

# COMMENT

## IT'S ALL IN YOUR HEAD: HOW NEUROSCIENCE CAN CHANGE THE TAXABILITY OF DAMAGE AWARDS FOR EMOTIONAL INJURY\*

### I. INTRODUCTION

Imagine a woman is driving down the street when a car from oncoming traffic swerves into her lane, barreling straight toward her. The woman is able to swerve out of the way but hits a tree, suffering a concussion and a broken arm. The police find the individual who caused the accident, and the woman sues him for the cost of her medical bills. She recovers these damages, but she will not need to include these damages in her gross income, meaning that they will not be taxed.

Now imagine a modified scenario where, instead of hitting a tree, the woman jumps the curb to avoid a two-car collision. She suffers no bodily injuries but develops severe anxiety as a result of the accident. In addition to no longer being able to drive, the woman suffers insomnia and develops an eating disorder. She sues the man who caused the accident and recovers damages for the costs of treating her psychiatric issues. However, in this situation, the woman must include her damage award in her gross income. Those damages will be taxed.

The root of this disparate treatment can be found in the Internal Revenue Code and U.S. Treasury regulations, which allow a taxpayer to exclude damages from gross income only if they are awarded for “personal physical injury.”<sup>1</sup> Therefore, taxpayers who suffer from and recover damages for mental and emotional distress are required to include those damage awards in their gross income, but those taxpayers who have bodily injuries may exclude them.<sup>2</sup> However, advancements in neuroscience have established that emotional injuries cause measurable changes in the brain, demonstrating that

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1. I.R.C. § 104(a)(2); *see also* I.R.S. Priv. Ltr. Rul. 200041022 (Oct. 13, 2000) (explaining damages “properly allocable to events prior to the First Pain Incident are not received on account of personal physical injuries or physical sickness” and “damages . . . properly allocable to punitive damages are includible in their gross income”).

2. *See* I.R.S. Priv. Ltr. Rul. 200041022 (Oct. 13, 2000) (defining the term physical injury as “bodily harm or hurt, *excluding mental distress, fright, or emotional disturbance*” (quoting BLACK’S LAW DICTIONARY (4th ed. 1968)) (emphasis added)).

emotional harm affects the physical body.<sup>3</sup> Because emotional injuries are inherently physical at the physiological level, they are “personal physical injuries” as defined by Section 104(a)(2) of the Internal Revenue Code. Therefore, in order for tax law to reflect a modern, scientific understanding of the brain, damages awarded on account of emotional injury should be excludable from gross income under Section 104(a)(2).

This Comment proceeds in two Sections. Section II of this Comment first provides a history of the personal injury exclusion. It then discusses the neuroscience underlying emotional harm, concluding with a discussion of judicial and legislative approaches to mental and emotional injury. Section III of this Comment recommends expanding the personal injury exclusion to include emotional injuries; it concludes by proposing a new method for determining the taxability of damages awarded on account of emotional harm.

## II. OVERVIEW

Section 104 of the Internal Revenue Code concerns compensation for injuries or sickness and details the instances in which that compensation would be excludable from gross income.<sup>4</sup> One of the most debated exclusions is outlined in Section 104(a)(2), which allows certain damage awards to be excluded from gross income. In its original form, the exclusion was allowed for any damages awarded for personal injury or sickness;<sup>5</sup> however, subsequent legislation narrowed the exclusion to only those damages awarded on account of personal, physical injury, disallowing exclusion in instances of emotional harm.<sup>6</sup> However, neuroscientific advances have called into question the nature of emotional injury, demonstrating that it causes measurable physiological harm to the individual.<sup>7</sup>

This Section proceeds in four Parts. Part II.A provides background on the legislative and judicial interpretive history of the personal injury exclusion. Part II.B discusses developments in neuroscience that demonstrate the physical nature of emotional harm. Part II.C examines how courts have interpreted the distinction between physical and emotional injury. Lastly, Part II.D discusses how federal statutes have addressed the significance of emotional harm.

### A. *A History of the Taxability of Damage Awards*

Congress has addressed the tax treatment of damage awards since the early 1900s, beginning with the Revenue Act of 1918.<sup>8</sup> In this Act, Congress determined that “[a]mounts received, through accident or health insurance or under workmen’s compensation acts, 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

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3. See Betsy J. Grey, *The Future of Emotional Harm*, 83 *FORDHAM L. REV.* 2605, 2633 (2015) (“[T]he physiological changes that occur in the brain after an individual experiences or witnesses a traumatic event can result in a dysfunction of the neural networks that regulate memory and fear.”).

4. I.R.C. § 104.

5. Revenue Act of 1918 Pub. L. No. 65-254, § 213(b)(6), 40 Stat. 1057, 1066 (1919).

6. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838–39.

7. Grey, *supra* note 3, at 2633.

8. Revenue Act of 1918, § 213(b)(6).

sickness” were not income and therefore not taxable.<sup>9</sup> This version of the personal injury exclusion promoted horizontal equity<sup>10</sup> within the tax system—a taxpayer could exclude her damages from gross income so long as they were personal; it made no difference whether those damages were for physical or emotional injury.<sup>11</sup>

Throughout the next several decades, Congress preserved this exclusion while also making slight changes to its language.<sup>12</sup> Additionally, as damage-award questions made their way through the court system, court rulings also helped to shape the tax treatment of damage awards.<sup>13</sup> The tax treatment of damage awards is codified in Section 104(a)(2) of the Internal Revenue Code, which states that an award for damages on account of personal physical injuries or physical sickness is excludable from gross income if those damages are not punitive.<sup>14</sup>

Several policy justifications support the exclusion, ranging from the academic to the philosophical. One of the most common policy arguments is the “return of capital theory,” which uses tax theory to support its assertion.<sup>15</sup> This theory rests upon the assumption that a taxpayer has basis in her body;<sup>16</sup> as a result, damage awards are simply a return of capital and therefore should not be subject to tax.<sup>17</sup> However, this theory has

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9. *Id.*

10. Horizontal equity is a principle which “demands that similarly situated individuals face similar tax burdens.” See David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL’Y REV. 43, 43 (2006). Similarly situated taxpayers are those who have equivalent situations, not identical situations. *Id.* at 44. Therefore, this principle focuses on individuals who are equally well off, requiring that such taxpayers are taxed equally. *Id.* at 45.

11. See Revenue Act of 1918 § 213(b)(6). *Contra* Laura Spitz, *I Think, Therefore I Am; I Feel, Therefore I Am Taxed: Descartes, Tort Reform, and the Civil Rights Tax Relief Act*, 35 N.M. L. REV. 429, 441–43 (2005) (depicting how similarly situated personal injury claimants are taxed differently based on the underlying injury).

12. See, e.g., I.R.C. § 22(b)(5) (1939) (current version at I.R.C. § 104). In 1982, the provision was amended to expand the form of damages received to those received “whether by suit or agreement and whether as lump sums or as periodic payments.” Pub. L. No. 97-473, § 101(a), 96 Stat. 2605, 2605 (1983) (emphasis added). In 1989, the provision was amended to limit the type of damages that were excludable from gross income by adding the following sentence: “Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness.” Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7641(a), 103 Stat. 2106, 2379.

13. See, e.g., *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 427 (1955) (examining the applicability of the income rule to a settlement award for punitive damages). Although the taxpayers asserted that the settlement award did not fall within the scope of I.R.C. § 61(a) gross income, the court chose to read the section broadly, denying their “windfall” argument. *Id.* at 429–30. Instead, the Court determined that the awards were income because they were “undeniable accessions to wealth, clearly realized, and over which the taxpayers ha[d] complete dominion.” *Id.* at 431. As such, the receipt of punitive damages was taxable just the same as if the award had been for actual damages. *Id.*

14. I.R.C. § 104(a)(2).

15. Robert Cate Illig, *Tort Reform and the Tax Code: An Opportunity To Narrow the Personal Injuries Exemption*, 48 VAND. L. REV. 1459, 1463–64 (1995).

16. In general, basis is “the amount of your capital investment in property for tax purposes.” *Topic No. 703 Basis of Assets*, INTERNAL REVENUE SERV., <http://www.irs.gov/taxtopics/tc703> [<http://perma.cc/CP2G-BRY7>] (last updated Jan. 24, 2022).

17. See Illig, *supra* note 15, at 1463–64, 1464 n.20.

faced much criticism, mainly because the “body as basis” theory is largely unsupported<sup>18</sup> and has been widely regarded as insufficient.<sup>19</sup>

Other theories focus on concern and sympathy for the taxpayer. The “compassion theory” looks to legislative intent; Congress has concern for injured taxpayers, and if a damage award that is taxed fails to cover the taxpayer’s expenses, then the goals of tort law have not been fulfilled.<sup>20</sup> “Emotional theories” may have guided the crafting of this provision; namely, “the feeling that the taxation of recoveries carved from pain and suffering is offensive, and the victim is more to be pitied rather than taxed.”<sup>21</sup> Regardless of which theory reigns, the common theme among them is that compensation for a personal injury is not profit to the taxpayer, and consequently, there are no grounds to tax the damage award.<sup>22</sup>

The history of the taxation of personal injury awards can be divided into two eras: tax treatment before and after the Small Business Job Protection Act of 1996 (SBJPA).<sup>23</sup> Throughout history, Treasury regulations have provided guidance on how to treat personal injury damage awards.<sup>24</sup> However, with the evolution of case law and legislative changes, these regulations have transformed greatly over time.

Part II.A.1 discusses the application of Section 104(a)(2) prior to the SBJPA. Next, Part II.A.2 explores the changes as a result of the SBJPA. Lastly, Part II.A.3 concludes with an exploration of how the SBJPA changed the interpretation and effect of the Section 104(a)(2) exclusion.

#### 1. The Personal Injury Exclusion Before 1996

Prior to 1996, taxpayers were allowed to exclude damages received in compensation for any personal injuries or sickness from gross income.<sup>25</sup> Treasury regulations originally defined “damages received” as “an amount received . . . upon tort or tort-type rights or through a settlement agreement entered into in lieu of such

18. See *id.* at 1464 (“[P]eople do not have a basis in their bodies, as they invested no money to purchase them. Moreover, the argument that the cost of maintaining our bodies constitutes our basis is disingenuous because it ignores the personal exemption and standard deduction received each year for just this purpose.” (footnote omitted) (citing I.R.C. § 63(c))).

19. See, e.g., Joseph W. Blackburn, *Taxation of Personal Injury Damages: Recommendations for Reform*, 56 TENN. L. REV. 661, 667 (1989) (“If section 104(a)(2) were founded on a return of capital concept, then our bodies and our personal rights might be the source of numerous deductions under sections 162, 165, 167, or 212.”); Mark W. Cochran, *Should Personal Injury Damage Awards Be Taxed?*, 38 CASE W. RESV. L. REV. 43, 45–46 (1987) (“[I]n the personal injury context, a taxpayer’s basis is zero because a taxpayer generally does not pay for his limbs or organs. . . . If the taxpayer’s basis in the ‘capital’ cannot be established, no part of the award can accurately be called a return of capital.” (footnote omitted)).

20. See Illig, *supra* note 15, at 1465–66 (stating that the primary goal of tort law is to compensate victims for personal injuries).

21. Edward Yorio, *The Taxation of Damages: Tax and Non-Tax Policy Considerations*, 62 CORNELL L. REV. 701, 706 (1977) (quoting Bertram Harnett, *Torts and Taxes*, 27 N.Y.U. L. REV. 614, 626–27 (1952)) (internal quotations omitted).

22. Illig, *supra* note 15, at 1467; Yorio, *supra* note 21, at 706.

23. Pub. L. No. 104-188, 110 Stat 1755.

24. See, e.g., Treas. Reg. § 1.104-1(c) (as amended in 1970).

25. See *supra* notes 9–12 and accompanying text.

prosecution.”<sup>26</sup> However, beyond this tort framework, Treasury did not elaborate upon what “personal injuries or sickness” entailed, leaving the interpretation of this indistinct phrase to the courts.<sup>27</sup>

In 1992, the United States Supreme Court addressed the personal injury question in *United States v. Burke*.<sup>28</sup> The case originated out of a Title VII<sup>29</sup> action against the Tennessee Valley Authority (TVA) by Judy Hutcheson, a female employee of the TVA who claimed that her employer had unlawfully discriminated on the basis of sex in its salary determinations.<sup>30</sup> The Office and Professional Employees International Union subsequently joined the action to represent other employees of TVA who had faced similar discrimination.<sup>31</sup> After the district court denied both parties’ cross-motions for summary judgment, the parties reached a settlement agreement wherein TVA paid \$4,200 to Hutcheson and a total of \$5 million to the other affected employees.<sup>32</sup> TVA did not withhold taxes on the award to Hutcheson; however, the settlement agreement stipulated that federal income taxes would be withheld on the payments to the other affected employees.<sup>33</sup>

Those employees filed claims with the Internal Revenue Service (IRS) for a refund of the taxes withheld from the settlement payments, which the IRS disallowed.<sup>34</sup> Consequently, the employees brought a refund action in the United States District Court for the Eastern District of Tennessee and claimed that the settlement payments qualified as damages received on account of personal injury, making it excludable from gross income under Section 104(a)(2).<sup>35</sup> The district court disagreed with the employees’ position, affirming the IRS’s judgment.<sup>36</sup> However, on appeal, the United States Court of Appeals for the Sixth Circuit reversed, holding that TVA’s unlawful sex discrimination qualified as a personal, tort-like injury; consequently, the back pay was excludable from gross income under Section 104(a)(2).<sup>37</sup>

The Supreme Court used tort law as the framework to determine whether back pay fell within the term “damages received” as indicated by Treasury regulations.<sup>38</sup> Though acknowledging that employment discrimination certainly caused harm to its victims, the

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26. Treas. Reg. § 1.104-1(c) (as amended in 1970).

27. See, e.g., *Roemer v. Comm’r*, 716 F.2d 693, 694 (9th Cir. 1983) (determining whether damages received in a defamation suit were excludable from gross income). The *Roemer* court, while acknowledging a distinction between personal and nonpersonal injuries, stated that “a personal injury is not limited to a physical one.” *Id.* at 697.

28. 504 U.S. 229 (1992).

29. 42 U.S.C. § 2000e.

30. *Burke*, 504 U.S. at 230–31.

31. *Id.* at 231.

32. *Id.*

33. *Id.*

34. *Id.* at 232.

35. *Id.*

36. See *id.*

37. *Id.*

38. See *id.* at 234 (“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 a settlement agreement entered into in lieu of such prosecution.” (omission in original) (quoting Treas. Reg. § 1.104-1(c) (1991))).

Court concluded that the true purpose of back pay was to “restor[e] victims . . . to the wage and employment positions they would have occupied absent the unlawful discrimination.”<sup>39</sup> The damage award in an employment discrimination claim did not redress the harms traditionally associated with personal injury.<sup>40</sup> Accordingly, a settlement award for back pay in an employment discrimination claim was not excludable from gross income.<sup>41</sup>

In his concurrence, Justice Antonin Scalia rebuked “the IRS’ ‘tort rights’ formulation,” stating that “personal injuries” commonly refer to personal, physical injuries.<sup>42</sup> According to Justice Scalia, because the statute reads “personal injuries or sickness,” the exclusion most likely references those damages awarded for harm to physical health, be it of the body or mind.<sup>43</sup> By using a broad “tort rights” formulation, damages for a claim such as defamation would fall within the Section 104(a)(2) exclusion, despite being far from an issue of health.<sup>44</sup> This interpretation, he reasoned, is supported by the phrase’s usage in other parts of Section 104(a)<sup>45</sup> and by an interpretive philosophy of applying narrow constructions to tax exemptions.<sup>46</sup> Like the majority, Justice Scalia acknowledged the potential psychological harm arising from race- or sex-based employment discrimination but emphasized that a showing of such harm would not impact the victim’s entitlement to back pay.<sup>47</sup> Accordingly, the harm addressed in a Title VII action is that of economic deprivation, and settlement awards in the form of back pay would not be received “on account of personal injuries” as defined by Section 104(a)(2).<sup>48</sup>

Three years later, in *Commissioner v. Schleier*,<sup>49</sup> the Court used its reasoning in *Burke* to further refine the personal injury exclusion determination, creating a standard test for courts to use in evaluating the tax treatment of damage awards.<sup>50</sup> The test the *Schleier* Court created retained the focus on tort claims from *Burke* but added a causal requirement between the injury and the damage award, directing future courts to ask the

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39. *See id.* at 238–39 (citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 421 (1975)).

40. *Id.* at 239.

41. *Id.* at 242.

42. *Id.* at 242–43 (Scalia, J., concurring).

43. *See id.* at 243–44.

44. *See id.*

45. *Id.* at 244; *see also* I.R.C. § 104(a)(1) (stating gross income does not include “amounts received under workmen’s compensation acts as compensation for personal injuries or sickness”); I.R.C. § 104(a)(3) (stating gross income does not include “amounts received through accident or health insurance . . . for personal injuries or sickness”); I.R.C. § 104(a)(4) (stating gross income does not include “amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces . . . or as a disability annuity payable under . . . the Foreign Service Act”).

46. *Burke*, 504 U.S. at 244 (Scalia, J., concurring).

47. *Id.* at 245

48. *Id.*

49. 515 U.S. 323 (1995).

50. The taxpayer in *Schleier* received a settlement in a claim under the Age Discrimination in Employment Act of 1967 (ADEA) and asserted that it should be excludable from gross income, claiming the damages were awarded for personal injury or sickness. *Schleier*, 515 U.S. at 327. The Court ultimately concluded that age, or a discharge because of age, is not a personal injury or sickness; consequently, unlike the loss of income that may spring from an automobile accident, “[t]he amount of back wages recovered is completely independent of the existence or extent of any personal injury.” *Id.* at 330.

critical question, “[I]n lieu of what was the settlement amount paid?”<sup>51</sup> Therefore, to determine whether a damage award is excludable from gross income under Section 104(a)(2), “[f]irst, the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is ‘based upon tort or tort type rights;’ and second, the taxpayer must show that the damages were received ‘on account of personal injuries or sickness.’”<sup>52</sup>

## 2. Small Business Job Protection Act of 1996

In 1996, Congress returned to the conversation about the tax treatment of damage awards.<sup>53</sup> As part of the SBJPA, Congress amended the language of Section 104(a)(2) to make punitive damages includable in gross income.<sup>54</sup> Punitive damages, Congress asserted, are meant to punish the wrongdoer, not to compensate the victim.<sup>55</sup> Because such awards are a windfall to the taxpayer, they do not satisfy the requirements for an exclusion under Section 104(a)(2).<sup>56</sup>

The SBJPA also redefined the scope of injuries for which damages received would be excludable from income. Whereas Treasury regulations previously required only evidence of a personal injury, the language of the SBJPA narrowed nontaxable damage awards just to those received “on account of personal physical injuries or physical sickness.”<sup>57</sup> Although Congress did not provide a definition for what constituted a “personal physical injury,” it did specifically state that emotional distress would no longer be treated as a physical injury or physical sickness.<sup>58</sup>

Furthermore, under the SBJPA, emotional distress is no longer limited to purely emotional symptoms but also those symptoms which result from emotional distress, such as insomnia, headaches, and stomach disorders.<sup>59</sup> However, if emotional distress resulted from a physical injury or sickness, damages consequently received would be considered attributable to the physical harm; thus, those damages would be excludable from gross income.<sup>60</sup>

## 3. The Personal Injury Exclusion After 1996

Since the enactment of the SBJPA, courts have been presented with many cases regarding the tax treatment of damages.<sup>61</sup> With the amended personal injury exclusion language, much of this litigation has turned on whether the taxpayer’s harm qualified as

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51. *Bagley v. Comm’r*, 105 T.C. 396, 406 (1995), *aff’d*, 121 F.3d 393 (8th Cir. 1997).

52. *Schleier*, 515 U.S. at 336–37 (internal quotations omitted).

53. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838–39.

54. *Id.* § 1605(a).

55. *See id.*

56. *See id.*

57. *Id.*

58. *Id.* Black’s Law Dictionary defines “physical injury” as physical “damage to a person’s body.” BLACK’S LAW DICTIONARY (11th ed. 2019).

59. H.R. REP. NO. 104-737, at 301 & n.56 (1996) (Conf. Rep.).

60. *Id.*

61. *E.g.*, *BNSF Ry. Co. v. Loos*, 139 S. Ct. 893, 896 (2019); *Stadnyk v. Comm’r*, 367 F. App’x 586, 588–89 (6th Cir. 2010); *Banaitis v. Comm’r*, 340 F.3d 1074, 1077–79 (9th Cir. 2003); *Parkinson v. Comm’r*, 2010 T.C.M. (RIA) 2010-142, at \*1–3 (2010); *Sanford v. Comm’r*, 95 T.C.M. (CCH) 1618, at \*2–4 (2008).

a personal, physical injury.<sup>62</sup> Although taxpayers have routinely tested the limits of this language,<sup>63</sup> the courts have generally interpreted the language of the amended Section 104(a)(2) narrowly.<sup>64</sup>

After Congress narrowed the scope of Section 104(a)(2), the IRS provided additional guidance on the newly narrowed exemption in a Private Letter Ruling issued in 2000,<sup>65</sup> later designated as “The Bruise Ruling.”<sup>66</sup> The ruling was issued to address the tax treatment of damages awarded to an employee who was sexually assaulted by her employer.<sup>67</sup> The IRS, using the new language of Section 104(a)(2) and *Black’s Law Dictionary*, concluded that only “direct unwanted or uninvited physical contacts resulting in observable bodily harms such as bruises, cuts, swelling, and bleeding” qualified as personal, physical injuries.<sup>68</sup> Because the taxpayer’s sexual assault did not result in “observable harms (e.g., bruises, cuts, etc.) to [her] body or cause [her] pain,” the IRS determined that the damages the taxpayer received were not on account of personal, physical injury or sickness, thus precluding them from exemption under Section 104(a)(2).<sup>69</sup> Nevertheless, in other Private Letter Rulings, the IRS acknowledged that some injuries are inherently physical, regardless of whether or not the taxpayer demonstrates observable bodily harm.<sup>70</sup>

#### B. *A New Neuroscientific Understanding of Emotional Injury*

Advances in neuroscientific research have changed our understanding of emotional injury.<sup>71</sup> This new research has begun to erase the distinction between physical and emotional harm, arguing instead that the mind and body are integrated.<sup>72</sup> Specifically, studies have indicated that there is a physical basis for psychiatric conditions, spurring a

62. *E.g.*, *BNSF Ry.*, 139 S. Ct. at 896; *Stadnyk*, 367 F. App’x at 589; *Banaitis*, 340 F.3d at 1077–79; *Parkinson*, 2010 T.C.M. (RIA) 2010-142, at \*1–3; *Sanford*, 95 T.C.M. (CCH) 1618, at \*2–4.

63. *E.g.*, *Stadnyk*, 367 F. App’x at 593 (involving a taxpayer who argued that false imprisonment necessarily involves a physical injury, even where there is no actual physical injury).

64. *See, e.g.*, *BNSF Ry.*, 139 S. Ct. at 904; *Stadnyk*, 367 F. App’x at 594; *Parkinson*, 2010 T.C.M. (RIA) 2010-142, at \*7; *Sanford*, 95 T.C.M. (CCH) 1618, at \*4.

65. A private letter ruling is “a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer’s specific set of facts.” *Understanding IRS Guidance—A Brief Primer*, INTERNAL REVENUE SERV., <http://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer#:~:text=A%20PLR%20is%20issued%20in,other%20taxpayers%20or%20IRS%20personnel> [<http://perma.cc/UZX2-MD28>] (last updated July 21, 2021). Because it is issued at the request of the taxpayer and is in regard to her specific situation, it may not be used as precedent by other taxpayers. *Id.*

66. *See, e.g.*, Robert W. Wood, *Are False Imprisonment Recoveries Taxable?*, 119 TAX NOTES 279, 285 (2008).

67. I.R.S. Priv. Ltr. Rul. 200041022, at \*1–3 (Oct. 13, 2000).

68. *Id.* at \*4.

69. *Id.* at \*4–5.

70. *See, e.g.*, Joi T. Christoff, *Tax Free Damages: Trespassory Torts and Emotional Harms*, 53 AKRON L. REV. 71, 104 (2019) (discussing a 2007 IRS memorandum in which the IRS allowed a Section 104(a)(2) exclusion in a sex abuse case where there was no observable bodily harm).

71. *See* David Biro, *Is There Such a Thing as Psychological Pain? And Why It Matters*, 34 CULTURE MED. & PSYCHIATRY 658, 662–63 (2010).

72. Grey, *supra* note 3, at 2623–24.

movement toward viewing psychiatric disabilities as disorders of brain physiology.<sup>73</sup> Part II.B.1 outlines the basics of the neuroscience underlying how humans process emotional events. Part II.B.2 discusses how neuroscience applies to a well-documented and well-understood brain-based injury: post-traumatic stress disorder (PTSD).

### 1. The Science of Emotional Injury

The brain was once considered to be merely a space-consuming organ, but advancements in medical technology have demonstrated that it is one of the most important parts of the human body.<sup>74</sup> These technologies, which include positron emission tomography (“PET scans”) and functional magnetic resonance imaging (“fMRI scans”), have been instrumental in allowing neuroscientists to evaluate the brain’s functionality.<sup>75</sup> By measuring living brain activity, both scans allow neuroscientists to examine changes in the brain over time.<sup>76</sup> These neuroimaging techniques have also helped researchers further understand how the brain processes emotions.<sup>77</sup> This development has allowed neuroscientists to research the neural circuitry associated with emotional function.<sup>78</sup> Specifically, these advances have demonstrated that acute stress as a result of trauma can over-activate chemical processes in individuals’ hormonal and neurotransmitter systems, altering their neural networks.<sup>79</sup>

Memories are encoded in an individual’s short-term memory before being consolidated into the long-term memory through a process that increases synaptic strength or sometimes changes the pattern of the synapses.<sup>80</sup> Long-term memories of emotionally significant events are aided by circuitry in the amygdala and prefrontal

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73. E.g., Dawn Capp & Joan G. Esnayra, *It’s All in Your Head—Defining Psychiatric Disabilities as Physical Disabilities*, 23 T. JEFFERSON L. REV. 97, 106 (2000).

74. See Shaun Cassin, *Eggshell Minds and Invisible Injuries: Can Neuroscience Challenge Longstanding Treatment of Tort Injuries?*, 50 HOUS. L. REV. 929, 940–41 (2013).

75. *Id.* at 941. A PET scan measures blood flow in the brain “by injecting a radioactive tracer into the bloodstream. As brain activity increases in certain areas, the tracers move throughout the bloodstream and can serve as indirect markers for neural activity.” *Id.* at 942. An fMRI scan is a noninvasive technique used to observe neural activity in the human brain by measuring blood oxygenation levels. *Id.* at 941. Here, the scan measures the blood-oxygen-level-dependent (BOLD) signal, which will peak after a brain area becomes active. F. GREGORY ASHBY, AN INTRODUCTION TO MODEL-BASED COGNITIVE NEUROSCIENCE 91 (Birte U. Forstmann & Eric-Jan Wagenmakers eds., 1st ed. 2015). When these data points are mapped, they create “a colorful statistical representation of neural activity superimposed on an anatomical image of the brain—a depiction of the BOLD response over time.” MATT CARTER & JENNIFER C. SHIEH, GUIDE TO RESEARCH TECHNIQUES IN NEUROSCIENCE 15 (2d ed. 2015).

76. Cassin, *supra* note 74, at 944, 947.

77. See *id.* at 944–47.

78. Grey, *supra* note 3, at 2625.

79. *Id.* at 2625–26.

80. *Id.* at 2627. A synapse is “the site of transmission of electric nerve impulses between two nerve cells (neurons) or between a neuron and a gland or muscle cell (effector).” *Synapse*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/science/synapse> [<http://perma.cc/LFJ6-G4R6>] (last updated Feb. 18, 2011). Synaptic plasticity, including long-term potentiation, is a change in strength of the synapses. Long-term potentiation is believed to regulate learning and memory, and the strengthening of the synapses in that region of the brain is what allows for learning and memory formation. Kayt Sukel, *What Happens at the Synapse?*, DANA FOUND. (Aug. 1, 2019), <http://dana.org/article/qa-neurotransmission-the-synapse> [<http://perma.cc/8DFJ-FZFK>].

cortex, with the hypothalamic-pituitary-adrenal (HPA) axis also contributing to memory consolidation.<sup>81</sup>

Known for controlling a human's "fight or flight response," the amygdala is a cluster of nuclei within the brain that helps regulate emotion and is associated with the fear and stress responses.<sup>82</sup> Research has also demonstrated that the amygdala is critical to memory consolidation, particularly for those memories that are emotionally arousing.<sup>83</sup> When an individual experiences a stressful event, the body releases adrenal stress hormones, specifically epinephrine and corticosterone.<sup>84</sup> The release of these hormones causes noradrenaline to be released in the basolateral complex of the amygdala.<sup>85</sup> The basolateral complex plays an important role in integrating different systems that influence memory consolidation by projecting to different regions of the brain that are involved in learning and memory.<sup>86</sup>

The release of stress hormones also activates other regions of the brain to enhance memory consolidation, such as the prefrontal cortex (PFC).<sup>87</sup> The PFC "regulates our thoughts, actions and emotions through extensive connections with other brain regions," like the amygdala.<sup>88</sup> It also monitors an individual's working memory, which is "the ability to keep in mind an event that has just occurred, or bring to mind information from long-term storage."<sup>89</sup> The PFC is able to carry out these tasks, as well as several others, by maintaining a very specific neurochemical environment.<sup>90</sup> When stress hormones are released after a stressful event, it upsets the neurochemical balance in the PFC, impairing the region's function, including the modulation of working memory.<sup>91</sup> Stress exposure also results in architectural changes in the PFC, with changes observed after just one event.<sup>92</sup>

Like the amygdala, the HPA axis also experiences hyperactivity during acute stress as a result of the release of stress hormones.<sup>93</sup> The HPA axis encompasses parts of the central nervous system and the endocrine system, which work together to manage an individual's stress response.<sup>94</sup> Stress exposure and the consequent hormonal changes—including the release of cortisol—upset the balance of neurochemicals in the

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81. Grey, *supra* note 3, at 2627–29.

82. *Id.* at 2627.

83. James L. McGaugh, *The Amygdala Modulates the Consolidation of Memories of Emotionally Arousing Experiences*, 27 ANN. REV. NEUROSCIENCE 1, 4–5 (2004).

84. *Id.* at 9; *see also* Benno Roozendaal, Bruce S. McEwen & Sumantra Chattarji, *Stress, Memory and the Amygdala*, 10 NATURE REV. NEUROSCIENCE 423, 425 (2009).

85. Roozendaal et al., *supra* note 84, at 426 fig.3.

86. *Id.* at 424 fig.1.

87. *Id.* at 426 fig.3.

88. Amy F. T. Arnsten, *Stress Signalling Pathways that Impair Prefrontal Cortex Structure and Function*, 10 NATURE REV. NEUROSCIENCE 410, 410 (2009).

89. *Id.*

90. *Id.*

91. *Id.* at 415.

92. *Id.* at 418 ("The layer II/III neurons that form PFC networks lose dendritic material—that is, dendrite length, branching and spine density are reduced by chronic stress.").

93. Sean M. Smith & Wylie W. Vale, *The Role of the Hypothalamic-Pituitary-Adrenal Axis in Neuroendocrine Responses to Stress*, 8 DIALOGUES IN CLINICAL NEUROSCIENCE 383, 386 (2006).

94. *Id.* at 383–84.

HPA axis, which can cause illness.<sup>95</sup> Moreover, repeated stress exposure and chronic activation of the HPA axis will exhaust it and lead to cortisol dysfunction.<sup>96</sup> This results in a physical loss of nuclei in the hippocampus and the HPA axis as a whole.<sup>97</sup> These responses have been linked to issues of fatigue, pain, and inflammation.<sup>98</sup>

The neurochemical changes in the brain that result from exposure to a stressful event have significant impacts on an individual's memory.<sup>99</sup> During the memory consolidation process, the brain interprets emotional information and controls the individual's attentional and interpretive processes.<sup>100</sup> When the circuitry in the amygdala and prefrontal cortex are disrupted after stress exposure, dysfunction occurs in the regions of the brain that regulate memory and fear.<sup>101</sup> It is this disruption—a physiological change—which causes emotional distress, including anxiety in the individual.<sup>102</sup>

Simultaneously, this stress exposure will cause the brain to be flooded with stress hormones, “enhancing the consolidation process of the mental and emotional experience of the event.”<sup>103</sup> Studies have indicated that memory retrieval in emotionally arousing information creates greater neural activity than that of emotionally neutral information.<sup>104</sup> The stress event structurally changes the neural circuitry associated with memory and fear, a process which continues even after the stressful event has concluded and which solidifies the memory of the traumatic event.<sup>105</sup> This process yields two results: first, it induces the amygdala to activate various arousal networks when a fear response is triggered;<sup>106</sup> second, it allows the individual to retrigger the fear response when the memory is retrieved.<sup>107</sup>

Accordingly, stress exposure both causes hyperactivity in the amygdala and impairs the functioning of other brain regions, influencing the neuroplasticity of the brain, even down to the synaptic level.<sup>108</sup> In essence, exposure to a stressful event causes measurable,

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95. Kara E. Hannibal & Mark D. Bishop, *Chronic Stress, Cortisol Dysfunction, and Pain: A Psychoneuroendocrine Rationale for Stress Management in Pain Rehabilitation*, 94 *PHYSICAL THERAPY* 1816, 1819 (2014); Mario Francisco Juruena, *An Integrative Science Approach: Neuroscience in the DSM-V and ICD-11*, 23 *ACTA NEUROPSYCHIATRICA* 143, 143 (2011).

96. Hannibal & Bishop, *supra* note 95, at 1818–20.

97. See Nuno Sousa & Osborne F.X. Almeida, *Disconnection and Reconnection: The Morphological Basis of (Mal)adaptation to Stress*, 35 *TRENDS IN NEUROSCIENCES* 742, 743–44 (2012).

98. Hannibal & Bishop, *supra* note 95, at 1820.

99. Grey, *supra* note 3, at 2626–27.

100. *Id.* The attentive process concerns “what individuals perceive in their environment” and the interpretive process governs “how they interpret that information.” *Id.*

101. *Id.* at 2633.

102. *Id.* at 2625–26.

103. *Id.* at 2628.

104. Roozendaal et al., *supra* note 84, at 426.

105. Grey, *supra* note 3, at 2628.

106. *Id.* at 2630.

107. *Id.* at 2629.

108. Roozendaal et al., *supra* note 84, at 429–31.

conformational changes to an individual's brain.<sup>109</sup> Just one traumatic experience can change an individual's brain at the cellular level for the rest of her life.<sup>110</sup>

## 2. Emotional Injury and Post-Traumatic Stress Disorder

The memory consolidation process is the basis for trauma- and stress-related disorders, one of the most prominent being PTSD.<sup>111</sup> PTSD studies have illuminated the neurophysiology of the disorder, namely that its symptoms represent extreme dysregulation of neural circuitry and that it causes chemical and structural changes to the brain.<sup>112</sup> Specifically, human neuroimaging studies have established that PTSD causes a physical atrophy of both the hippocampus and PFC; additionally, the disorder results in increased responsiveness in the amygdala but diminished responsiveness in the PFC.<sup>113</sup>

Many of these PTSD studies have zeroed in on the disorder's impact on memory.<sup>114</sup> Notably, this research has demonstrated that individuals with PTSD had better recall for trauma-related material than those without it, demonstrating an enhanced memory for stressful events.<sup>115</sup> Studies have also shown that PTSD patients who are exposed to reminders of trauma tend to retrieve "overgeneral" memories and have difficulty accessing specific personal memories.<sup>116</sup> These results imply that, because individuals with PTSD dedicate most of their neural function to processing traumatic events, they are left with less capacity to perform memory tasks.<sup>117</sup> Overall, the research conducted on individuals with PTSD demonstrates that there are measurable, conformational changes to the brain and its function as a result of a stressful event.<sup>118</sup>

### C. Judicial Treatment of Emotional Injury

Emotional distress has long been considered by courts to be a compensable injury, with the earliest litigation occurring in 1885.<sup>119</sup> In *Stuart v. Western Union Telegraph Co.*,<sup>120</sup> the Supreme Court of Texas held that the plaintiff could recover damages for mental suffering resulting from indignity,<sup>121</sup> a ruling that was subsequently supported in

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109. *See id.* at 429.

110. Grey, *supra* note 3, at 2627.

111. *Id.* at 2628.

112. *Id.* at 2629–30.

113. Roozendaal et al., *supra* note 84, at 431 box2.

114. *See* Richard J. McNally, *Implicit and Explicit Memory for Trauma-Related Information in PTSD*, 821 ANNALS N.Y. ACAD. SCIENCES 219, 221 (1997) [hereinafter McNally, *Implicit and Explicit Memory*]; Richard J. McNally, *Cognitive Processing of Trauma-Relevant Information in PTSD*, 6 PTSD RSCH. Q. 1, 1 (1995) [hereinafter McNally, *Cognitive Processing*].

115. McNally, *Implicit and Explicit Memory*, *supra* note 114, at 221; McNally, *Cognitive Processing*, *supra* note 114, at 2.

116. McNally, *Implicit and Explicit Memory*, *supra* note 114, at 222.

117. *See id.*

118. *See* Roozendaal et al., *supra* note 84, at 431 box2.

119. Dennis G. Bassi, *It's All Relative: A Graphical Reasoning Model for Liberalizing Recovery for Negligent Infliction of Emotional Distress Beyond the Immediate Family*, 30 VAL. U. L. REV. 913, 920 (1996).

120. 18 S.W. 351 (Tex. 1885).

121. *Stuart*, 18 S.W. at 353.

other jurisdictions.<sup>122</sup> However, these early cases focused on injuries that flowed from physical injury, barring recovery in instances where only emotional injury occurred.<sup>123</sup> It was not until over half a century after the Texas court's decision in *Stuart* that intentional infliction of emotional distress was recognized as an independent tort for the first time in the United States;<sup>124</sup> twenty years after such recognition, the landmark case *Dillon v. Legg*<sup>125</sup> recognized a plaintiff's right to recover for negligent infliction of emotional distress absent a physical manifestation of injury.<sup>126</sup>

Over time, many jurisdictions have come to treat a wide assortment of mental or emotional injuries as recoverable, which can be sorted into three main categories: (1) emotional injuries resulting from physical impact sustained by the plaintiff; (2) physical manifestations of emotional injury; and (3) "severe fright, horror, grief, shame, humiliation, anger, embarrassment, and worry" without an accompanying physical injury.<sup>127</sup> Additionally, a separate category of harm combines elements of both physical and emotional harm: invisible injuries.<sup>128</sup> This type of harm includes traumatic brain injury, mild traumatic brain injury, and chronic pain—conditions that are so microscopic that they do not present in neuroimaging studies.<sup>129</sup>

The purpose of allowing recovery for such injuries lies in the purpose of tort law itself—corrective justice and deterrence.<sup>130</sup> However, instances of emotional injury face evidentiary concerns: How can a jury evaluate and assign damages to something as subjective as another person's experience of pain?<sup>131</sup> Furthermore, emotional harms are typically viewed as a social construct, placing the individual in control of her emotional responses.<sup>132</sup> This "argument of agency" is reflected in the "severe" or "serious" evidentiary standard—comparing the plaintiff's response to that of a reasonable person, which implies that a reasonable person has control over which situations would or would not cause emotional distress.<sup>133</sup> Consequently, if a plaintiff behaves contrarily to societal norms of a reasonable emotional response, she is urged to "just get over it" and "not make mountains out of molehills."<sup>134</sup> But for those in situations where a "reasonable

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122. *E.g.*, *Ky. Traction & Terminal Co. v. Roman's Guardian*, 23 S.W.2d 272, 275 (Ky. 1929); *Consol. Traction Co. v. Lambertson*, 36 A. 100, 102 (N.J. 1896).

123. *E.g.*, *Ky. Traction*, 23 S.W.2d at 275 ("Fright caused by negligence is not of itself a cause of action, and none of its consequences can give rise to a cause of action; but, if there was [physical impact], plaintiff has a cause of action."); *Stuart*, 18 S.W. at 353 ("We find no case . . . which holds that a party may come into court solely to redress an injury to his feelings. Such injury is not to the name, person, or property; but if to either of these an actionable injury is done, the complaining party may then recover, as actual damages, compensation for the proximate results of the wrongful act.").

124. *See* Grey, *supra* note 3, at 2610 & n.37.

125. 441 P.2d 912 (Cal. 1968).

126. *Dillon*, 441 P.2d at 924–25.

127. *See* Bassi, *supra* note 119, at 926–27.

128. Cassin, *supra* note 74, at 935.

129. *Id.* at 936.

130. *See* Grey, *supra* note 3, at 2616.

131. *See* Cassin, *supra* note 74, at 937–38.

132. Grey, *supra* note 3, at 2641–42.

133. *Id.* at 2642–43.

134. *Id.* at 2642.

person could not be expected to control her response . . . she is a [sic] viewed as a victim rather than an agent.”<sup>135</sup>

As a result of such scrutiny, some scholars argue that courts often arbitrarily reduce damages or even deny recovery in cases where there is no physical injury.<sup>136</sup> However, advancements in neuroscience are addressing this concern by providing evidence of the measurable impact of emotional harm.<sup>137</sup> In fact, the medical field already views emotional injury as physical harm, recognizing that such injuries “produce well marked changes in the body, and symptoms that are readily visible to the professional eye.”<sup>138</sup> Part II.C.1 discusses *Allen v. Bloomfield Hills School District*,<sup>139</sup> in which the court recognized neurological injury to be a physical injury.<sup>140</sup> Next, Part II.C.2 explores case law in the disability and insurance context, which have addressed the physicality of emotional harm.

### 1. *Allen v. Bloomfield Hills School District*

Courts have begun to address cases that attempt to blur the line between physical and emotional injuries.<sup>141</sup> The Michigan Court of Appeals faced such an issue in *Allen v. Bloomfield Hills School District*.<sup>142</sup> Allen, who was operating a train, collided with a school bus that was attempting to cross railroad tracks.<sup>143</sup> Although no children were on the bus, the bus driver was severely injured, and Allen developed PTSD as a result of the accident.<sup>144</sup> The trial court held that because Allen did not suffer a “bodily injury,” the harm he suffered did not fall within the motor vehicle exception of governmental immunity from tort liability.<sup>145</sup>

On appeal, Allen sought to present evidence of physical injury by providing PET scans of his brain that depicted impairment to the frontal and subcortical regions consistent with PTSD.<sup>146</sup> He also introduced a report from a doctor who confirmed the physiological and conformational changes to the brain as a result of PTSD.<sup>147</sup> The appellate court found that because the brain is a part of the human body, injury to the brain falls within the common meaning of “bodily injury,” acknowledging advancements of modern medical science.<sup>148</sup> Notably, the court found:

Although the brain is the organ responsible for our thoughts and emotions, it is also the organ that controls all our physical functions. The fact that it

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135. *Id.* at 2643.

136. Cassin, *supra* note 74, at 938–39.

137. *See id.* at 954.

138. WILLIAM LLOYD PROSSER, W. PAGE KEETON, DAN B. DOBBS, ROBERT E. KEETON & DAVID G. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS 56 (W. Page Keeton ed., 5th ed. 1984).

139. 760 N.W.2d 811 (Mich. Ct. App. 2008).

140. *Allen*, 760 N.W.2d at 816.

141. *See Cassin*, *supra* note 74, at 954–55.

142. *Allen*, 760 N.W.2d at 812.

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.* at 815.

147. *Id.*

148. *Id.*

serves more than one function hardly detracts from the fact that it is one of our major organs. It can be injured. It can be injured directly and indirectly. It can be injured by direct and indirect trauma. What matters for a legal analysis is the existence of a manifest, objectively measured injury to the brain.<sup>149</sup>

In a departure from state precedent, the *Allen* court held that “[a] brain injury is a ‘bodily injury,’” likening the acceptance of this truth to the recent acceptance of closed head injuries suffered by soldiers.<sup>150</sup> So long as a plaintiff can present the requisite evidence of such injury, he should not be precluded from stating a claim of physical harm.<sup>151</sup>

Aside from *Allen*, tort cases involving the classification of brain-based injuries are scarce, with most emotional distress cases being covered under intentional infliction of emotional distress or negligent infliction of emotional distress claims.<sup>152</sup> Although tort law has recognized the significance of emotional injury, it largely still views such harm as a separate, distinct category from physical harm.<sup>153</sup>

## 2. Disability Law and Insurance Litigation

The discussion of what constitutes a physical injury has also appeared in disability law and insurance litigation. In *P.P. v. Compton Unified School District*,<sup>154</sup> students filed a class action lawsuit in the Central District of California alleging that their school district failed to provide them special education, as required under Section 504 of the Rehabilitation Act.<sup>155</sup> The plaintiffs contended that the complex trauma that they had experienced resulted in “neurological and endocrine effects,” which were physiological impairments that qualified as a physiological disorder or condition under the Americans with Disabilities Act.<sup>156</sup>

Specifically, the plaintiffs noted that a “fight or flight” state can lead to “severe, prolonged, or unpredictable” stress that disrupts the brain’s equilibrium; alternatively, such a state can cause the victim to detach and dissociate, a response that is more common in children.<sup>157</sup> Furthermore, the plaintiffs argued that trauma can result in physiological changes to the brain, such as decreased activity in the hippocampus and underdevelopment of the prefrontal cortex.<sup>158</sup> The court ultimately permitted the plaintiffs’ claim to proceed past the pleading stage, finding that “complex trauma can

149. *Id.*

150. *Id.* at 816.

151. *See id.* at 816–17.

152. *Grey*, *supra* note 3, at 2610–15.

153. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 45 cmt. a (AM. L. INST. 2012). The Restatement (Third) of Torts separates liability for physical harm and liability for emotional harm into different subchapters, Chapters 2 and 8, respectively. *Id.* §§ 4, 45.

154. 135 F. Supp. 3d 1098 (C.D. Cal. 2015).

155. *P.P.*, 135 F. Supp. 3d at 1107.

156. *Id.* at 1109–10. The regulations enforcing the Americans with Disabilities Act define a physical impairment as “[a]ny physiological disorder or condition . . . such as neurological.” 29 C.F.R. § 1630.2(h)(1) (2021).

157. *P.P.*, 135 F. Supp. 3d at 1110.

158. *Id.*

result in neurobiological effects constituting a physical impairment for purposes of the [Rehabilitation Act and the Americans with Disabilities Act].”<sup>159</sup>

In other practice areas, however, courts have been hesitant to include emotional injury in the physical injury category.<sup>160</sup> For example, the physical-versus-mental injury debate has appeared in several insurance claims disputes.<sup>161</sup> Many of these cases arise from the definition of “bodily injury,” which can vary among insurance policies and can sometimes be broadly construed.<sup>162</sup> In most states, “bodily injury” is generally accepted as “physical injury to the body, excluding from its reach purely emotional injuries.”<sup>163</sup> However, New York courts have often strayed from this strict interpretation and instead have considered emotional injury to be a bodily injury in certain insurance policies.<sup>164</sup> Specifically, the case law in the state generally “ha[s] recognized that emotional trauma may be as disabling as physical injury.”<sup>165</sup>

#### D. Congressional Response to Mental Health Disorders

Mental health disorders are the outward expression of neurological dysfunction, which is often the result of emotional injury.<sup>166</sup> Since 1970, state legislatures have implemented policies to create parity between the coverage of mental health services and that of physical services like general medical and surgical care.<sup>167</sup> Yet, for nearly three decades, insurers were not required to cover mental health care costs.<sup>168</sup>

In 1996, Congress passed the Mental Health Parity Act (MHPA)<sup>169</sup> to ensure that, in group health plans, annual or lifetime dollar limits for mental health benefits would be the same as those for medical and surgical benefits.<sup>170</sup> Over a decade later, the Mental

159. *Id.* at 1110–11.

160. *See Grey, supra* note 3, at 2608–09.

161. *E.g., State Farm Fire & Cas. Co. v. El-Moslimany*, 178 F. Supp. 3d 1048, 1052–53, 1060–61 (W.D. Wa. 2016) (analyzing whether a homeowners policy covered damages in connection with a claim for intentional infliction of emotional distress); *Allstate Prop. & Cas. Ins. Co. v. Winslow*, 66 F. Supp. 3d 661, 666, 678–79 (W.D. Pa. 2014) (analyzing whether the phrase “bodily injury” in a homeowners policy covered the emotional and physical injuries a defendant sustained because of defamation).

162. *E.g., El-Moslimany*, 178 F. Supp. 3d at 1053–54 (defining “bodily injury” as “physical harm to a person, including any resulting sickness or disease” and excluding “emotional distress, mental anguish, humiliation, mental injury, or similar injury unless it arises out of actual physical injury to some person”); *Winslow*, 66 F. Supp. 3d at 665 (defining “bodily injury” as “physical harm to the body, including sickness or disease, and resulting death” and excluding venereal diseases, herpes, AIDS, AIDS-related Complex, and HIV as well as “any resulting symptom, effect, condition, disease or illness related to such conditions”).

163. M. JANE GOODE, 1 LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION § 6:12 (2021).

164. *See, e.g., Lavanant v. Gen. Accident Ins. Co. of Am.*, 595 N.E.2d 819, 822–23 (N.Y. 1992); *Tortoso v. MetLife Auto & Home Ins. Co.*, 799 N.Y.S.2d 506, 508 (App. Div. 2005).

165. *Lavanant*, 595 N.E.2d at 822.

166. *See Juruena, supra* note 95, at 1443; *Grey, supra* note 3, at 2624.

167. Assistant Secretary for Public Affairs, *Mental Health and Substance Use Insurance Help*, U.S. DEP’T OF HEALTH & HUM. SERVS., <http://www.hhs.gov/programs/health-insurance/mental-health-substance-use-insurance-help/index.html> [<http://perma.cc/7UR2-46GK>] (last reviewed Dec. 1, 2021).

168. *See id.*

169. Pub. L. 104–204 §§ 701–03, 110 Stat. 2874, 2944–50 (1996).

170. *See* Mental Health Parity Act §§ 701–03. The Mental Health Parity and Addiction Equity Act expanded the MHPA by extending the parity rules to cover benefits for substance abuse disorders. Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act, Pub. L. 110–343 §§ 511–12, 122

Health Parity and Addiction Equity Act of 2008 (MHPAEA)<sup>171</sup> was enacted, preserving the protections of the MHPA and extending parity requirements to substance use disorders.<sup>172</sup> Nevertheless, federal parity legislation focused on group health plans; consequently, over half of states did not require individual market plans to cover mental health services.<sup>173</sup> The Patient Protection and Affordable Care Act,<sup>174</sup> enacted in 2010, addressed this problem by providing access to services for individuals seeking health insurance on the individual market and requiring that the parity rules also apply to individual plans.<sup>175</sup>

The federal government has enacted other legislation that speaks to mental health parity. When Congress enacted the Americans with Disabilities Act in 1990, “disability” was defined as “[a] physical or mental impairment that substantially limits one or more major life activities of [an] individual.”<sup>176</sup> Moreover, the tax system has also addressed mental health as it relates to medical care under Section 213 of the Internal Revenue Code, which allows a taxpayer to deduct medical expenses.<sup>177</sup> Medical expenses can comprise treatments for mental disability or illness, including those for psychiatric care and therapy.<sup>178</sup> Even when the SBJPA was drafted, Congress was careful to note that while the gross income exclusion does not apply to claims of emotional distress, medical expenses are deductible.<sup>179</sup>

In April 2021, sixteen members of Congress drafted a letter to Janet Yellen, the Secretary of the Department of the Treasury, and Charles Rettig, the Commissioner of the Internal Revenue Service, requesting that Section 104(a)(2) be expanded to include

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Stat. 3765, 3881–93 (2008). The MHPAEA also required insurers to guarantee parity in terms of financial requirements on benefits, such as deductibles, and limitations on treatment benefits, such as caps on provider visits. *Id.* § 512.

171. Pub. L. 110–343 §§ 511–12, 122 Stat. 3765, 3881–93 (2008).

172. *See The Mental Health Parity and Addiction Equity Act (MHPAEA)*, CTRS. FOR MEDICARE & MEDICAID SERVS., [http://www.cms.gov/CCIIO/Programs-and-Initiatives/Other-Insurance-Protections/mhpaea\\_factsheet](http://www.cms.gov/CCIIO/Programs-and-Initiatives/Other-Insurance-Protections/mhpaea_factsheet) [<http://perma.cc/FWA8-7HHE>] (last visited May 1, 2022).

173. *See* DANIA PALANKER, JOANN VOLK, KEVIN LUCIA & KATHY THOMAS, MENTAL HEALTH PARITY AT RISK 2 (2018), <http://www.nami.org/Support-Education/Publications-Reports/Public-Policy-Reports/Mental-Health-Parity-at-Risk/ParityatRisk> [<http://perma.cc/V9EZ-EUXU>]. Enrollment questions asked as part of a screening process often resulted in individuals with preexisting mental health conditions being denied coverage. *Id.* For those who were able to obtain plans, some of those plans applied a twenty to fifty percent premium increase and others did not include mental health services at all. *Id.* at 2–3.

174. Pub. L. No. 111-148, 124 Stat. 119 (2010).

175. Pub. L. 111-148, 124 Stat. 119 (2010). The Affordable Care Act also “bann[ed] coverage exclusions for preexisting conditions and end[ed] rating based on health status (which increased the premium a person with a health condition or history of a health condition, paid) in the individual market.” PALANKER ET AL., *supra* note 173, at 5.

176. Americans with Disabilities Act, 29 C.F.R. § 1630.2(g)(1)(i) (2018).

177. I.R.C. § 213. Medical care expenses are defined as the costs of “diagnosis, cure, mitigation, treatment, or prevention of disease, [and] for the purpose of affecting any part or function of the body.” *Id.* § 213(d)(1)(A).

178. INTERNAL REVENUE SERV., U.S. DEP’T OF TREASURY, PUB. 502, MEDICAL AND DENTAL EXPENSES 13 (2021) [hereinafter MEDICAL AND DENTAL EXPENSES], <http://www.irs.gov/pub/irs-pdf/p502.pdf> [<http://perma.cc/6G4D-FWZN>].

179. H.R. REP. NO. 104-737, at 88 (1996) (Conf. Rep.).

damages arising from PTSD.<sup>180</sup> Looking to modern science, the members argued that “PTSD creates physical damage to the limbic system,” which can be shown in magnetic resonance imaging of the brain, meaning that “someone with a clinical diagnosis of PTSD has suffered a physical harm.”<sup>181</sup> Additionally, in the long term, PTSD left untreated can result in permanent disability or even death.<sup>182</sup> Therefore, PTSD is a physical injury; however, the tax code creates an injustice by “put[ting] those suffering with PTSD at a disadvantage when claiming damages related to their disorder relative to other physical injuries” by making PTSD-related damages taxable.<sup>183</sup> Accordingly, because PTSD is a physical injury, PTSD-related damages should qualify as a physical injury within the meaning of Section 104(a)(2) and should be excludable from gross income.<sup>184</sup>

### III. DISCUSSION

Section 104(a)(2) of the Internal Revenue Code affirms the restorative purpose of personal damage awards. However, by noting that “physical” injury extends only to bodily injury, Congress has created an underinclusive exclusion which disrupts horizontal equity among taxpayers. This outdated perception of emotional injury denies the physiological nature of emotional harm and relegates it to an invisible problem that borders on imaginary. Because modern science has demonstrated the physical nature of emotional harm, emotional injury should be viewed simply as a subcategory of physical injury, rather than separate from it. Accordingly, damages received on account of demonstrable emotional injury should be treated as a personal, physical injury under Section 104(a)(2) and, thus, should be excludable from gross income.

This Section discusses how tax law would change if it expanded to include emotional injury within the personal injury exclusion. Part III.A proposes a new approach to the tax treatment of damages and argues why this approach should be implemented. Part III.B considers the obstacles that may arise because of these changes and what must be done to overcome them.

#### A. *A New Approach to the Personal Injury Exclusion*

A tax system represents the values and beliefs of its society.<sup>185</sup> The justifications of the income exclusion in Section 104(a)(2) speak to societal values, such as compassion, which have largely remained unchanged over time.<sup>186</sup> However, over the decades, societal beliefs surrounding emotional injury have changed;<sup>187</sup> specifically, advancements in neuroscience have demonstrated that what was once believed to be a

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180. Letter from Cong. Members to Janet Yellen, Sec’y of the Dep’t of the Treasury, and Charles Rettig, Comm’r of the Internal Revenue Serv. (Apr. 15, 2021).

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. Alice G. Abreu, *Taxes, Power, and Autonomy*, 33 SAN DIEGO L. REV. 1, 14 (1996).

186. See Illig, *supra* note 15, at 1465, 1465 n.31.

187. Grey, *supra* note 3, at 2643–44.

subjective feeling is actually a measurable, physiological change in the body.<sup>188</sup> Because these developments have demonstrated that emotional injuries can result in the same physiological changes in the body as physical injuries, it has blurred the line between physical and emotional injuries. In fact, it raises the question: Is there a distinction between physical and emotional injuries at all?

Overwhelmingly, modern neuroscience has pointed to an answer of no.<sup>189</sup> Neuroscientific studies have proven that emotional injury is more than just “hurt feelings” by showing that emotional harm can cause the brain to experience neurochemical changes,<sup>190</sup> disruptions to neural circuitry,<sup>191</sup> and subsequent structural alterations.<sup>192</sup> Because these observable, physiological changes occur in the brain—a part of the physical body—the experience of a traumatic event results in bodily injury. Therefore, emotional harm truly stands not as a separate type of injury but rather a subset of physical injury; as such, damages received on account of demonstrable<sup>193</sup> emotional harm should fall within the personal, physical injury income exclusion under Section 104(a)(2).

This understanding of the true nature of emotional injury is not limited to those in the neuroscientific community. Courts, too, have begun to consider the science behind emotional harm.<sup>194</sup> Specifically, some courts have acknowledged that brain injuries qualify as a bodily injury.<sup>195</sup> This consideration chips away at the distinction between the mind and the body by viewing them as one in the same; consequently, modern jurisprudence supports the conclusion that emotional harm is merely a subset of physical injury.

Additionally, through various legislation, the federal government has acknowledged that mental health is an important component of one’s overall wellness.<sup>196</sup> Be it in terms of healthcare law or tax deductions, the government has enacted laws that equalize mental health with the health of the body.<sup>197</sup> Although these policies focus

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188. See Roozendaal et al., *supra* note 84, at 429.

189. See, e.g., Biro, *supra* note 71, at 662–63; Grey, *supra* note 3, at 2623, 2628.

190. See Arnsten, *supra* note 88, at 415; Grey, *supra* note 3, at 2629; Hannibal & Bishop, *supra* note 95, at 1818.

191. Grey, *supra* note 3, at 2628.

192. Arnsten, *supra* note 88, at 418.

193. Because of evidentiary concerns related to emotional injury, I conclude that a taxpayer must be able to demonstrate the extent of the emotional harm in order to receive the Section 104(a)(2) exclusion. See *infra* Part III.B.

194. See *supra* Part II.C.

195. See, e.g., Allen v. Bloomfield Hills Sch. Dist., 760 N.W.2d 811, 817 (Mich. Ct. App. 2008) (holding that the brain injury sustained by a plaintiff who developed PTSD after a train accident qualified as a bodily injury); P.P. v. Compton Unified Sch. Dist., 135 F. Supp. 3d 1098, 1110–11 (C.D. Cal. 2015) (holding that “complex trauma can result in neurobiological effects constituting a physical impairment for purposes of the [Rehabilitation Act and Americans with Disabilities Act]”).

196. See Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (2010); Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act, Pub. L. 110-343 §§ 511–12, 122 Stat. 3765, 3881–93 (2008); Mental Health Parity Act, Pub. L. 104-204 §§ 701–03, 110 Stat. 2874, 2944–50 (1996); see also Americans with Disabilities Act, 29 C.F.R. § 1630.2(g)(1)(i) (2021); MEDICAL AND DENTAL EXPENSES, *supra* note 178.

197. See *supra* notes 170–178.

mostly on mental health parity, rather than discerning whether mental health disorders are physical injuries to the body, it is significant that the federal government is participating in the conversation at all. By creating these pieces of legislation, the government legitimizes mental health disorders while also acknowledging the impact that such disorders can have on the individual. These laws indicate the changing manner in which the federal government views emotional injury, further demonstrating why the personal injury exclusion in the Internal Revenue Code merits an update reflecting the modern scientific understanding of personal injury.

Expanding the personal injury exclusion also promotes the policy reasons for which Section 104(a)(2) was created. First, emotional harm has proven to result in brain damage;<sup>198</sup> therefore, a damage award for such harm restores a taxpayer's capital in her body, specifically her brain. Accordingly, including emotional injury in the Section 104(a)(2) exclusion supports the return of capital theory.<sup>199</sup> Second, emotional injury can be costly as a taxpayer may have to pay for psychiatrists, therapists, medication, or treatment for any physical symptoms resulting from the harm.<sup>200</sup> Consequently, if a taxpayer's damage award is taxed, the net amount may not cover the taxpayer's expenses, one of Congress's expressed justifications for enacting Section 104(a)(2).<sup>201</sup> Lastly, a taxpayer who has experienced emotional harm has experienced resulting pain and suffering; therefore, she deserves "to be pitied rather than taxed," much like the victim of a bodily injury.<sup>202</sup>

Most importantly, expanding the personal, physical injury exclusion promotes horizontal equity, arguably one of the most important criteria of a good tax system.<sup>203</sup> Under the current treatment of Section 104(a)(2), a taxpayer who receives one hundred dollars of damages on account of emotional injury is taxed differently from a taxpayer who receives the same amount on account of physical injury.<sup>204</sup> Although the taxpayers are in equivalent financial situations, they do not face equivalent tax burdens: for the taxpayer who suffered emotional injury, her one-hundred-dollar recovery is included in gross income and therefore taxed, whereas the recovery of the taxpayer who suffered physical injury is excluded and not taxed. This split is what leads to horizontal inequity. By allowing demonstrable emotional harm to be categorized as physical injury, these two taxpayers will both be able to exclude the damage award from gross income and both individuals will face the same tax burden, thus promoting the principle of horizontal equity.

The understanding of the nature of emotional injury has experienced a significant shift both legally and scientifically since the SBJPA was enacted.<sup>205</sup> Not only has the scientific community validated the physicality of emotional harm but courts have also made strides to acknowledge it. Additionally, through legislation, the federal government

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198. *See supra* notes 108–110.

199. *See supra* notes 15–17 and accompanying text.

200. *See* I.R.C. § 213(d).

201. *See supra* note 20 and accompanying text.

202. *See* Yorio, *supra* note 21, at 706 (quoting Harnett, *supra* note 21, at 626 (internal quotations omitted)).

203. *See* Elkins, *supra* note 10, at 43.

204. *See* Spitz, *supra* note 11, at 441–43.

205. *See supra* Parts II.B–D.

has demonstrated a willingness to accept the tangible harm of emotional injury.<sup>206</sup> Expanding the personal injury exclusion not only conforms to these evolving views but it both promotes and is supported by long-standing tax principles. Because of these sweeping changes, tax law should adopt a modern approach to emotional harm, regarding it as a physical injury. Therefore, Section 104(a)(2) needs to be expanded to include damages awarded on account of emotional injury.

### B. *Obstacles to Expanding the Personal Injury Exclusion*

There are two primary obstacles to changing the language of the personal injury exclusion. The first obstacle consists of evidentiary concerns. Due to the subjective nature of emotional harm, it can be difficult to produce evidence demonstrating the existence and extent of the harm.<sup>207</sup> However, given advancements in neuroscience, what was once intangible and subjective is now measurable.<sup>208</sup> Whereas a plaintiff previously had to rely on abstract and seemingly subjective descriptions of her pain, a plaintiff can now present neuroscientific tests as evidence of her injury.<sup>209</sup> A plaintiff can also bring in an expert witness to explain the extent of her psychiatric injury, particularly if the injury is substantial but cannot be explicitly categorized as any recognized psychiatric illnesses.<sup>210</sup>

Just as a plaintiff could not receive damages for a broken leg without evidence of having broken that leg, a taxpayer also would not be found to have satisfied the Section 104(a)(2) exclusion without a sufficient demonstration of the emotional harm. Not only would this evidence prove that the plaintiff suffered physical harm from the emotional injury but it would also provide insight into how severe the injury was. Therefore, neuroscientific evidence would address concerns of ambiguity regarding the reality and magnitude of the plaintiff's emotional harm. Accordingly, if a plaintiff can prove that the emotional injury resulted in conformational change to the brain, she would sufficiently demonstrate physiological injury, thus satisfying the "personal, physical impact" rule under Section 104(a)(2).

The second obstacle to change is acceptance. In order to effectuate changes to the personal injury exclusion—or even suggest them—a greater national shift in how we view mental health is needed. Mental health services are often underfunded on the provider side and overpriced for the patient, resulting in many individuals not getting the care that they need.<sup>211</sup> Although the tone of the conversation surrounding mental illness

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206. See, e.g., Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (2010); Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act, Pub. L. 110-343, §§ 511–12, 122 Stat. 3765, 3881–93 (2008); Mental Health Parity Act, Pub. L. 104-204, §§ 701–03, 110 Stat. 2874, 2944–50 (1996); see also Americans with Disabilities Act, 29 C.F.R. § 1630.2(g)(1)(i) (2021); MEDICAL AND DENTAL EXPENSES, *supra* note 178.

207. Cassin, *supra* note 74, at 938; see also *supra* note 131.

208. See, e.g., Arnsten, *supra* note 88, at 418; Grey, *supra* note 3, at 2628–30.

209. Grey, *supra* note 3, at 2633–34.

210. *Id.* at 2649.

211. See Azza Altirafi & Nicole Rapfogel, *Mental Health Care Was Severely Inequitable, Then Came the Coronavirus Crisis*, CTR. FOR AM. PROGRESS (Sept. 10, 2020), <http://www.americanprogress.org/issues/disability/reports/2020/09/10/490221/mental-health-care-severely-inequitable-came-coronavirus-crisis> [<http://perma.cc/2UUX-LAHX>].

has improved, mental health is still considered a type of harm separate from physical harm, which upholds emotional injury as a separate and, often times, lesser harm.<sup>212</sup> Therefore, it is still possible that Congress could face pushback in trying to amend the language of Section 104(a)(2) if the public—specifically the lawmakers elected to represent them—do not view emotional injury as a legitimate harm.

In order to combat this perception, there needs to be a public reeducation regarding mental and emotional health. Through healthcare providers, educators, and other national leaders, mental health wellness must be prioritized at the same level as bodily health, branding it as an extension of physical health. By emphasizing that mental health is a critical issue, individuals will be more receptive to supporting legislative initiatives that promote it.

Lawmakers then need to amend existing laws to position mental and bodily health as equally important. These changes can primarily be made by ensuring that provisions relating to mental health are not separate from those dealing with other bodily concerns. By categorizing bodily and mental health together, lawmakers will announce to the public that both issues are deserving of equal treatment, equal funding, and equal importance.

#### IV. CONCLUSION

The personal injury exclusion has been part of the tax system since the early 1900s.<sup>213</sup> The lengthy history of this exclusion demonstrates that the values underlying it—compassion for the taxpayer and basis in one's body—have consistently been meaningful within American society. However, by disallowing the exclusion where there is only emotional harm, Section 104(a)(2) announces that compassion is not needed for emotional injury and that the investment into one's brain is insignificant.

Yet, modern neuroscience has demonstrated that emotional harm causes measurable, physiological change to the brain, making it evident that emotional injury is a personal, physical injury deserving of Section 104(a)(2) treatment. Therefore, the Section 104(a)(2) exclusion needs to be expanded to make damages awarded on account of demonstrable emotional injury excludable from gross income. Doing so will ensure that the personal injury exclusion continues to serve those deeply entrenched values contained within the tax system and, most importantly, will modernize the tax system, aligning it with a contemporary, scientific understanding of emotional injury.

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212. See *supra* notes 160–165, 176–179 and accompanying text.

213. Revenue Act of 1918 Pub. L. No. 65-254, § 213(b)(6), 40 Stat. 1057, 1066 (1919).