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Third Circuit holds that plaintiffs who receive a back pay award may be entitled to money to offset negative tax consequences.

In a case of first impression, the Third Circuit Court of Appeals has held that a district court has the discretion to award a prevailing plaintiff in an employment discrimination case an additional sum of money to compensate for the increased tax burden a back pay award may create. There is no question that back pay awards in discrimination cases are taxable in the year they are paid. Therefore, employees who receive a lump sum back pay award may end up in a higher tax bracket and, consequently, may be subject to higher taxes than if the employee were to have received the money in the normal course of business. For example, in a case in the Tenth Circuit, an employee was awarded 17 years of back pay in one lump sum, obviously pushing the plaintiff into a higher tax bracket. The court addressed this situation by awarding an additional amount of money to offset those tax consequences. Courts, including the Third Circuit, also routinely grant prevailing plaintiffs “pre-judgment interest” to compensate the plaintiff for the loss of the use of money that he would have earned had he not been terminated. Both of these awards are considered by the courts to be appropriate equitable relief.

Joan Eshelman was employed by Agere Systems as a supervisor of its chief information office in Reading, Pennsylvania. Eshelman took a medical leave of absence in 1998 and 1999 to receive chemotherapy treatments. Upon returning to work she notified her supervisors that she was experiencing some memory loss related to her treatment. Despite the fact that her memory loss did not negatively impact her work performance—in fact, she received outstanding evaluations and a promotion—she was laid off as part of a company-wide restructuring in 2001.

Eshelman filed suit against Agere alleging that the company discriminated against her because of her age and disability. The jury ultimately found that the company had discriminated against Eshelman in violation of the Americans with Disabilities Act and awarded her a lump sum of \$170,000 in back pay and \$30,000 in compensatory damages. The court also granted Eshelman’s motion for an additional monetary award to offset the negative tax consequences of receiving the large amount of money in a lump sum. Agere appealed arguing, among other things, that the court did not have authority to award the additional money as a “tax gross up” to Eshelman.

The Third Circuit, addressing this issue for the first time, disagreed with Agere and affirmed the award of additional money to offset the negative tax consequences of the backpay award. In its decision, the Third Circuit stated that the “tax gross up” is in line with the “make whole” remedial purpose of the anti-discrimination laws. The court went on to say that, without the additional money to cover the tax consequences, it would not be possible to restore the employee to the economic status quo that would exist absent the employer’s conduct.

The Third Circuit in its decision cautioned that not all prevailing plaintiffs are entitled to an additional award to offset tax consequences. Such awards are to be determined on a case-by-case basis depending upon the extent of the injury suffered by plaintiff and whether the award has negative tax implications.

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