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"Grossing Up" Back Pay Awards: What That Means and Why You Need to Know About It

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The Third Circuit Court of Appeals (covering Delaware, New Jersey, Pennsylvania and the Virgin Islands) recently held that courts may grant a plaintiff who wins an employment discrimination case a monetary award to compensate for additional tax liability. *Eshelman v. Agere Systems, Inc.*, 554 F.3d 426 (3rd Cir. 2009). This is often referred to as "grossing up" the amount of the back pay because the effect is the same as if the back pay had been received during the ordinary course of employment. The decision increases the potential liability employers face in employment discrimination suits and has implications for litigation strategies in the defense of employment discrimination suits.

In *Eshelman*, the jury found that the employer discharged the plaintiff because of her disability in violation of the Americans with Disabilities Act of 1990 and awarded the plaintiff back pay in the amount of \$170,000. The back pay was for a period of approximately four (4) years. After the trial, the plaintiff requested that the Court award her an additional \$6,893 to offset the negative tax

consequences of receiving the back pay in a single lump sum.

These negative tax consequences occur because back pay awards under discrimination statutes are taxable in the year they are paid. Therefore, receipt of a lump sum back pay award may lift the plaintiff into a higher tax bracket in the year the back pay award is received. If the plaintiff is lifted into a higher tax bracket, the plaintiff will pay more in taxes on the back pay award than if the pay would have been received in the normal course of employment in different calendar years.

The trial court granted the plaintiff's motion to "gross up" the back pay award to offset the negative tax consequences of the lump sum award. On appeal, the Third Circuit affirmed the trial court's decision for several reasons. First, the Court relied upon the broad equitable powers that Courts have to restore the plaintiff "to the economic status quo that would exist but for the employer's [discriminatory] conduct." *Eshelman*, 554 F.3d at 440. Second, the Court analogized the situation to prejudgment interest on back pay awards. Numerous cases hold that, to make victims of discrimination whole, an award should include prejudgment interest.

The Court reasoned that an award to compensate the plaintiff for her increased tax burden created by the lump sum award of back pay would help make the employee whole. In other words, it would put her in the position that would have existed if the plaintiff had not discriminated against her. Finally, the Court relied upon an earlier decision of the Tenth Circuit Court of Appeals (covering Colorado, Kansas, New Mexico, Oklahoma, Utah and Wyoming), which awarded the plaintiffs compensation for the additional tax liability incurred as the result of receiving seventeen (17) years of back pay in a lump sum. *Sears v. Atchison, Topeka & Santa Fe Ry. Co.*, 749 F.2d 1451 (10th Cir. 1984).

In *Eshelman*, the Court emphasized that a plaintiff who wins a discrimination case is not "presumptively entitled to an additional award to offset tax consequences above the amount to which she would otherwise be entitled." *Eshelman*, 554 F.3d at 443. Rather, the plaintiff bears the burden of proving that she will pay additional taxes as a result of receiving a lump sum back pay award and the amount of the additional taxes. Therefore, plaintiffs will have to retain expert witnesses to prove their additional tax liability, and employers will have to retain their own experts to challenge the calculations of the plaintiff's experts.

The only other federal appellate court that has considered the issue has held to the contrary. The United States District Court for the District of Columbia (the "D.C. Circuit"), which only covers the District of Columbia, concluded that "the general rule that victims of discrimination should be made whole does not support 'gross-ups' of backpay to cover tax liability." *Dashnaw v. Pena*, 12 F.3d 1112, 1116 (D.C. Cir. 1994). It remains to be seen how federal appellate courts in other parts of the country will decide the issue.

When assessing their potential liability in employment

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discrimination cases, employers should work closely with their counsel to determine if they are before a court that may award "gross ups" of back pay liability. If the plaintiff may be awarded a "gross up" of back pay, the employer's potential liability increases, particularly if the case is pending for multiple years. This potential increase in liability should be considered when deciding whether to settle a case and whether to engage in defense strategies that would significantly delay the disposition of the case.

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