . . on account of personal injuries or sickness . . . ." \textit{Id.} \textit{See supra}
or not Congress by "necessary implication" made its taxing act "de-
pendent" upon state law\textsuperscript{120} is uncertain. The Ninth Circuit appar-
ently believed it had.\textsuperscript{121}

The other problem with the Ninth Circuit's interpretation is its
refusal to give credence to the command for "nationwide" uniform-
ity.\textsuperscript{122} Certainly, to the extent Congress intends uniform application
of section 104(a)(2), this intent is not repealed by any language con-
tained in section 104(a)(2).\textsuperscript{123} In the absence of any such language
of differing purpose, the intent of Congress provides for nationwide
uniform application.\textsuperscript{124}

The language relied upon does provide that "[t]he state law cre-
ates legal interests but the federal statute determines when and how
they shall be taxed."\textsuperscript{125} This suggests that state law will play a role
in certain circumstances,\textsuperscript{126} but clearly provides that federal law de-
determines "how they shall be taxed."\textsuperscript{127} One need only consider the
issue in \textit{Roemer}\textsuperscript{128} to conclude that the Ninth Circuit may have mis-
used this text by utilizing state law to determine how the damages
were taxed.\textsuperscript{129}

\textit{Morgan v. Commissioner}\textsuperscript{130} sheds further light on the subject of
state created rights. There the Court stated,

State law creates legal interests and rights. The federal revenue acts desig-
nate what interests or rights, so created, shall be taxed. Our duty is to as-
certain the meaning of the words used to specify the thing taxed. If it is
found in a given case that an interest or right created by local law was the
object intended to be taxed, the federal law must prevail no matter what
name is given to the interest or right by state law.\textsuperscript{131}

The \textit{Morgan} decision, citing precedent,\textsuperscript{132} offers language which

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\begin{footnotesize}
\textsuperscript{120.} See \textit{supra} note 117 and accompanying text.
\textsuperscript{121.} See \textit{supra} note 110.
\textsuperscript{122.} See \textit{supra} note 116 and accompanying text.
\textsuperscript{123.} See \textit{supra} note 119 and accompanying text.
\textsuperscript{125.} \textit{Id. See infra} notes 131, 143 and accompanying text.
\textsuperscript{126.} \textit{See infra} notes 143-66 and accompanying text on property law applications.
\textsuperscript{128.} 716 F.2d at 693. The issue was whether the damages received by the taxpayer
were excludible from income.
\textsuperscript{129.} \textit{Id.}, \textit{supra} notes 125-27 and accompanying text; \textit{see also} Estate of Steffke,
538 F.2d 730, 732 (7th Cir.), cert. denied, 429 U.S. 1022 (1976) (federal law controls
the meaning of words in federal revenue statutes in the absence of language evincing a
different purpose).
\textsuperscript{130.} \textit{Morgan v. Commissioner}, 309 U.S. 78 (1940).
\textsuperscript{131.} \textit{Id. at 80-81. See also} \textit{Burnet v. Harmel}, 287 U.S. 103, 110 (1932); Bankers
Pocahontas Coal Co. v. \textit{Burnet}, 287 U.S. 308, 310 (1932); Palmer v. Bendler, 287 U.S.
551, 555 (1933); \textit{Thomas v. Perkins}, 301 U.S. 655, 659 (1937); \textit{Heiner v. Mellon}, 304
(1934); \textit{Blair v. Commissioner}, 300 U.S. 5 (1931); \textit{Lang v. Commissioner}, 304 U.S. 264
(1938).
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supports the Ninth Circuit's position by stating, "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property or income sought to be reached by the statute." 133 This statement, taken in isolation, suggests that the Ninth Circuit ruled properly in Roe-mer by turning to state law. 134 Yet, when combined with the language in Burnet, inconsistencies appear. 135 "[D]ifferences in state law should not override the intent of Congress in enacting federal taxing statutes." 136 Congress's intent was to promote uniform application of a nationwide scheme of taxation. 138 Yet, "Congress in drafting the tax code clearly did not intend to redefine whole areas of legal relationships created by state... law, but instead sought to impose a generally uniform system of taxation upon the existing legal structure." 139

Perhaps the confusion that results from analyzing the various precedents arises because state law does play a primary role in many federal tax cases. 140 Whether by necessity, 141 Supreme Court decision, or congressional intent, state law has been involved in almost all federal tax determinations. 142

B. Property Law in General

In terms of the federal income tax, state law usually controls in determining the nature of the legal interest the taxpayer has in the property sought to be taxed. 143 The state has a legitimate and traditional interest in creating and defining the property interest of its

133. 309 U.S. at 82.
134. See supra notes 57-58 and accompanying text.
135. See supra notes 115-17 and accompanying text.
137. In re Vaughan, 719 F.2d 196, 200 (6th Cir. 1983).
140. See infra notes 143-252 and accompanying text.
141. See supra note 117 and accompanying text.
142. See Comment, supra note 139, at 1350.
In *Aquilino v. United States*, it was argued that property interest definitions should be governed by federal law. The Supreme Court disagreed stating, "[I]t ignores the long-established role that the States have played in creating property interests and places upon the courts the task of attempting to ascertain . . . property rights under an undefined rule of federal law." As stated by the Court in *United States v. Mitchell*, "with respect to . . . income, federal income tax liability follows ownership." When ownership is to be determined, state law controls. The state law creates legal interests but the federal statute determines when and how they shall be taxed. Property law is state law. State law usually determines who owns the property. The federal tax code "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." "[O]nce it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of [the statute], state law is inoperative . . . ."

The Supreme Court has usually held that in matters of property ownership, state law controls. However, a taxpayer who holds legal title to property under state law is not necessarily the owner for purposes of the federal income tax. The courts have carefully scrutinized transactions involving mere title-passing. "[T]axation is not so much concerned with the refinements of title as it is with actual command over the property taxed . . . ." The Court has

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144. *Id.* at 514.
145. *Id.* at 509.
146. *Id.* at 513, n.3.
147. *Id.*
149. *Id.* at 197. *See also Blair v. Commissioner, 300 U.S. 5, 11-14 (1937); Hoeper v. Tax Comm'n, 284 U.S. 206 (1931).*
150. Mitchell, 403 U.S. at 197.
151. *Id.* (quoting *Burnet v. Harmel*, 287 U.S. 103, 110 (1932)).
155. *Id.* at 56-57.
156. *But cf.* Gregory v. Helvering, 293 U.S. 465, 470 (1935) (corporate tax case stating that the economic realities of the transaction as a whole, not who has title under state law, decides who are the owners for federal income tax purposes).
158. *See Lazarus v. Commissioner*, 513 F.2d 824 (9th Cir. 1975) (holding that the transfer of shopping center stock to trust reserving life estate was a gift, not a sale with annuity as consideration).
never regarded ‘the simple expedient of drawing up papers’ as controlling for tax purposes when the objective economic realities are to the contrary.” Substance, not form, is controlling in determining property ownership.

Nonetheless, property ownership often is found by resort to state law. “The federal revenue interest . . . consists entirely of the expectation that the . . . rights will be determined accurately in accordance with the prevailing state rules.” When Congress drafted the tax code, it did not intend to redefine whole areas of legal relationships created by state property law. Instead, where Congress has legislated that tax consequences depend upon “primary legal relationships,” state law has controlled. Therefore, in the area of property law, the tax authority has usually turned on state law classifications with certain exceptions. This result appears rational since the parties expect state law relationships to bind them.

C. Applying These Principles

A detailed examination into an exhaustive listing of tax areas where state law has significance is beyond the scope of this Comment. However, briefly exploring some principle areas where the courts turn to state law can offer insight into our analysis of Roe-mer. By introducing the fundamental concepts underlying these “state-controlled” areas of tax law, perhaps the inconsistencies above can be reconciled.

The use of state law to define personal injury damages is distinguishable from the examples that follow. The reasons for using state law in these situations vary, and perhaps many of these could be


161. Lazarus, 513 F.2d at 828. See also Helvering v. Clifford, 309 U.S. 331, 334 (1940).


164. See Comment, supra note 139, at 1352.

165. See supra notes 156-61 and accompanying text.

166. For example, if the state determines that X is the owner of Blackacre, a judicial determination that Y is the owner for income tax purposes may confuse and unfairly hinder the state’s substantive law and its enforcement.

167. 716 F.2d 693 (9th Cir. 1983).

168. See supra notes 110-42 and accompanying text.
argued in favor of using some aspect of state law to define personal injury damages. This Comment does not argue that state law has no utility in section 104(a)(2) exclusion analysis. Rather, turning solely to state law "labels" is something discouraged even in those areas of law where state law dominates. It is hoped that by analyzing these areas and their exceptions, the problems surrounding the use of state law in defining personal injuries for federal income tax exclusion will appear more obvious and troublesome.

1. Casualty Losses

Section 165(c)(3) of the I.R.C. allows the taxpayer to deduct "losses of property . . . if such losses arise from fire . . . or other casualty, or from theft."169 However, the Code does not define "theft."170 The applicable treasury regulation171 states that theft includes, but is not limited to, larceny, embezzlement, and robbery.172 The courts have allowed "theft" to include the taking of property which is illegal under the criminal law of the state where the loss occurred.173

The law of the jurisdiction is applicable in determining a theft within the meaning of section 165(c)(3).174 This is true even if the alleged theft is not prosecuted.175 However, "theft" requires a criminal act.176 The nature of the crime is irrelevant, as long as a theft occurs.177 But whether a theft occurs depends upon the law of the jurisdiction where the loss is sustained.178

The Fifth Circuit referred to the courts' resort to state law as a rule of convenience only.179 In Bagur v. Commissioner, the Fifth Circuit determined theft loss under federal law.180 The court stated

172. Id.
179. Bagur v. Commissioner, 603 F.2d 491, 502 (5th Cir. 1979), rem'g 66 T.C. 817 (1976)(where husband allegedly appropriated community income while wife was liable for taxes on her half).
180. 603 F.2d at 502.
that the question was not "whether the taxpayer's husband should be punished as a thief under state law but whether the taxpayer should be allowed a tax loss as the victim of a theft under the federal tax law." The Commissioner conceded that a loss may have been realized, but argued that it could not be classified as a theft loss because Louisiana community property law made a theft by a husband impossible. The Fifth Circuit, unpersuaded by the Commissioner's argument (and perhaps motivated by equitable principles), found the issue a matter of federal law.

In the area of "other casualty" losses courts appear concerned with proof of loss. Events giving rise to the loss must be "sudden, unexpected, violent and not due to deliberate or willful actions." By requiring sudden, nondeliberate acts, the courts seem to address the concern of fraudulent loss claims. The area of casualty losses under section 165(c)(3) is one area where the courts and the IRS have traditionally turned to state law, even though uniformity in the taxation of individuals may suffer. "Because the elements of theft vary with the criminal statutes of each state, the question of whether a theft loss has been sustained is determined by reference to the criminal law of the jurisdiction where the loss occurred." When the result of defining "theft" using state law seems inequitable or against the intent of Congress, the courts may create an exception and use federal law. The readily apparent rationale seems to focus on the position the IRS has taken with regard to Treasury Regulation section 1.165-8(d), proof of loss, or necessity.

181. Id. (emphasis omitted).
182. Id. at 501.
183. Id. at 502.
184. See supra note 169 and accompanying text.
189. See supra notes 179-83 and accompanying text.
190. See supra note 171 and accompanying text.
191. See supra notes 184-86 and accompanying text.
192. See supra notes 170, 188 and accompanying text.
2. Marital Status

Certain sections of the Code directly address marital status and the accompanying definitions.193 Where the Code is silent, a federal court is presumably bound by state law when determining marital status.194 In these situations, the Tax Court has consistently held that marital status is defined by state law.195 "Marriage, its existence and dissolution, is particularly within the province of the states."196 Likewise, whether a party is legally separated depends upon the state law of that party's marital domicile.197 Termination of marital status under an interlocutory decree of divorce is dependent upon state law.198

In many cases, the IRS has supported the courts' view and stated that the marital status as determined by state law would be recognized for federal income tax purposes.199 The IRS has also held that a common-law marriage is recognized for tax purposes if recognized by the state where entered into.200 However, the IRS will not recognize "sham divorces."201

Cases arising due to the "marriage penalty"202 have often involved an exception to the use of state law. For instance, in Boyter v. Commissioner,203 the Fourth Circuit held that the "sham transaction

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194. Eccles v. Commissioner, 19 T.C. 1049, aff'd per curiam, 208 F.2d 796 (4th Cir. 1953).
195. See Lee v. Commissioner, 64 T.C. 552 (1975), aff'd, 550 F.2d 1201 (9th Cir. 1977); Gersten v. Commissioner, 28 T.C. 756 (1957), aff'd in relevant part, 267 F.2d 195 (9th Cir. 1959); Eccles v. Commissioner, 19 T.C. 1049, aff'd per curiam, 208 F.2d 796 (4th Cir. 1953); Calhoun v. Commissioner, 27 T.C. 115 (1956); Estate of Buckley v. Commissioner, 37 T.C. 664 (1962).
196. Eccles, 19 T.C. at 1051.
197. See Capodanno v. Commissioner, 69 T.C. 638 (1978), aff'd, 602 F.2d 64 (3d Cir. 1979)(under New Jersey law, a separate maintenance decree does not create a legal separation); Dunn v. Commissioner, 70 T.C. 361 (1978)(holding a Wisconsin order for temporary alimony, child support, and debt payments does not constitute a legal separation).
198. See Eccles, 19 T.C. at 1049; Commissioner v. Evans, 19 T.C. 1102 (1953), aff'd, 211 F.2d 378 (10th Cir. 1954); Lane v. Commissioner, 26 T.C. 405 (1956). See also Commissioner v. Ostler, 237 F.2d 501 (9th Cir. 1956); United States v. Holcomb, 237 F.2d 502 (9th Cir. 1956).
200. Id. See also Von Tersch v. Commissioner, 47 T.C. 415 (1967); Amaro v. Commissioner, 29 T.C.M. (CCH) 914, 916 (1970).
202. The marriage penalty can be generally described as the higher taxes a married couple pays as compared with single taxpayers. For further discussion, see Wendy C. Gerzog, The Marriage Penalty: The Working Couple's Dilemma, 47 FORDHAM L. REV. 27 (1978). See also Drucker v. Commissioner, 679 F.2d 46 (2d Cir. 1982), cert. denied, 461 U.S. 957 (1983) ("marriage penalty" not a violation of any constitutional right).
203. Boyter v. Commissioner, 668 F.2d 1382 (4th Cir. 1981), rem'g 74 T.C. 989
doctrine may apply in this case involving a year-end divorce and subsequent remarriage. The Fourth Circuit determined that a federal question still existed and should be decided before resort to state law and how that law affects the questioned divorce. This holding supports the notion that the courts will resort to state law only after the statute and federal law questions have been exhausted.

In a different situation, the Second Circuit in Borax v. Commissioner allowed a deduction for alimony payments made under a settlement agreement even though the New York courts held the divorce invalid. This case also suggests that state law will not always determine marital status for federal income tax purposes.

Marital status definition within the context of the federal income tax does not present the only situation where federal courts resort to state law for definitions concerning domestic relations. The focus on state law when defining classes within a federal statute has its primary roots in a 1916 Supreme Court decision. In Seaboard Air Line Railway v. Kenney, the Court had to decide how “next of kin” was defined. The Supreme Court stated,

[A]s speaking generally under our dual system of government, who are next of kin is determined by the legislation of the various states to whose authority that subject is normally committed, it would seem to be clear that the absence of a definition in the act of Congress plainly indicates the purpose of Congress to leave . . . that question to the state law.

The Court, unpersuaded by an argument for a common law definition, stated,

[T]he contention amounts to saying that Congress . . . must be assumed to have overthrown the local laws of the States, and substituted another law for it, when . . . it is clear that no such extreme result could possibly be attributed to the act of Congress without express and unambiguous provisions rendering such conclusion necessary.

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206. Boyter, 668 F.2d at 1385.
207. Borax v. Commissioner, 349 F.2d 666 (2d Cir. 1965), cert. denied, 383 U.S. 935 (1966) (alimony payments deductible despite New York ruling that Mexican divorce was invalid).
208. Id.
210. Id. at 493. “Plainly the statute contains no definition of who are to constitute the next of kin to whom a right of recovery is granted.” Id.
211. Id. at 493-94.
212. Id. at 494.
The Supreme Court also used state law to determine the definition of “children.” In *De Sylva v. Ballentine*, the Court stated, “[t]he scope of a federal right is . . . a federal question, but that does not mean that its content is not to be determined by state, rather than federal law.” The Court went on to hold, “This is especially true where a statute deals with a familial relationship; there is no federal law of domestic relations, which is primarily a matter of state concern.”

In matters of familial relationship definition, the courts will look to state law. “To provide a federal tax law of marriage would create greater confusion in divorce courts than now exists. Some individuals would be validly married for all purposes except federal taxes, and others validly married for federal tax purposes only. Marriage is peculiarly a creature of state law . . . ” Where Congress has failed to provide definitions of marital status, the courts usually turn to state law. This appears rational since Congress has provided definitions in specific instances. Utilizing state law when the statute is silent seems supportable considering the state-law nature of domestic relations.

3. Corporate Existence

A corporation under the Code, as defined in section 7701(a)(3) of the I.R.C. includes “associations, joint-stock companies, and insurance companies.” When interpreting section 7701(a)(3), state law is normally determinative.

One of the leading cases on corporate existence is *Morrissey v.*
Commissioner.\textsuperscript{222} There, the Supreme Court set out the salient features of a corporate organization for federal income tax purposes.\textsuperscript{223} The court in \textit{United States v. Kintner}\textsuperscript{224} relied on \textit{Morrissey}\textsuperscript{226} when it found an association of doctors was taxable as a corporation.\textsuperscript{226} The court in \textit{Larson v. Commissioner}\textsuperscript{227} also turned to the \textit{Morrissey} factors\textsuperscript{228} when it found a limited partnership organized under California was taxable as a partnership.\textsuperscript{229}

The court in \textit{O'Neill v. United States}\textsuperscript{230} held that \textit{Morrissey}\textsuperscript{231} was not controlling there, since \textit{Morrissey}\textsuperscript{232} involved the classification of a trust.\textsuperscript{233} The Sixth Circuit stated, "The inquiry is whether the state granted existence to a corporate entity under its law."\textsuperscript{234} "It appears clear that the corporate entity created by state law is the corporation taxed under the Internal Revenue Code."\textsuperscript{235} The Sixth Circuit went on to hold that a professional business organization incorporated under state law was a corporation within the meaning of section 7701(a)(3).\textsuperscript{236} The IRS has supported this view by promulgating Revenue Ruling 70-101\textsuperscript{237} and stating that "professional service organizations formed under state professional association or

\begin{itemize}
\item \textsuperscript{222} Morrissey v. Commissioner, 296 U.S. 344 (1935) (holding trustees of an express trust were an association).
\item \textsuperscript{223} \textit{Id.} at 359. "A corporation, as an entity, holds the title to the property embarked in the corporate undertaking ... Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation." \textit{Id.} The interests of the corporation's members may be secure from termination or interruption by the death of owners. \textit{Id.} The organization "facilitates ... the transfer of beneficial interests without affecting the continuity of the enterprise, and also the introduction of large numbers of participants." \textit{Id.} Personal liability of the participants is limited. \textit{Id.}
\item \textsuperscript{224} 216 F.2d 418 (9th Cir. 1954).
\item \textsuperscript{225} 296 U.S. 344 (1935).
\item \textsuperscript{226} \textit{See generally United States v. Kintner}, 216 F.2d 418 (9th Cir. 1954). The history of professional corporations is detailed, but interesting. \textit{See generally} Lester B. Snyder & Donald T. Weckstein, \textit{Quasi-Corporations, Quasi-Employees and Quasi-Tax Relief for Professional Persons}, 48 \textit{CORNELL L.Q.} 613 (1963) (discussing Kintner, the IRS reaction, and other historical developments).
\item \textsuperscript{227} Larson v. Commissioner, 66 T.C. 159 (1976).
\item \textsuperscript{228} \textit{See supra} notes 222, 223 and accompanying text.
\item \textsuperscript{229} Larson, 66 T.C. at 172.
\item \textsuperscript{230} O'Neill v. United States, 410 F.2d 888 (6th Cir. 1969).
\item \textsuperscript{231} 296 U.S. 344 (1935).
\item \textsuperscript{232} \textit{Id.}
\item \textsuperscript{233} \textit{O'Neill}, 410 F.2d at 890.
\item \textsuperscript{234} \textit{Id.} at 898. \textit{But cf.} Kurzner v. United States, 413 F.2d 97 (5th Cir. 1969) (where professional corporation issue was analyzed without regard to state law label).
\item \textsuperscript{235} \textit{O'Neill}, 410 F.2d at 896.
\item \textsuperscript{236} \textit{Id.} at 899. For further discussion on professional corporations, see Snyder & Weckstein, \textit{supra} note 226.
corporation statutes will generally be treated as corporations for tax purposes."  

Exceptions to the general rule do exist. "Whether an organization is to be taxed as a corporation under the Code is determined by Federal, not state, law." It is often necessary to ignore state labels and analyze the underlying legal relationships. An agency relationship may be recognized by focusing on the transactions at issue. In addition, corporate characteristics may be obtained by contract without filing any articles of incorporation.

Corporate existence, as opposed to partnership classification, can have dramatic tax consequences due to the "double taxation" of corporate dividends and corporate tax deductions. Accordingly, depending on the taxpayer's position at issue, corporate form may or may not be desirable. Yet, the title a business holds under state law will not always determine what legal tax consequences follow. A state law partnership may be taxed as a corporation.

Corporate existence represents one area where the courts usually resort to state law, with some exceptions. One explanation for the exceptions is that the state label is not a reliable indicator of the legal and economic consequences of the organization. Another is

239. Ochs v. United States, 305 F.2d 844, 847 (Cl. Ct. 1962), cert. denied, 372 U.S. 968 (1963). See also Burk-Waggoner Oil Ass’n v. Hopkins, 269 U.S. 110 (1925). "Neither the conception of unincorporated associations prevailing under the local law, nor the relation . . . to its shareholders, nor . . . to outsiders, is of legal significance as bearing upon the power of Congress to determine how and at what rate the income of the joint enterprise shall be taxed." Id. at 114.  
243. See I.R.C. § 7701(a)(2) (1991). "The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation . . . ." Id.  
247. See supra notes 219-38 and accompanying text.  
248. See supra notes 239-46 and accompanying text.  
249. See Comment, supra note 139, at 1353.
that the courts value substance over form.\textsuperscript{250} Whatever the dominant reasons, corporate existence serves as a useful analogy to marital status\textsuperscript{251} and casualty losses.\textsuperscript{252}

\textbf{D. A Non-Tax Issue: Jury Instructions on Damage Awards}

At this point, a brief departure from federal income taxation issues is welcomed. As discussed above, federal courts often consider state law when deciding federal income tax decisions.\textsuperscript{253} State courts also consider federal income tax issues, but in a different context. Perhaps the most familiar area of law is that involving jury instructions.

Personal injury awards and settlements are excluded from gross income for federal income tax purposes.\textsuperscript{254} Often, defendants seek to have juries informed of the section 104(a)(2) exclusion in figuring damage awards. Courts are in conflict as to whether the jury should be so instructed.\textsuperscript{255} Irrespective of whether such an instruction is proper or not, jurisdictions do vary in their treatment of jury instruction requests on the tax consequences of personal injury damage awards.

The Supreme Court in \textit{Norfolk & Western Ry. Co. v. Liepelt}\textsuperscript{256} held that it was error to exclude defense evidence pertaining to income tax consequences and, when requested by the defense, a jury

\begin{itemize}
\item \textsuperscript{250} See Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945); Interstate Transit Lines v. Commissioner, 319 U.S. 590, 594 (1943); Deputy v. duPont, 308 U.S. 488, 496 (1940). See infra note 308 and accompanying text.
\item \textsuperscript{251} See supra notes 193-218 and accompanying text.
\item \textsuperscript{252} See supra notes 169-92 and accompanying text.
\item \textsuperscript{253} See supra notes 167-248 and accompanying text.
\item \textsuperscript{254} I.R.C. § 104(a)(2) (1991). See supra notes 3-5 and accompanying text.
\item \textsuperscript{256} Norfolk & Western Ry. Co. v. Liepelt, 444 U.S. 490 (1980), rev’d 378 N.E.2d 1232 (Ill. 1979) (wrongful death action brought under FELA requires instruction upon defense request).
\end{itemize}
instruction should be given.\textsuperscript{257} This decision may be limited to Federal Employer Liability Act actions.\textsuperscript{258} The Seventh Circuit has held that Liepelt\textsuperscript{260} does not control in cases involving purely state law.\textsuperscript{260} Currently, this is a very unsettled and developing area of law.\textsuperscript{261} Some states refuse to give the instruction fearing that if the jury mitigated damages because of the income tax exemption, the plaintiff would not receive the tax benefits intended by Congress.\textsuperscript{262} One court allowed the instruction when the impact of future taxes was substantial.\textsuperscript{263} Of course, jury instructions have relevance in either the federal or state court action,\textsuperscript{264} but only an attenuated impact in the actual tax litigation itself, where the issue involves solely the taxation of damages received.\textsuperscript{265} However, uniformity of federal income tax treatment will not be achieved if some courts require the jury instructions, some allow it, and still others prohibit it. In the current state of affairs, whether a party is granted the instruction will depend upon the forum chosen,\textsuperscript{266} the action filed,\textsuperscript{267} or both.

IV. REASONS FOR THE EXCLUSION

A discussion of section 104(a)(2)\textsuperscript{268} would be incomplete without mention of the purposes and policy behind the exclusion. Numerous

\begin{itemize}
  \item \textsuperscript{257} Id.
  \item \textsuperscript{259} 444 U.S. at 490.
  \item \textsuperscript{260} In re Air Crash Disaster Near Chicago v. Commissioner, 701 F.2d 1189 (7th Cir.), cert. denied, 464 U.S. 866 (1983).
  \item \textsuperscript{262} See Hall v. Chicago & N.W. Ry. Co., 125 N.E.2d 77 (Ill. 1955).
  \item \textsuperscript{263} Cox v. Northwest Airlines, Inc., 379 F.2d 893 (7th Cir. 1967), cert. denied, 389 U.S. 1044 (1968).
  \item \textsuperscript{264} Jury instructions are procedural, subject to state or federal procedural law as applicable in each case.
  \item \textsuperscript{265} The Tax Court considers whether the award granted is taxed or not, not how much the award should be, or how the award was arrived at.
  \item \textsuperscript{266} See supra note 255 and accompanying text.
  \item \textsuperscript{267} See supra notes 255-60 and accompanying text.
  \item \textsuperscript{268} I.R.C. § 104(a)(2) (1991).
\end{itemize}
commentators have struggled with identifying this policy. The legislative history behind section 104(a)(2) and its predecessors has offered little guidance. Nonetheless, to fully understand the significance of turning to state law as in Roemer, the exclusion policy remains quite important. For purposes of this Comment, mention of the offered theories will be helpful without conducting a thorough re-examination.

Most commentators have concluded that the exclusion is based on humanitarian grounds. This theory suggests that the exclusion is a matter of public policy. Professor Harnett, the pioneer of the "Suffered-Enough" concept, explained that "the taxation of recoveries carved from pain and suffering is offensive, and the victim is more to be pitied rather than taxed." This "Suffered-Enough" concept has received some acceptance in the courts for explaining the exclusion.

Several other explanations have been developed, though each has its own limitations. Perhaps the most familiar is the "Return of Capital" justification. The "Return of Capital" concept centers on the idea of "being made whole." The basic idea is that the plaintiff, having suffered a loss or injury, is just being returned to the pre-accident condition. Two obvious problems with this rationale surface.

270. See supra notes 6-11 and accompanying text.
271. See supra notes 20-21 and accompanying text.
273. See Harnett, supra note 269, at 626-27 (concluding the exclusion is founded on "emotional and traditional" factors).
274. See Schabes, supra note 8, at 226 (referring to Harnett, supra note 269, at 627).
276. See Huddell v. Levin, 395 F. Supp. 64, 87 (D. N.J. 1975), vacated on other grounds, 537 F.2d 726 (3d Cir. 1976); Roemer v. Commissioner, 716 F.2d 693, 696 (9th Cir. 1983).
277. See infra notes 278-89 and accompanying text.
278. See Cochran, supra note 269, at 45.
First, the “Return of Capital” approach necessarily involves an element of “human capital” of which the taxpayer has no readily discernable basis.\textsuperscript{280} Second, often the taxpayer is compensated for lost future earnings and pain and suffering. Besides being made whole, the plaintiff is also awarded punitive damages in many instances, often with no tax consequences.\textsuperscript{281}

One further justification is that the plaintiff should not be taxed for an involuntary conversion.\textsuperscript{282} This explanation has two serious flaws.\textsuperscript{283} The most obvious and significant flaw is that section 104(a)(2) excludes personal injury awards completely, rather than just deferring them.\textsuperscript{284} If Congress meant to exclude personal injury awards as involuntary conversions, then section 1033\textsuperscript{285} and section 104(a)(2)\textsuperscript{286} are inconsistent.

Other explanations, such as viewing damage awards as imputed income\textsuperscript{287} or as not derived from labor or capital,\textsuperscript{288} have been struck down as only partially applicable.\textsuperscript{289} At this stage, perhaps the safest and most consistent view is that Congress, in passing section 104(a)(2), sought to grant the exclusion for public policy reasons.\textsuperscript{280} Whatever the justification or underlying rationale, tax exemptions do depend upon legislative grace.\textsuperscript{290} I join the other commentators who have concluded that humanitarian reasons are at the foundation of the exclusion.\textsuperscript{282}

V. MESHING TAX POLICIES WITH THE EXCLUSION

Combining the policies behind the Code, the section 104(a)(2) exclusion, and the use of state law is a difficult but necessary task, as

\[\text{\textsuperscript{280} I.R.C. \textsection 1012 (1991) (basis of property shall be the cost of such property). I.R.C. \textsection 1001(a) provides that any return greater than basis is taxable gain. I.R.C. \textsection 1001(a) (1991). The idea that human capital has no basis is questionable. See United States v. Garber, 589 F.2d 843, 850 (5th Cir. 1979) (dissent) ("it was not so obvious she had no basis in the [blood plasma] sold"). See also Cochran, supra note 269, at 45-46. Consider also that I.R.C. \textsection 101 (providing that loss of life compensation is not taxable) may indicate Congress recognizes value in human capital.}
\[\text{\textsuperscript{281} See Roemer v. Commissioner, 716 F.2d 693 (9th Cir. 1983).}
\[\text{\textsuperscript{282} See Cochran, supra note 269, at 46-47 (referring to \textsection 1033 which allows deferral of tax).}
\[\text{\textsuperscript{283} Id. First, involuntary conversion does not exclude the gain, but rather defers it. Second, \textsection 1033 requires reinvestment in replacement property. Id.}
\[\text{\textsuperscript{284} See supra notes 4, 5 and accompanying text.}
\[\text{\textsuperscript{285} I.R.C. \textsection 1033 (1991).}
\[\text{\textsuperscript{286} I.R.C. \textsection 104(a)(2) (1991).}
\[\text{\textsuperscript{287} See Cochran, supra note 269, at 48-49.}
\[\text{\textsuperscript{288} See Palmer, supra note 272, at 86.}
\[\text{\textsuperscript{289} See supra notes 287-88.}
\[\text{\textsuperscript{290} See supra notes 272-76 and accompanying text.}
\[\text{\textsuperscript{291} Luehrmann v. Commissioner, 272 F.2d 10, 15 (8th Cir. 1961).}
\[\text{\textsuperscript{292} See supra note 272 and accompanying text.}
state law often does enter into federal tax court decisions.\textsuperscript{293} However, this Comment presents two approaches to the issue which logically explain how and when the use of state law is warranted.\textsuperscript{294} Under either analysis, the Ninth Circuit's approach in \textit{Roemer}\textsuperscript{295} is clearly questionable.

\section*{A. The Eighth Circuit Test}

In \textit{Doll v. Commissioner},\textsuperscript{296} the Eighth Circuit laid down useful guidelines for determining whether Congress intended state law to control in a tax statute. State law usually "determines the creation and existence of legal relationships and their attendant rights, duties, obligations and incidents."\textsuperscript{297} Since state laws govern legal relationships, and the national revenue laws sometimes recognize them, the court set out a useful approach for ascertaining when state law applies.\textsuperscript{298}

The Eighth Circuit began with two general rules.\textsuperscript{299} First, the plenary power of Congress to tax is not subject to state control.\textsuperscript{300} However, Congress may choose its own criteria and make or not make state law control the application of its acts.\textsuperscript{301}

The intention of Congress governs.\textsuperscript{302} The Eighth Circuit presented several factors useful in determining whether Congress intended state law to control.\textsuperscript{303} First, state law does not control unless required by the express language of the statute or by necessary implication.\textsuperscript{304} The second factor inquires whether a uniform application of a nationwide taxation scheme would be interfered with if

\begin{itemize}
  \item \textit{See supra} notes 143-252 and accompanying text.
  \item \textit{See infra} notes 296-376 and accompanying text.
  \item \textit{See supra} notes 51-62 and accompanying text.
  \item Doll v. Commissioner, 149 F.2d 239 (8th Cir.), cert. denied, 326 U.S. 725 (1945).
  \item \textit{Id.} at 241.
  \item \textit{Id.} at 241-42. In this regard, the Eighth Circuit mentioned several factors to be considered. \textit{Id.}
  \item \textit{Id.} at 242.
  \item \textit{Id. See also} Helvering v. Stuart, 317 U.S. 154, 161 (1942); Lyeth v. Hoey, 305 U.S. 188, 194 (1938); Burnet v. Harmel, 287 U.S. 103, 110 (1932); Farmers' Union Co-op. Co. v. Commissioner, 90 F.2d 488, 492 (8th Cir. 1937); Wholesalers' Adjustment Co. v. Commissioner, 88 F.2d 156, 158 (8th Cir. 1937); Mississippi Valley Trust Co. v. Commissioner, 72 F.2d 197, 200 (8th Cir. 1934).
  \item Doll, 149 F.2d at 241-42.
  \item Doll, 149 F.2d at 242.
  \item \textit{Id. See also} Helvering v. Stuart, 317 U.S. 154, 161 (1942); United States v. Pelzer, 312 U.S. 399, 402 (1941); Lyeth v. Hoey, 305 U.S. 188, 194 (1938). \textit{See supra} note 117 and accompanying text.
\end{itemize}
state law controlled.\textsuperscript{305} Finally, the last inquiry involves whether the purposes of the taxing act would be avoided by applying state law.\textsuperscript{308}

The court in \textit{Doll} focused on the purpose test.\textsuperscript{307} In so doing, the Eighth Circuit stated that "[s]ubstance and not form controls in applying income tax statutes . . . ."\textsuperscript{308} The Eighth Circuit's tests, when applied to the section 104(a)(2) exclusion, provide a coherent approach in analyzing the Ninth Circuit's use of state law to determine a "personal injury."\textsuperscript{309}

First, section 104(a)(2) does not expressly provide that state law controls.\textsuperscript{310} Similarly, the Code does not define "personal injury."\textsuperscript{311} It has been argued that Treasury Regulation section 1.104-1(c),\textsuperscript{312} by use of the term "tort or tort type rights,"\textsuperscript{313} necessarily implies that Congress intended section 104(a)(2) to depend "to some degree, upon classifications under State law."\textsuperscript{314} However, it appears that the Ninth Circuit in \textit{Roemer} relied solely on the state law classification, not just to some degree.\textsuperscript{315} The Ninth Circuit's necessary implication rationale hardly explains the fact that courts have successfully applied the exclusion under section 104(a)(2) and its predecessors without resort to state law classifications.\textsuperscript{316}

Second, using state law to define "personal injury" can interfere with the application of a nationwide uniform tax scheme.\textsuperscript{317} The Ninth Circuit's use of California tort law to label defamation a personal injury may provide uniformity within the state, but uniformity


\textsuperscript{306}. \textit{Doll}, 149 F.2d at 247 n.5.

\textsuperscript{307}. \textit{Id.} at 243.


\textsuperscript{309}. \textit{See supra} notes 51-62 and accompanying text.

\textsuperscript{310}. \textit{See supra} notes 4, 18 and accompanying text.

\textsuperscript{311}. \textit{Id.}

\textsuperscript{312}. Tress. Reg. § 1.104-1(c) (as amended in 1970).

\textsuperscript{313}. \textit{Id.} "The term 'damages received' . . . means an amount received . . . based upon tort or tort type rights . . . ." \textit{Id.}

\textsuperscript{314}. \textit{Threlkeld} v. \textit{Commissioner}, 87 T.C. 1294, 1306 n.6 (1986).

\textsuperscript{315}. \textit{Roemer}, 716 F.2d at 693, 697-700. \textit{See supra} notes 51-62 and accompanying text.

\textsuperscript{316}. \textit{See supra} note 19 and accompanying text.

\textsuperscript{317}. \textit{See supra} note 305 and accompanying text; \textit{but cf. supra} notes 169-92 and accompanying text on casualty losses and notes 219-50 and accompanying text on corporate existence.
even within the Ninth Circuit may not result. Various torts and their state civil code classifications may or may not be uniform throughout the nation. But, if two torts identical in nature are committed in separate states, the belief that Congress intended its section 104(a)(2) exclusion to rest upon state law labels is doubtful at best, especially in light of the Tax Court’s position prior to Roemer.

Third, the purposes of the exclusion could be defeated by applying state law. It is clear that section 104(a)(2) does not exclude business injuries from taxation. Assuming a taxpayer can pigeon-hole the injury into a state “personal injury” classification, many business injuries could go untaxed because state courts awarded damages in “personal injury-type” pleaded actions. The purpose of relieving the pain under a “Suffered-Enough” concept is stretched beyond the clear intent of Congress in granting exclusion only to personal injuries. The intent of Congress must ultimately control.

Since the dominant purpose of the revenue laws is the taxation of income, any efforts by the courts to expand the exemption coverage should be suspect. Congress can choose to make state law determinative, but tax courts should be hesitant to utilize the “necessary implication” rationale when doing so would interfere with a uniform national tax scheme and effectively defeat the purpose of the statute. Because such an exclusion derives from an act of Congress, the exclusion should be applied with congressional intent in mind.

Alternatively, state legislatures seldom, if ever, classify their tort

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318. Perhaps another Ninth Circuit state does not offer a similar civil code classification.
319. See supra note 19 and accompanying text.
320. See supra note 306 and accompanying text.
322. The injury in Roemer itself, involving an insurance broker’s reputation, certainly can fit this assumption. See supra notes 33-63 and accompanying text.
323. See supra notes 272-76 and accompanying text.
324. See supra notes 131, 138 and accompanying text.
327. See supra note 301 and accompanying text.
328. See supra note 304 and accompanying text.
329. See supra note 305 and accompanying text.
330. See supra notes 306, 320-26 and accompanying text.
331. See supra notes 4, 291 and accompanying text.
332. See supra notes 137, 302-06 and accompanying text.
laws with federal income tax consequences considered. With the acceptance of the Ninth Circuit's approach, this certainly could change prospectively. However, because state tort law and federal tax law do not pursue the same overall objectives, using state law to define a federal tax exclusion is inconsistent with federal policy.

B. Factors Involved in Choosing State Law: A Second Analysis

As a starting point, state law as used in tax court varies from state law used in diversity cases. Under the Erie doctrine, where the substantive law is of state origin, state law furnishes the rule of decision. However, the federal income tax operates under federal substantive law. Therefore, when concerning federal tax cases, federal law applies unless Congress provides expressly or by necessary implication for the use of state law.

Several factors help determine if state law should be used in the absence of express provision. Among the most relevant are:

1) Do the tax consequences depend on the existence of a primary legal relationship?
2) What is the feasibility of creating federal law definitions?
3) How difficult is ascertaining which state's law applies?
4) Would reliance on state law create nonuniformity among similarly situated taxpayers?

Certainly, other factors come into play which may be helpful; but for our purposes, these four questions present a useful guide in the comparison of "personal injury" definition to the analogous areas of law mentioned above.

333. The reason for California's two-tort system on defamation is not discussed, but would certainly present an issue for future commentary. See supra notes 59-61 and accompanying text.

334. See supra note 21 and accompanying text.

335. The common law of torts has two general purposes: 1) to deter conduct which is contrary to public policy and harmful to society, and 2) to make the injured party whole again. Price Waterhouse v. Hopkins, 490 U.S. 228, 264-65 (1989) (O'Connor, J., concurring in the judgment). The dominant purpose of the revenue laws is the taxation of income, while the purpose of the exclusion appears to be humanitarian in nature. Deterring wrongful conduct and reparation do not appear at the heart of § 104(a)(2). See supra notes 269-92 and accompanying text.

336. See Comment, supra note 139, at 1351.


338. Id.

339. See supra notes 116, 125-27, 131 and accompanying text.

340. See supra note 117 and accompanying text.

341. See Comment, supra note 139, at 1352-57.

342. Id. Certain revisions have been made to adapt these to our discussion of I.R.C. § 104(a)(2).

343. See supra notes 169-252 and accompanying text.
1. Primary Legal Relationship

When applying a federal tax act, state law determines the nature of the legal interest which the taxpayer had in the property. When drafting the Code, Congress did not intend to redefine whole areas of legal relationships established by state law. In this regard, courts usually turn to state law when property interests are involved. Likewise, when complex legal relationships are involved, such as marriage, state law generally controls.

The Ninth Circuit in Roemer used state law to define “personal injury” for purposes of I.R.C. section 104(a)(2) exclusion. Had the court faced the issue of property ownership, perhaps its resort to state law would have been more supportable. But once Roemer’s ownership was determined, state law (in property law terms) became inoperative.

Certainly, the Ninth Circuit approach offers both convenience and predictability. However, if the Ninth Circuit’s approach was fully utilized, a defamed plaintiff in California could choose his cause of action and benefit thereby. Additionally, the Ninth Circuit’s opinion in Roemer involved a long, detailed analysis of California defamation history—hardly a convenient alternative at the outset.

Perhaps the most troubling aspect of the Roemer decision is its lack of reliability concerning the resultant legal consequences. State law classifications of legal relationships are best used for tax consequences when the “state label is a reliable indication of specific legal and economic consequences.” Incident to this relationship are the various rights, duties, and obligations that flow from the classification. Arguably for this reason, courts sometimes ignore state classifications of businesses for federal income tax purposes. When the

345. See supra note 139 and accompanying text.
346. See supra notes 143-66 and accompanying text.
347. See supra notes 194-218 and accompanying text.
348. See supra notes 51-62 and accompanying text.
349. For example, were the injury damages property of Roemer for tax purposes?
350. See supra note 155 and accompanying text.
351. See Comment, supra note 139, at 1353.
352. Roemer, 716 F.2d at 693, 699. See supra notes 59-61 and accompanying text.
353. 716 F.2d at 697-99.
354. See Comment, supra note 139, at 1353.
355. Id. at 1352. See also Doll v. Commissioner, 149 F.2d 239, 241 (8th Cir. 1945). See supra text accompanying note 287.
356. See supra notes 239-46 and accompanying text.
state classification offers little assistance to understanding the underlying relation, its use should be inconclusive.\textsuperscript{367} The legal status "for federal tax purposes need not be identical to their . . . legal effect under state law."\textsuperscript{368} The state law classification of an injury award as "personal" suggests little about the rights, obligations, and consequences that flow from the classification.

2. \textit{Feasibility of Creating Federal Law Definitions}

The definition of "theft" for casualty loss purposes is one area where the feasibility of creating a federal law definition may be prohibitive.\textsuperscript{359} Not only is "theft" traditionally an element of criminal law left to the states, creating a separate, all-encompassing definition for federal tax purposes would be unduly burdensome on Congress. Instead, the IRS and the courts have chosen to defer to state law in lieu of a federal definition.\textsuperscript{360}

Defining "personal injury" for federal tax purposes, on the other hand, is less burdensome and less infringing upon state autonomy. Though Congress has chosen not to define "personal injury,"\textsuperscript{361} the courts have functioned without resort to state law definitions before \textit{Roemer}.\textsuperscript{362} By focusing on "the nature of the claim,"\textsuperscript{363} courts have been able to evaluate several factors before reaching a definitional conclusion. State law classifications can be helpful, but making that classification determinative cannot be based on the infeasibility of creating a federal standard.\textsuperscript{364}

3. \textit{Ascertaining Which State's Law Applies}

In most personal injury cases, the choice of law decision made at the trial court level would suffice for tax definitional purposes as well. Therefore, if use of federal law was based upon the difficulty of state law choice, deferring to state law would not significantly lessen the overall decisional burden. The choice of law question will always exist at the state court level (assuming a state cause of action), and its choice would bind the Tax Court in most cases. However, for present purposes, this factor has little weight in the definition of

\textsuperscript{357} See Comment, supra note 139, at 1352.
\textsuperscript{358} Estate of Steffke v. Commissioner, 538 F.2d 730, 732 (7th Cir. 1976). See also Commissioner v. Tower, 327 U.S. 280 (1946); Lyeth v. Hoey, 305 U.S. 188 (1938).
\textsuperscript{359} See supra notes 169-79 and accompanying text. It is important to remember that the courts' concern with losses under I.R.C. § 165(c)(3) also involve proof of loss. See supra notes 185-86 and accompanying text.
\textsuperscript{360} See supra notes 173, 178 and accompanying text.
\textsuperscript{361} See supra notes 4, 18 and accompanying text.
\textsuperscript{362} See supra note 19 and accompanying text.
\textsuperscript{363} Roemer, 716 F.2d at 693, 697. See supra notes 19, 26, 46, 57, 104 and accompanying text.
\textsuperscript{364} See supra note 301 and accompanying text.
"personal injury" under section 104(a)(2).

A situation could arise where a particular state's law is unduly restrictive or expansive, thus operating against the federal exclusion policy. Here, the ascertainment of which state law to apply could become a significant issue. Yet, the ultimate choice of law question would still be decided in a non-tax court arena and would always be present.

4. **Uniformity**

As stated by the Supreme Court in *Burnet*, "[i]t is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation." When tax results vary for similarly situated taxpayers, Congress must either expressly provide or necessarily imply otherwise. The intent of Congress provides for nationwide uniform application of the federal income tax.

The strongest argument for use of state law in defining "personal injury" under section 104(a)(2) of the I.R.C. is resort to the "necessary implication" requirement. As previously discussed, necessary implication is a dubious explanation for state law usage in this context. In the absence of a necessary implication rationale, use of state law necessarily fails from promoting national inconsistency. Differences in state law may not be read into the Code to spell out a lack of uniformity. In interpreting an unclear statute, the Supreme Court defined its duty as "find[ing] that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested." The scheme is that of uniform nationwide tax treatment. The general purpose, though unclear,
appears to be humanitarian in nature.\footnote{375} Use of state law diminishes congressional control over both, while it is clear federal tax law is not subject to state control.\footnote{376}

VI. Conclusion

The Ninth Circuit took a big step in \textit{Roemer}, a step that other courts are likely, or required,\footnote{377} to follow. By resorting solely to state law, the Ninth Circuit uniquely applied precedent to produce an outcome that may or may not have been correct. When the Ninth Circuit utilized California's classification of defamation to define "personal injury," it effectively ignored or distinguished other precedent calling for federal law governance of federal income tax consequences and national uniformity.

Two arguments on the side of the Ninth Circuit's approach are: 1) Congress necessarily implied the use of state law, and 2) "personal injury" awards are property rights definable by state law. Ownership interest was not at issue in \textit{Roemer}; certainly, Roemer had property rights in his damage award. Yet, once the ownership interest was decided, state law became inoperative, and federal law was to determine how that interest was taxed under the federal income tax system. To say that Congress implied exclusive use of state law to define "personal injury" is doubtful when viewed in terms of past court treatment, IRS pronouncements, and the language of section 104(a)(2) itself.

"Personal injury" awards do not reflect primary legal relationships, such as marital status or property rights. Rather, a "personal injury" award offers little to reliably indicate the underlying legal relation and its attendant duties. Use of state court "labels" is suspect, especially when the result is variation of tax treatment and uncertainty of exclusion scope.

One additional problem with the use of state law is the federal courts' problematic need to ascertain what that state law is. Most, if not all, states have not addressed the classification of their torts in terms of personal injury definition, especially as it relates to federal income taxation. Certainly, confusion and unpredictability in the Tax Court could result.

In \textit{Roemer}, the Ninth Circuit took a short cut in its analysis of the nature of the underlying claim of defamation. It will now be left to Congress, the Supreme Court, or the Ninth Circuit itself to put the

\footnote{375}{See supra note 272 and accompanying text.}
\footnote{377}{\textit{See supra} note 77.}
courts back on the right road. In the meantime, the Ninth Circuit's approach will only add confusion, more uncertainty, and misguided efforts in determining the nature of a claim seeking the generously granted exclusion of "personal injury" awards from federal income taxation.

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