6-1-2002

The Taxation of Crime Victim Restitution: An Unjust Penalty on the Victim

Linda Trang

Recommended Citation

Available at: https://digitalcommons.lmu.edu/llr/vol35/iss4/7
THE TAXATION OF CRIME VICTIM RESTITUTION: AN UNJUST PENALTY ON THE VICTIM

I. INTRODUCTION

There is no question that a tort plaintiff may recover damages for personal physical injuries tax-free; but what are the tax consequences for the crime victim who recovers victim restitution? The recoveries of both the tort plaintiff and the crime victim are compensation for personal physical injuries, but differ slightly in that the tort plaintiff receives damages in a civil action, whereas the crime victim receives victim restitution in a criminal proceeding. Nonetheless, this subtle difference between an award in civil court versus one in criminal court may be the underlying basis for taxing one but not the other.

Section 104(a)(2) of the Internal Revenue Code (the “Code”) is the governing statutory law on the taxation of recoveries received. This section provides an exclusion from gross income for personal physical injury recoveries. More precisely stated, the provision provides a gross income exclusion for “the amount of any damages ... received ... on account of personal physical injuries or physical sickness.” In general, it is well settled under section 104(a)(2) that civil damages recovered by the tort plaintiff may be excluded from income. The law on the taxation of crime victim restitution, however, is less established.

Reconciling victim restitution awards with section 104(a)(2) hinges on the meaning given to the term “damages” as provided in the statute. Victim restitution may be subject to section 104(a)(2) treatment if damages under the statute are construed broadly to

2. See infra Part II.B.3.
4. Id. (emphasis added).
5. See infra Part II.B.3.
include not only damages per se, but all forms of recoveries that are compensatory in nature. If however, damages under the statute are construed narrowly to include only recoveries in the name of damages, then victim restitution falls outside the scope of section 104(a)(2). In effect, under this narrow reading and absent any other applicable gross income exclusion in the Code, it appears that a recovery of victim restitution would be taxable income.

This narrow construction of section 104(a)(2) may have been justified during a period when damages and restitution were based on separate and distinct recovery theories. That is, the concept of damages is rooted in compensation but restitution was originally based upon unjust enrichment. Following the integration of crime victim restitution laws into the federal sentencing structure in 1982, damages and restitution no longer stand as autonomous principles. Victim restitution, in contrast to simple restitution, adopts a compensatory purpose similar to damages—recovery is measured by the victim's loss, not by the criminal's gain. Compensation, in essence, no longer exists solely in damages received in a civil judgment; instead, it has journeyed into criminal proceedings in the form of victim restitution.

This Comment addresses the taxation of victim restitution awards in criminal proceedings in the context of section 104(a)(2) and takes the broader view that damages under the statute encompass not only damages per se, but also any other recoveries that are compensatory in nature. Because victim restitution functions as compensation, it should be included in the same gross income exclusion afforded to damages under section 104(a)(2) and thus be nontaxable. In Part II, this Comment reviews the Internal Revenue Service's (IRS) tax treatment of recovery awards. Receipts of

6. This is assuming that victim restitution serves a compensatory purpose and satisfies the statute's other requisite element that it be received “on account of personal physical injuries or physical sickness.” I.R.C. § 104(a)(2).


8. See DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES 816 (2d ed. 1994).
various recoveries, such as punitive damages, compensatory damages, and restitution, will be analyzed under general tax principles governing gross income and under the exclusionary provisions of the Code. Part III then focuses on restitution awards and traces their development from civil beginnings into the criminal framework. Recognizing that victim restitution is a hybrid remedy in both criminal and civil law, Part IV proposes that victim restitution, like compensatory damages, should be excludible under section 104(a)(2) due to its compensatory nature. Finally, this Comment provides recommended revisions, consistent with this theory, to the language of certain legislative and administrative materials.

II. BACKGROUND: THE TAXABILITY OF RECOVERIES RECEIVED

A. Gross Income

The IRS imposes federal income tax on “taxable income”;⁹ that is, “gross income”¹⁰ less deductions authorized by the Code.¹¹ This Section analyzes whether recoveries of crime victim restitution for personal physical injuries fall within the meaning of gross income under section 61 of the Code. Section 61(a), in particular, provides that “gross income means all income from whatever source derived.”¹² Gross income, in other words, is a broad term of art that includes any and all amounts received that improves the taxpayer’s economic position.¹³ With respect to recoveries from litigation settlements and judgments, unless the Code provides an applicable

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¹⁰ Id. § 61.
¹² I.R.C. § 61(a) (emphasis added).
¹³ Congress did not so much define gross income by what it is, but rather by what it is not via exclusionary provisions in the Code. Part II of the Code’s Subchapter B, in particular, details items specifically excluded from gross income. See I.R.C. subtitle A, ch. 1B, pt. II (1994 & Supp. 2000); see also Jennifer J.S. Brooks, Tax Consequences of Settlements and Judgments, in 1986 A.B.A. NAT’L INST. ON DAMAGES, NEW SETTLEMENT TECHNIQUES AND TAX CONSEQUENCES 213, 217 (1986) (“[A]nything that better the taxpayer’s economic position could be thought ‘includible’ in gross income.”).
exclusion, and unless it represents a mere recovery of capital, the award is included in the recipient’s gross income.\textsuperscript{14}

Before inquiring whether an amount falls under an exclusionary provision, it must first be established that the amount is actually income. If it is not income, then it is simply nontaxable and no further analysis is required. If it is income, the taxpayer must meet an exclusionary provision under the Code for the amount to be excluded from gross income. Absent an applicable exclusion, the amount will ultimately be included in gross income and subject to income tax imposed by section 1 of the Code.\textsuperscript{15}

The first question with respect to taxability is whether an amount is in fact income. The Supreme Court’s landmark case of \textit{Commissioner v. Glenshaw Glass}\textsuperscript{16} provides that any “undeniable accessions to wealth, clearly realized, and over which the taxpayer[] has] complete dominion” is income within the meaning of section 61(a).\textsuperscript{17} In other words, income equals those amounts over which the taxpayer has enjoyed an economic benefit, when such wealth was realized,\textsuperscript{18} and the taxpayer has exercised dominion and control over this wealth.\textsuperscript{19}

Under this general definition of income, a victim who receives a pecuniary recovery from a settlement or court judgment appears to meet the criterion set forth in \textit{Glenshaw Glass}. The victim receives a net economic benefit by virtue of a monetary recovery, realizes the wealth by immediately claiming ownership over the recovery, and has dominion and control over the recovery because of legal entitlement to the wealth. Ostensibly, receipt of any monetary awards could be considered income under section 61(a).

\textbf{B. An Exclusion for Certain Damages}

Once it is established that an amount received is income, the question becomes whether such amount falls under a gross income

\textsuperscript{16} 348 U.S. 426 (1955).
\textsuperscript{17} \textit{Id.} at 431 (holding that punitive damages for fraud and antitrust violations were windfalls includible in gross income).
\textsuperscript{18} See Eisner v. Macomber, 252 U.S. 189 (1920) (establishing the “realization” requirement).
\textsuperscript{19} See \textit{Glenshaw Glass}, 348 U.S. at 431.
exclusionary provision. Amounts received for injuries or sickness are generally governed by Code section 104.\textsuperscript{20} Section 104(a)(2), in particular, excludes from gross income "any damages . . . received . . . on account of personal physical injuries or physical sickness."\textsuperscript{21} Note that section 104(a)(2) distinguishes between damages and other forms of recovery. Thus, the classification of a recovery as either damages or non-damages determines taxability.\textsuperscript{22}

Although it is clear that only damages will be eligible for favorable tax treatment under the statutory exclusion, a considerable area of uncertainty lies within the meaning of damages under the statute. Vagaries in the interpretation of damages have contributed to an incoherent body of law on the taxation of recoveries.\textsuperscript{23} For instance, damages can be construed to encompass various recoveries, including punitive damages, compensatory damages or restitution. It is confusing and unpredictable as to which of these variants fall under the rubric of damages in section 104(a)(2).

Courts have nonetheless attempted to provide some sense of order and structure to alleviate ambiguity. To that end, the Supreme Court announced a two-prong test in \textit{Commissioner v. Schleier}\textsuperscript{24} that became a standard commonly used by the courts in determining whether a personal injury recovery may be excluded under section 104(a)(2).\textsuperscript{25} First, the underlying cause of action giving rise to the recovery must be "based upon tort or tort-type rights."\textsuperscript{26} Second,

\textsuperscript{20} Beyond the scope of this Comment are other Code sections addressing the inclusion of damages or settled recoveries of other types of recoveries. For example, these include: I.R.C. section 71, Alimony and separate maintenance payments; section 80, Restoration of value of certain securities; section 111, Recovery of tax benefit items; section 1341, Computation of tax where taxpayer restores substantial amount held under claim of right; and section 1351, Treatment of recoveries of foreign expropriation losses.


\textsuperscript{22} Assuming no other exclusionary provisions in the Code apply.

\textsuperscript{23} \textit{See} Brooks, \textit{supra} note 13, at 215.

\textsuperscript{24} 515 U.S. 323 (1995).

\textsuperscript{25} \textit{See id. at} 336-37 (establishing two independent requirements that a taxpayer must meet before a recovery may be excluded under section 104(a)(2)).

\textsuperscript{26} Treas. Reg. § 1.104-1(c) (as amended in 1970); \textit{see Schleier}, 515 U.S. at 337. Courts have generally followed state law in determining what constitutes a tort. \textit{See} Threlkeld v. Comm’r, 87 T.C. 1294, 1305-06 (1986),
damages must be received "on account of personal physical injuries or sickness." These independent requirements must be satisfied before excluding a personal injury recovery under section 104(a)(2). By meeting the tort or tort-type rights requirement, the test ensures that the recovery received was one with a compensatory function. The second prong, requiring that the recovery be received on account of personal injury, represents a causation element that links the damages recovered to the personal injury itself.

1. Punitive damages

Punitive damages in personal injury cases are sometimes recovered in addition to compensatory damages, and are generally awarded to punish the tortfeasor. Until recently, great inconsistency existed in the proper taxation of punitive damages. Under the test laid down in Schleier, punitive damages seem to fail to qualify for section 104(a)(2) treatment. Even if the recovery is received with respect to a personal physical injury claim that satisfies the second requirement, punitive damages are nonetheless included in gross income because they are not based on tort-type rights; rather, they arise from the lawsuit and are intended to punish the defendant for wrongful conduct.

The language of section 104(a)(2), moreover, explicitly bars punitive damages from its applicability. It provides that the

aff'd, 848 F.2d 81 (6th Cir. 1988). The IRS, however, takes a contrary position and ruled that what constitutes a tort is governed by the nature of the injury and not by state law. See Rev. Rul. 85-143, 1985-2 C.B. 55, 56. Any further study in determining what constitutes a tort according to the Treasury Regulations is beyond the scope of this Comment.

27. Schleier, 515 U.S. at 333.


29. See id. at 540-41.

30. See Brooks, supra note 13, at 228.


32. In a 1984 ruling, the IRS concluded that punitive damages do not qualify for the exclusion because they are intended to punish the tortfeasor rather than to restore a capital loss. See Rev. Rul. 84-108, 1984-2 C.B. 32, 34; Brooks, supra note 13, at 228.

33. See I.R.C. § 104(a)(2).
exclusion applies to "the amount of any damages (other than punitive damages) received... on account of personal physical injuries or physical sickness."  

Before the 1996 amendment to the statute, however, there did not exist such a bright-line exclusion for punitive damages from the section 104(a)(2) exclusion from gross income.

Until the 1996 amendment added the parenthetical phrase "other than punitive damages," which once and for all excluded punitive damages from section 104(a)(2) treatment, there was much confusion and conflict among the circuits as to whether the statute extended to punitive damages. The IRS took the position, which was later confirmed by the 1996 amendment, that all exemplary and punitive damages are taxable. In general, something is "taxed in the same manner as the items for which the recovery is intended to substitute." Punitive damages, then, are a taxable substitute for ordinary income because they are "windfall" income—they do not compensate for loss.

On the other hand, proponents for the exclusion of punitive damages relied on the Omnibus Budget Reconciliation Act enacted in 1989, which provided that the gross income exclusion was available for awards of punitive damages involving physical injury

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34. Id. (emphasis added).
35. The 1996 amendment inserted the parenthetical phrase, "other than punitive damages" following "damages." I.R.C. § 104(a)(2). Before the 1996 amendment, section 104(a)(2) read: "gross income does not include 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." I.R.C. § 104(a)(2) (1994).
36. See Rev. Rul. 84-108, 1984-2 C.B. 32, 34. The Fourth, Fifth, Ninth, and Tenth Circuits joined the IRS's position that section 104(a)(2) did not exclude punitive damages—all punitive damages, irrespective of whether they were received for physical injury or sickness, are fully taxable. See O'Gilvie v. United States, 66 F.3d 1550, 1560 (10th Cir. 1995); Estate of Moore, 53 F.3d 712, 716 (5th Cir. 1995); Wesson v. United States, 48 F.3d 894, 902 (5th Cir. 1995); Hawkins v. United States, 30 F.3d 1077, 1084 (9th Cir. 1994); Miller v. Comm'r, 93 T.C. 330, 352 (1989), rev'd, 914 F.2d 586, 592 (4th Cir. 1990).
37. Morgan, supra note 14, at 882; see also Raytheon Prod. Corp. v. Comm'r, 144 F.2d 110, 113 (1st Cir. 1944).
38. See Brooks, supra note 13, at 227.
or sickness. In other words, any damages, whether compensatory or punitive, which were received on account of personal physical injuries were excludible under section 104(a)(2).

In 1996, Congress rejected this overreaching proposition, and the IRS's narrower position ultimately prevailed. Congress reasoned that:

[punitive damages are intended to punish the wrongdoer and do not compensate the claimant for lost wages or pain and suffering. Thus, they are a windfall to the taxpayer and appropriately should be included in taxable income. Further, including all punitive damages in taxable income provides a bright-line standard which avoids prospective litigation on the tax treatment of punitive damages received in connection with a case involving a physical injury or physical sickness.]

As a result, punitive damages, even if received in a personal physical injury case, are viewed as windfall income and clearly fall outside the scope of the section 104(a)(2) exclusion.

2. Compensatory damages

The taxability of compensation awards, on the other hand, differs entirely from punitive damages. In personal injury cases, compensatory damages are typically awarded for actual loss suffered. This receipt of compensatory damages is the quintessential type of recovery falling within the breadth of the statutory exclusion and has been tax exempt since 1918. Perhaps most telling of all is

40. See id. § 7641(a), 103 Stat. at 2379; see also United States v. Burke, 504 U.S. 229, 237 (1992) (deciding that the focus must be on the nature of the claim underlying the damage award in determining taxability); Horton v. Comm'r, 100 T.C. 93, 94 n.2 (1993), aff'd, 33 F.3d 625, 630 (6th Cir. 1994); Miller v. Comm'r, 93 T.C. 330, 339 (1989), rev'd, 914 F.2d 586, 592 (4th Cir. 1990).


42. Id. at 143.

43. See Revenue Act of 1918, Pub. L. No. 65-254, § 213(b)(6), 40 Stat. 1057, 1066 (1919); T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918). Compensatory recovery for personal injury is the hallmark of excludability under section 104(a)(2) because it has been analogized to returns of capital—it merely restores the taxpayer to the status quo by making the taxpayer whole. See Brooks, supra note 13, at 220.
the language of section 104(a)(2), which explicitly provides for the excludability of personal physical injury damage awards from gross income. The exclusionary provision applies to "the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness." 

As a general rule, damage recoveries for injury to the person are nontaxable by statute because it "adds nothing to the individual . . . . It is an attempt to make the plaintiff whole as before the injury." Another way to understand it is that if the award is a "pecuniary restoration of a nontaxable 'something' the taxpayer has lost," then it may be excluded from income. In the context of a recovery for personal physical injuries, the nontaxable something the plaintiff lost is the value of being uninjured. Thus, when the plaintiff recovers compensatory damages to restore that something the victim lost—"being physically whole"—from the defendant's wrongful conduct, it is nontaxable income because it was never taxable to begin with. Plaintiff's receipt of the compensatory damages, therefore, is not a substitute for ordinary income because its purpose is to place the injured plaintiff in the position the plaintiff would have occupied had the wrongful conduct not been committed; that is, the rightful position.

44. Section 104(a)(2), however, does not provide a blanket exclusion for all kinds of damage awards, but rather is limited to only those amounts received on account of personal injuries or sickness. See I.R.C. § 104(a)(2) (1994 & Supp. 2000). Even prior to the 1996 amendment, the title of section 104, "Compensation for injuries or sickness" already seemed to suggest that it applied only to compensatory damages. Id. § 104 (emphasis added).

45. Id. § 104(a)(2) (emphasis added).

46. Hawkins v. Comm'tr, 6 B.T.A. 1023, 1025 (1927). In contrast to punitive damages, there is wide acceptance that compensatory damages for personal injury are excludible under section 104(a)(2). Because compensatory damages have always been generally excludible, the focus in litigation is not on whether personal injury damages are taxable, but rather on which personal injury damages are nontaxable.

47. Brooks, supra note 13, at 221.

48. See id. at 222.

49. Id.

50. Compensatory payments for losses otherwise received tax-free but for the injury should also be received tax-free. See id. at 216.

51. See RESTATEMENT (SECOND) OF TORTS § 903 cmt. a (1982). If, however, a damage award replaces something taxable that the taxpayer had and lost before it was included in gross income, then it is not entitled to an exclusion and is thus taxable. See Brooks, supra note 13, at 227.
Beyond that, an award of compensatory damages for personal physical injury meets the requirements for excludability under the test established in Schleier.\(^5\) First, the underlying cause of action giving rise to compensatory damages for personal physical injury is unquestionably based on tort-type rights. The damages originate from the right to personal integrity and are not based on some other theory, such as breach of contract or injury to one's business or property, nor are they punitive damages.\(^5\) Second, it is self-evident that these damages for personal physical injury are received on account of personal physical injuries or sickness.

This special tax treatment under section 104(a)(2) is also based on compassion for the victim. Such benevolent exclusionary provisions of the Code are based on the compassionate belief that the taxpayer has suffered enough in personal injury cases\(^5\) and the public policy against overburdening injured plaintiffs\(^5\).

To require the inclusion of compensatory damages in gross income would seem to defeat the remedial purpose of putting the plaintiff in the rightful position by fully compensating the victim for his injury. For example, a victim sustaining $500 worth of injuries might sue for compensatory damages in the amount of $500. When the court awards this amount, the victim is returned to the financial

\(^{52}\) See 515 U.S. at 333.

\(^{53}\) To qualify for the exclusion under section 104(a)(2), the recovery must be paid under a tort theory and must represent compensatory damages. It cannot be based on some other theory, such as breach of contract, nor can it represent punitive damages. See MARK J. STEGMAN & PATRICK B. MATHIS, TAX ASPECTS OF LITIGATION, ILLINOIS CIVIL PRACTICE, VOL. II, § 3.18 (1997).

\(^{54}\) Because physical injuries usually result in extensive financial hardship and personal trauma, the Code provides a gross income exclusion of payments received as compensation for the injuries. See FREELAND ET AL., supra note 11, at 188; SANFORD M. GUERIN & PHILIP F. POSTLEWAITE, PROBLEMS AND MATERIALS IN FEDERAL INCOME TAXATION 183 (5th ed. 1998).

position he started in. The remedy puts the victim back to where he would have been had the injury never occurred. Without the exclusion, however, the victim’s compensatory award is included in gross income and taxed. Thus, the net total recovery falls short of the victim’s rightful position.

Arguably, the exclusion is at odds with tax theory because it creates inequities between personal injury victims and other taxpayers. While a personal injury victim takes damage awards tax-free, other taxpayers with equal consumable incomes are subject to taxation. That is, an amount of disposable income received for personal injuries is taken tax-free, yet the same amount of disposable income received as wages is taxed, which results in less disposable income. Nonetheless, over the years, section 104(a)(2) has received little criticism because the “exclusion is justified on humanitarian grounds.”

The taxpayer receives the damages, not only in the taxpayer’s capacity as a plaintiff, but also in the taxpayer’s capacity as a victim.

3. Restitution

Recovery of restitution, however, is a fairly modern remedy, separate and distinct from other bases of recovery. For the moment, the law on the taxation of restitution remains unsettled due to the incongruence between legislative and administrative authorities. The crux of the uncertainty lies in the breadth of interpretation given to the term damages in the statute. If the statutory language is construed narrowly to cast all recoveries other than damages per se as being outside the ambit of its gross income exclusion, then restitution is a casualty of section 104(a)(2)’s hard-and-fast rule that the recovery must be in the name of damages. If, however, the statutory language is construed broadly to apply not only to damages per se but to any damages-like recovery that is

57. See id. at 570.
58. See id.
59. Id. at 565.
60. See infra Part III.A.
compensatory, then victim restitution may well qualify for the section 104(a)(2) exclusion.

On the one hand, legislative materials such as the Code enacted by Congress, and administrative materials such as the Regulations prescribed by the Secretary of the Treasury, carve out and recognize a gross income exclusion for only personal physical injury damages under section 104(a)(2). The language of the Code and the Regulations contain repeated reference to damages as specifically coming within the statute's purview, but neither makes mention of restitution. Because these materials only speak to damages and do not address restitution, it would be ill-advised for a taxpayer to infer either a narrow or broad interpretation of damages.

Other administrative materials, such as rulings emanating from the Treasury Department have produced rulings consistent with the broad view—some payments to crime victims, although not called damages, are nontaxable. In particular, victim compensation awards, although not labeled damages, have been ruled nontaxable. In a 1974 Revenue Ruling, the Treasury ruled that “[a]wards made by the Crime Victims Compensation Board of the State of New York to victims of crime . . . are not includible in the gross income of the recipients.” The ruling did not refer to or base its decision on section 104(a)(2) for the income exclusion, but rather relied on the “general welfare doctrine,” which provides that “disbursements from a general welfare fund in the interest of the general public which are not made for services rendered are not includible in gross income.”

Almost a decade later, in a 1983 private letter ruling, the Treasury again ruled that victim compensation was nontaxable. In contrast to the 1974 ruling, the 1983 private letter not only referred to the section 104(a)(2) exclusion but used it as the underlying basis for concluding that a gross income exclusion applied. In its reply to a request for a ruling concerning the taxability of awards made under

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62. Victim compensation and victim restitution are not the same and are not used interchangeably in this Comment. The rulings on the taxation of victim compensation are mentioned here only to suggest that section 104(a)(2) was intended to be read broadly to include not only damages, but any recoveries that are compensatory.
the Department of Justice’s Crime Victim Compensation Program (the “Program”), the Treasury ruled that “amounts received by a claimant under the [Program] are excludible from the claimant’s gross income under section 104(a)(2) of the Code.”

However, victim compensation and victim restitution are not the same recoveries. Awards of victim compensation are administered through state compensation programs where victims must meet certain eligibility requirements; namely that the recipient was a victim of certain enumerated violent crimes and was not related to the offender.

Victim restitution, on the other hand, is an order by the court in criminal cases that the offender directly pay remuneration to the victim and is generally not limited to specific crimes or offenses. The crucial difference is that victim restitution allows victims otherwise ineligible for victim compensation to obtain compensation for personal physical injuries in a criminal case.

Even if victim compensation and victim restitution are of like kind, the letter rulings excluding victim compensation from gross income cannot be cited as precedent for the excludability of victim restitution. Letter rulings have only limited precedential value since they are issued solely in response to the taxpayer who requested it and may not be used as authority by anyone else. Therefore, although the 1983 ruling is on point to address the taxation of victim compensation and victim restitution recoveries in the context of section 104(a)(2), it cannot be relied upon as authority.

Since a taxpayer cannot assert letter rulings excluding victim compensation from gross income as a basis for excluding victim restitution, the Code and the Regulations must be viewed as the primary sources of authority. Unfortunately for the recipient of victim restitution, the Code and the Regulations provide little guidance in determining whether those receipts will be taxable. If the reference to damages in section 104(a)(2) is construed strictly, then it seems that, absent an applicable gross income exclusionary

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67. See id. at 148.
68. See id. at 151-52.
provision for restitution, victim restitution will ultimately be included in gross income under section 61. However, if the ambit of damages is open to interpretation, then on a case-by-case analysis, taxpayers might reason that their particular recovery is really damages but by another name.

Assuming arguendo that the Code and the Regulations really intend for damages in section 104(a)(2) to be construed broadly, it still does not answer whether victim restitution is characteristically similar enough to damages to qualify under the statute. The question remains whether victim restitution is more akin to punitive damages versus compensatory damages for purposes of the statutory exclusion. If restitution is characterized as punitive, then arguably it lies outside the scope of the statute, and thus, would be included in gross income. However, if it is characterized as compensation, then it is analogous to compensatory damages, which fall under the meaning of damages in section 104(a)(2) and thus is excludible from gross income.

III. DECIPHERING CRIME VICTIM RESTITUTION

To properly assess how crime victim restitution recoveries should be taxed, a firm understanding of the underlying nature and purpose of the recovery is helpful. The logical starting point of analysis is to look at restitution itself. Because restitution is a sweeping term that is not self-defining, it is better understood as an entire body of law rather than simply a remedy. In order to make sense of victim restitution, its evolutionary development must be traced from its very inception.

A. The Evolutionary Development of Restitution

Historically, the Anglo-American legal system maintained "a strict separation of criminal law from civil law." This division has been seemingly relaxed, with restitution crossing the boundary between civil law into criminal law. With its roots in the civil law,

70. Bruce Jacob, The Concept of Restitution: An Historical Overview, in RESTITUTION IN CRIMINAL JUSTICE: A CRITICAL ASSESSMENT OF SANCTIONS 45, 47 (Joe Hudson & Burt Galaway eds., 1975). By contrast, the German legal system, for example, sometimes combined a "criminal case and civil action . . . for purposes of procedural processing." Id. at 48.
restitution had always been widely used in tort and contract cases. However, with Congress’ enactment of crime victim restitution laws, restitution, once known to exist only in civil cases, became available in criminal proceedings.

1. Origins in civil law

The restitution suit first emerged in civil law as an alternative remedy to suing in tort or contract to recover damages. Based upon the principle of unjust enrichment, “[a] person upon whom a tort has been committed . . . [could] elect[] to sue in restitution to recover the defendant’s unjust benefit rather than to sue in tort to recover damages; he has a choice of alternative remedies.” Likewise, a person could elect to sue under a quasi-contract theory based upon unjust enrichment to recover money paid to the defendant, on the ground that it had been paid under a mistake or that it lacked consideration. Unjust enrichment essentially provided plaintiffs a restoration of benefits without having to resort to the fields of contract or tort law.

As such, it is not surprising that the substantive law of restitution is largely devoted to and commonly associated with the equitable theory of unjust enrichment, as indicated in the very beginning of the American Law Institute’s Restatement (Third) of Restitution and Unjust Enrichment. Section 1 of the Restatement states that “[a] person who is unjustly enriched at the expense of another is liable in restitution to the other.” The Restatement illustrates this principle with the following hypothetical: “A owes B $100 on account. By mistake, A pays B $200. There is no contract between A and B establishing a duty to refund a payment not due. B’s obligation to refund the overpayment is a liability in restitution.”


72. See id.

73. Id.

74. See id. at 3.

75. See id. at 12.

76. Restatement (Third) of Restitution and Unjust Enrichment § 1 (Discussion Draft 2000).

77. Id. § 1 cmt. d, illus. 6.
allows a successful plaintiff in a tort or contract case to recover the defendant’s unjust benefit obtained at the plaintiff’s expense.\(^7\)

On the whole, the principle of unjust enrichment “presupposes three things: First, the defendant must have been enriched by the receipt of a [benefit]. Secondly, that benefit must have been gained [at the plaintiff’s expense]. Thirdly, it would be [unjust] to allow the defendant to retain that benefit.”\(^8\)

The first prong concerning the “benefit” conferred upon the defendant, for purposes of taxation, provides insight into whether restitution would qualify under the gross income exclusion of section 104(a)(2). In a restitution claim, the benefit referred to is “the [enrichment] gained by the defendant at the plaintiff’s expense.”\(^9\)

In the previous illustration from the Restatement, B gains $100 because of overpayment by A. Because B is enriched by $100, B benefits by this overpayment and is liable to A in restitution.

Whether the recovery in restitution of a benefit conferred is taxable depends significantly on how that benefit is measured. When a plaintiff recovers restitution for unjust enrichment, it is an award measured by the defendant’s gain and not by plaintiff’s loss.\(^10\) For example, a defendant may be ordered to account for the profits arising from a breach of contract even if the plaintiff suffered no loss.\(^11\) Unlike compensatory damages, restitution as described is not an attempt to compensate or make the plaintiff whole. Moreover, restitution awards conceivably may exceed the plaintiff’s actual loss and overcompensate the plaintiff.\(^12\) Restitution would then be a windfall to the plaintiff and should be included in taxable income.\(^13\)

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78. See Goff & Jones, supra note 71, at 3.
79. Id. at 16.
80. Id.
81. See id. at 16-17.
83. Miscellaneous items of income and windfall income may constitute gross income under section 61. See Treas. Reg. § 1.61-14 (2001); see also Cesarini v. United States, 296 F. Supp. 3 (N.D. Ohio 1969), aff’d per curiam, 428 F.2d 812 (6th Cir. 1970) (requiring that a treasure trove found in a used piano be included in gross income).
84. See supra Part II.B.1 (discussing the taxability of punitive damages and windfall income).
2. Progression into criminal law

Although the emergence of crime victim restitution laws allow victims to recover directly from the defendant, the separation between criminal and civil law is still respected. In a criminal case, the state remains the party initiating the prosecution, not the individual victim. Before victim restitution laws, the custom of suing a defendant in a criminal court began with the state assuming full responsibility for punishment of the criminal and the state receiving any corresponding payment. The victim was still entitled to commence a civil suit against the defendant for recovery of damages. However, it was often futile to try to collect anything from the assailant, especially after the state had already done so in the criminal proceeding and exhausted whatever resources the defendant had to begin with. This inequity between the criminal and the victim led to legislation compensating victims of violence.

Until Congress passed the Victim and Witness Protection Act (VWPA) in 1982, the victim’s only means of obtaining monetary compensation was to instigate a separate civil suit. The VWPA essentially created crime victim restitution as “a sanction imposed by officials of the criminal justice system that requires offenders to make redress in the form of monetary . . . payments to . . . the direct victims.” Victim restitution laws allow prosecutors to seek court-ordered restitution to directly compensate victims. The primary purpose of such a law is to have criminals make restitution to the


86. Empirical studies indicate that only a very small percentage of violent crime victims who sue their assailants collect a recovery. See id. at 13 n.43.

87. See id. at 13-14.

88. See supra note 7.


victim by restoring or indemnifying victims for all losses suffered. In criminal sentencing, "[d]efendants are often ordered to pay full or partial compensation to their victims [in the name of] restitution, although they are always measured by the victim's loss . . . and never by the criminal's gain."

As the nineteenth century marked the movement of restitution into criminal law to compensate victims of crime, it also compounded the confusion surrounding unjust enrichment and the law of restitution. Even in its beginning stages before restitution was introduced into the criminal setting, there was already serious controversy over the interrelation between unjust enrichment and the law of restitution. It was unclear whether restitution was the equivalent of unjust enrichment or something more. In other words, did restitution merely restore to the plaintiff what the defendant had gained at the plaintiff's expense, or was it an amount above and beyond such equilibrium?

As restitution made headway into criminal law, the task of deciphering the confusion surrounding the law of restitution became even more bleak. The bifurcation of restitution into ordinary restitution in civil law and victim restitution in criminal law resulted

92. LAYCOCK, supra note 8, at 816.
94. Restitution has long suffered linguistic confusion and many legal scholars today "do not know what restitution is . . . . The technical competence of published opinions in straightforward restitution cases has noticeably declined; judges and lawyers sometimes fail to grasp the rudiments of the doctrine even when they know where to find it." Andrew Kull, Rationalizing Restitution, 83 CAL. L. REV. 1191, 1195 (1995).
95. Is restitution—or ought it to be—the law of unjust enrichment, pure and simple? Is it unjust enrichment and something else besides: restitution in the sense of restoration or giving back? . . . Is unjust enrichment a legitimate unifying principle for this body of law, or is it at best no more than 'a convenient explanation of specific results' among 'a truly superlative collection of jurisprudential loose ends'—employed to unwind, reverse, or pick up the pieces after anomalous transactions of one kind and another?

Id. at 1193 (emphasis in original).
in distinct methods by which the recovery was to be measured. Crime victim restitution—in contrast to ordinary restitution, which was usually measured by the defendant’s gain—was to be measured instead by the victim’s loss.\footnote{96} In effect, on a sliding scale, crime victim restitution moved away from restitution and towards compensatory damages—recovery is measured by the victim’s loss, not by the criminal’s gain.\footnote{97}

**B. Victim Restitution as a Hybrid Remedy: Criminal and Civil**

Because restitution in civil cases differs from restitution in criminal cases, it follows that they should each be taxed in accordance with their distinctive nature and purposes. The characterization as one kind of remedy or another is the watershed which determines whether a recovery should be taxed. However, there is great disagreement over the proper classification of victim restitution as either a civil remedy or a criminal remedy.\footnote{98} According to Holdsworth’s treatise on the history of English law: If a remedy compensates victims, then it is a civil remedy; if it penalizes offenders, then it is a criminal remedy.\footnote{99}

To no surprise, victim restitution serves both purposes. Restitution in the system of criminal justice demands that “whatever else the sanctioning power of society does to punish its wrongdoers, it should also insure that the wrongdoer is required to the degree possible to restore the victim to his or her prior state of well being.”\footnote{100} Victim restitution is not one or the other; rather it is a

\footnote{96. See \textit{LAYCOCK}, supra note 8, at 816.}

\footnote{97. See \textit{id}.}

\footnote{98. See Bonnie Arnett Von Roeder, \textit{The Right to a Jury Trial to Determine Restitution Under the Victim and Witness Protection Act of 1982}, 63 \textit{TEX. L. REV.} 671, 676-77 (1984).}

\footnote{99. See \textit{id}. at 676 (quoting \textit{WILLIAM HOLDSWORTH, A HISTORY OF THE ENGLISH LAW} 306 (1922)).}

\footnote{100. Catherine M. Goodwin, “\textit{Looking at the Law}”—The Imposition of Restitution in Federal Criminal Cases, 62 \textit{FED. PROBATION} 95, 95 (1998) (emphasis added) (citing United States v. Webb, 30 F.3d 687, 689 (6th Cir. 1994)); see also Elizabeth P. Miller, Recent Development, United States v. Hicks: \textit{The Victim Witness Protection Act Precludes Restitution for Emotional Injury in the Absence of Physical Injury}, 20 \textit{J. CONTEMP. L.} 195, 196 (1994) (arguing that victims suffering from emotional, but not physical, injury should be compensated for their loss).}
hybrid remedy—both criminal and civil.\textsuperscript{101} Therefore, the dual purpose of crime victim restitution—punishment and compensation—should be the guiding principle in devising a model for its taxation.

At the outset, the VWPA classified victim restitution as a penalty and thus a criminal remedy.\textsuperscript{102} The statutory language of the VWPA in 1982 allowed judges to order restitution “in addition to ... any other penalty authorized by law.”\textsuperscript{103} This construction seems to imply that victim restitution itself is a penalty and that other similar penalties are covered by the VWPA. In addition, restitution is a penalty which promotes social reform because “[i]t is constructed to fit the crime and to emphasize the wrongfulness of the offense and the defendant’s moral responsibility.”\textsuperscript{104} Ordered in the criminal justice system, victim restitution “constitutes an element of the offender’s sentence and therefore must be penal in character.”\textsuperscript{105} Because it penalizes offenders and because “restitution has actually always been considered a form of punishment,”\textsuperscript{106} victim restitution is a criminal remedy under Holdsworth’s test.

In addition to being a criminal remedy, victim restitution is also a civil remedy because of its compensatory nature.\textsuperscript{107} Crime victim restitution can be viewed as civil in character although awarded in criminal proceedings.\textsuperscript{108} Arguably, the primary and most significant purpose of victim restitution, consistent with its civil character, is to help crime victims.\textsuperscript{109} Despite victim restitution’s punitive character, Congress was more concerned with compensating victims when it enacted the VWPA.\textsuperscript{110} When a victim is hurt by his offender, the

\textsuperscript{101} See Von Roeder, supra note 98, at 676.
\textsuperscript{102} See id. at 680.
\textsuperscript{105} Von Roeder, supra note 98, at 677.
\textsuperscript{106} Abel & Marsh, supra note 91, at 23.
\textsuperscript{107} Victim restitution orders are also characterized as compensatory despite their inclusion in criminal justice. See Von Roeder, supra note 98, at 680.
\textsuperscript{108} See Considering the Victim, supra note 93, at xxiii.
\textsuperscript{110} See Von Roeder, supra note 98, at 684.
injury is remedied through the court by a compensatory judgment for the injury in the form of victim restitution.\textsuperscript{111}

Restitution, in effect, is a misnomer for victim compensation in criminal cases because the purpose of crime victim restitution is "not based primarily on unjust enrichment, but on compensation for harm."\textsuperscript{112} By definition, victim compensation is the "court-ordered payment of money... by a person convicted of a crime as \textit{compensation for losses suffered} by the victim."\textsuperscript{113} That is, crime victim restitution is not restitution by its literal reading, but is essentially the criminal case equivalent to compensatory damages. The \textit{Restatement of Restitution} calls attention to and expounds this misconception about the law of restitution and crime victim restitution:

Law that establishes (by statute or otherwise) the terms on which a convicted criminal may be ordered to make restitution to crime victims is not part of the law of restitution as defined by this Restatement.... The confusion is primarily a linguistic one, illustrating one of the fundamental objections to using the name "restitution" to refer to the law of unjust enrichment.\textsuperscript{114}

Hence, it appears more fitting to think of crime victim restitution not as restitution, but as victim compensation.

Crime victim restitution, therefore, is not restitution and does not carry the same connotations of restitution, unjust enrichment, quasi-contract, or the like. Instead, victim restitution is an independent basis of recovery in criminal cases with a striking resemblance to compensatory damages in tort cases.\textsuperscript{115} Like the

\begin{itemize}
  \item \textsuperscript{111} \textit{See} Marvin E. Wolfgang, \textit{Victim Compensation in Crimes of Personal Violence, in Considering the Victim, supra} note 93, at 116, 119.
  \item \textsuperscript{112} \textit{Restatement (Third) of Restitution and Unjust Enrichment} § 1 cmt. h (Discussion Draft 2000).
  \item \textsuperscript{114} \textit{Restatement (Third) of Restitution and Unjust Enrichment} § 1 cmt. h (Discussion Draft 2000); \textit{see also id.} § 1 cmt. c.
  \item \textsuperscript{115} It is confusing how restitution, termed a "third category of the common law, generically different from contract and tort," exists in relation to compensatory damages. Jack Beatson, \textit{Should There Be Legislative Development of the Law of Restitution?}, in \textit{Essays On The Law Of Restitution, supra} note 82, at 279. The \textit{Restatement of Torts}, however, seems to suggest that restitution falls under the grouping of compensatory
personally injured tort plaintiff, victims of crime also have interests in their persons. Thus, when any of these personal interests are damaged, victims of crime are awarded restitution as compensation for their losses.

IV. ELIMINATING THE DISPARITY: A PROPOSED METHOD OF TAXING VICTIM RESTITUTION IN LIGHT OF ITS DUAL PURPOSE

Unlike damages, no exclusionary Code provision exists specifically for restitution. The safe harbor of section 104(a)(2) has rarely been acknowledged in the context of restitution awards. Since its inception, the statute has been read to require recovery in the form of damages. Therefore, only compensatory damages and punitive damages have been illuminated in discussions regarding statutory exclusions for recoveries received. Because restitution does not have the term damages in its name, its place within section 104(a)(2) is uncertain.

Damages by defining compensatory damages as those awarded as "compensation, indemnity or restitution for harm sustained." RESTATEMENT (SECOND) OF TORTS § 903 (1979) (emphasis added).

116. Victims of crimes have interests in their persons which include:

(1) interests in physical integrity (e.g., immunity from physical impact: assault and battery, rape, murder, manslaughter), (2) interests in physical and mental freedom (e.g., immunity from physical and mental coercion: extortion by physically threatening either the victim or a third party the victim wishes to protect as in kidnapping, false imprisonment), (3) interests in their emotional state, good name, and privacy concerning any "weaknesses" they might have (i.e., immunity from any anxiety, humiliation, embarrassment or invasion of privacy not ordinarily expected in the day-to-day commerce of society), and (4) interests in their general physical and mental health (e.g., immunity from reasonably preventable health hazards resulting from pollution or from being used as an object in experimentation). Any given crime might include a trespass on any or all of these interests.

ABEL & MARSH, supra note 91, at 160.

117. See id. at 161.

118. Under narrow circumstances in Code section 118, restitution awards may be excluded from gross income. Because the gross income exclusion of section 118 applies only to corporations, it does not apply to individual plaintiffs or victims. Thus, the provision will not be discussed in this Comment. See I.R.C. § 118 (1994 & Supp. 2000).

119. Perhaps the lack of familiarity with restitution contributes to its neglect in the Code. See Kull, supra note 94, at 1195-96.
Recognizing that victim restitution serves the dual purpose of compensating victims and punishing criminals, this Comment suggests a review of the current law on the taxation of victim restitution in gross income. First, although victim restitution is associated with punishment, it is not the same as punitive damages in the sense that awards of punitive damages are oftentimes astronomical and clearly windfall income. Victim restitution, on the contrary, is measured by the victim’s loss and does not overcompensate. Victim restitution is considered punishment only in the sense that it is awarded in a criminal justice system with the goals of social reform. In other words, it bears a penal character only because it is imposed as part of the defendant’s criminal sentence, and not because of how the award is measured. Irrespective of being branded as punitive, the amount ordered is dictated by the victim’s loss and not by principles governing punitive damages.

Victim restitution’s other function—compensation—should therefore be the overriding principle governing its taxation. Because victim restitution serves to compensate for loss to the plaintiff, it is akin to compensatory damages and thus must be acknowledged under section 104(a)(2). In light of victim restitution’s dual purpose to compensate and punish, the disparate tax treatment of similarly situated victims can be resolved by opening the door to a section 104(a)(2) exclusion for the victim based upon its compensatory nature.

A. Toward Uniformity: Excludible by the Victim Under Section 104(a)(2)

This Comment is primarily focused on the plight of victims and how victim restitution has been discriminatorily excluded from section 104(a)(2) analysis. The most straightforward and equitable approach to correcting the tax disparity between similarly situated victims is to allow the same section 104(a)(2) exclusion for a

120. See Miller, supra note 100, at 196.
122. See supra Part III.B.
123. See Procedural Analysis, supra note 104, at 939.
124. See Von Roeder, supra note 98, at 677.
recovery, irrespective of the court from which it originates or what the recovery is called, so long as it is compensation or compensation like. The treatment of victim restitution under section 104(a)(2) should be no different than the treatment of compensatory damages if the action had been brought as a tort case instead of a criminal one. In other words, if the recovery of victim restitution in the form of compensatory damages from a civil suit is excludible, then it should be excludible in a criminal proceeding as well.

Victim restitution should undergo the same substantive analysis for determining taxability as applied to compensatory damages without regard to the linguistic ambiguity arising from it characterization as restitution. Although the language of section 104(a)(2) explicitly limits the rule to personal physical injury damage awards, the term damages should not be so narrowly construed as to exclude other kinds of recoveries that serve the same purpose as compensatory damages for physical injury. The scope of the statute should be broadened to apply to any type of recovery that is compensatory in nature; nonetheless, it should be subject to the existing statutory requirement that the recovery originate from personal physical injuries or sicknesses.

1. Origination in tort-type rights

Revisiting the test set forth in Schleier, one finds that victim restitution for personal physical injuries, like compensatory damage for personal physical injuries, meets the requirements for excludability under section 104(a)(2). The second-prong requirement that the taxpayer recover for personal physical injury or sickness is satisfied because at issue is victim restitution for personal physical injury. Therefore, the core analysis lies in the first

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125. Section 104(a)(2) does not provide a blanket exclusion for all kinds of damage awards, but rather is limited to only those amounts received on account of personal injuries or sickness. See I.R.C. § 104(a)(2) (1994 & Supp 2000).


127. See supra Part II.B.2.
prong of the Schleier test—whether the underlying cause of action giving rise to the recovery is based upon tort or tort-type rights. 128

What is the underlying cause of action giving rise to a recovery of victim restitution? One answer is that it is a cause of action for restitution based on the theory of unjust enrichment, and thus, not based on tort rights. That assertion, however, is unfounded because victim restitution is not the same and cannot be mistaken for the law of restitution and unjust enrichment. 129 As mentioned earlier in this Comment and affirmed by the Restatement of Restitution, court-ordered restitution against a convicted criminal “is not part of the law of restitution.” 130

On the contrary, victim restitution, although imposed by criminal sanctions, has its basis in civil liability and tort-type rights. 131 As discussed earlier, victim restitution is not only a criminal sanction but is also a civil remedy. 132 This interplay in victim restitution has been considered by some commentators to be an entirely “new paradigm” 133 in the criminal justice system which seems to “collapse the distinction between crimes and torts” 134 since both call for damages. 135 When a victim of crime recovers restitution for injuries to his person, it is compensation originating from the right to recover losses of tort-based interests in personal integrity. 136 Indeed, victim restitution, like compensatory damages for personal physical injuries, is based upon tort-type rights ultimately meeting the Schleier test, and therefore, should qualify for exclusion under section 104(a)(2). 137

129. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. h (Discussion Draft 2000).
130. Id.; see supra Part III.B.
131. See supra Part III.A.
132. See supra Part III.B.
135. See A New Paradigm, supra note 133, at 299.
136. See supra note 116 and accompanying text.
137. This Comment advocates uniformity and consistency in analyzing recoveries under section 104(a)(2). Although the Schleier test has been frequently referred to in analyzing recoveries, it is not the only standard available. The thesis of this Comment is not to advocate one particular test
2. A recovery of capital

Excludability is further justified by the capital recovery theory. Personal injury recoveries have, for a long time, been held to be a nontaxable return of human capital; that is, one's basis in his person. Generally speaking, basis recovery is permitted before taxation begins. Only if and when basis is fully replaced will capital recoveries result in taxable income. With respect to victim restitution and compensatory damages, they are equal to a basis recovery in the plaintiff's injured human capital. Thus, such a recovery represents an absolute return of capital, which is not taxable under the basis recovery rules. Under the human capital concept, "investors in human capital would take an immediate deduction for their costs and would include all of their returns when realized." A person who has something (capital), loses it (actual loss or damage), and then recovers it (judgment or settlement) does not have an "accession to wealth" under the notion of Glenshaw Glass. Simply stated, the taxpayer has not received anything more than what he had originally—the monetary recovery merely restores the victim to his status quo.

3. The rule of offset suggests victim restitution is comparable to compensatory damages

Finally, and perhaps most convincingly, the rule of offset strongly suggests that victim restitution is comparable to compensatory damages, and thus, the section 104(a)(2) exclusion

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over another; rather, it recommends that all recoveries that are compensatory in nature be afforded uniform and consistent analysis under section 104(a)(2), irrespective of the then-accepted standard.

138. The human capital concept is a controversial topic involving economic, practical, and moral problems in defining human capital. This Comment will only address the role it has on federal income tax, and will defer any remaining issues to other commentators.

139. In effect, accumulation of human capital occurs tax-free. Therefore, to the extent the award represents a mere restoration of capital, it is not income under section 61(a). See Raytheon Prod. Corp. v. Comm'r, 144 F.2d 110, 113 (1st Cir. 1944); Rev. Rul. 81-277, 1981-2 C.B. 14, 15.

140. See Morgan, supra note 14, at 887.


should apply. If victim restitution in a criminal proceeding and damages in a civil proceeding could be recovered in whole and independently from one another, then perhaps victim restitution and damages are really not the same. In fact, victim restitution and damages would be entirely different principles of recovery if one award could be received in its entirety, completely unaffected by the other.

The law, however, does not permit this kind of double recovery. The rule of offset maintains that "[a]ny amount paid to a victim under an order of restitution shall be reduced by any amount later recovered as compensatory damages." In other words, a victim can recover only one or the other, not both. If a victim received or will receive compensatory damages, then a victim restitution order will be reduced by that amount of damages. This double recovery preclusion for loss significantly confirms that victim restitution and compensatory damages are, in fact, parallel remedies. For purposes of defining the meaning and scope of section 104(a)(2), this rule of offset essentially identifies victim restitution as being like compensatory damages, and thus, should also be excludible under the statute.

B. Policy Considerations

In addition to the above-mentioned substantive reasons supporting the exclusion from gross income of victim restitution for personal injuries, the proposition also rests on compelling policy bases. These policy implications vary from civil procedure concerns against forum shopping to matters affecting the prosecution's criminal case in chief and the early justification of the section 104(a)(2) exclusionary provision itself—compassion for the victim.

1. Forum shopping

Section 104(a)(2) as it currently stands with reference only to damages, may encourage taxpayers to engage in forum shopping. To illustrate, under the statute it is clear that a plaintiff may take civil damages for personal injury tax-free, whereas it is not as obvious whether a similarly situated victim with comparable personal injuries would be subject to tax for crime victim restitution. The principal
basis for the potential separate tax treatment between the aforementioned plaintiffs is the forum in which the recovery is sought.

Because the section 104(a)(2) exclusion specifically applies only to damage recoveries, all other non-damage recoveries such as restitution might be ineligible for the exclusion and thus subject to tax. Hence, from a tax-planning standpoint, victims are better off foregoing restitution in a criminal proceeding and the uncertainty accompanying its taxation, and instead seeking damages in a civil suit. By virtue of venue and remedy shopping, a plaintiff can ensure the proper characterization of the recovery as damages, which are eligible for section 104(a)(2), by bringing an action in a civil court instead of a criminal court.

2. Collateral consequences affecting the prosecutor’s criminal case

In the abstract, a victim in the midst of a criminal proceeding who is aware of the tax consequences for a victim restitution recovery and knows about the offset rule may hurt the prosecutor’s criminal case. First, the rule of offset says that any amounts recovered in a criminal proceeding will be offset by any future compensatory damages in civil actions.144 If the victim plans to pursue a civil action in addition to being part of the state’s criminal case, the victim’s attorney in the civil suit would likely advise the victim of this offset limitation. With that knowledge, if the victim plans to pursue a civil suit, the victim might proceed through the criminal case with lackluster testimonies, knowing that whatever amount of victim restitution is ordered in the criminal case inevitably will be offset by compensatory damages later recovered in the civil suit. Furthermore, it is unlikely that the possibility of an acquittal would deter victims from such a lackadaisical mindset in the criminal proceeding because evidence of the defendant’s acquittal is not admissible in the victim’s subsequent civil action for damages.145 Thus, as a taxpayer, regardless of the outcome, the incentives for pursuing a victim restitution recovery are smaller than the incentives for pursuing a damages recovery.

144. See id.
145. See STARK & GOLDSTEIN, supra note 66, at 213.
Second, a plaintiff who is knowledgeable of the possible gross income exclusion of civil damages and aware of the uncertain tax consequences of victim restitution might be driven by self-interest to pursue the civil action more vigorously than the criminal proceeding. Again, plaintiff's knowledge of the tax consequences of a victim restitution recovery may have a detrimental effect on the prosecutor's case. That is, a taxpaying plaintiff would prefer to concentrate efforts in securing an award of tax-free civil damages, rather than expending energy on a criminal case that could generate victim restitution with its unclear tax consequences. Once again, a potential acquittal in the criminal case may be meaningless to the victim because such evidence cannot be introduced in the victim's subsequent civil suit for damages.

Overall, a victim's awareness of the possible tax consequences together with knowledge of the offset rule might compound to result in lackluster involvement by the victim in the prosecutor's criminal case. The offset rule, regrettably, cannot be eliminated if compensatory damages and victim restitution are to be treated the same under section 104(a)(2). If they are both compensation excludible from gross income under the statute, then the offset rule must remain as such to properly preclude double recovery.

The litigation tax consequences, however, can and should be modified to encompass not only damages, but also victim restitution as falling within the gross income exclusion under section 104(a)(2). By allowing victim restitution the benefit of the same gross income exclusion as applied to compensatory damages, then at least one of the damaging effects on the prosecutor's criminal case will no longer be a concern. In other words, if victim restitution becomes excludible from gross income, then there would be no tax advantage for the victim to pursue compensatory damages more vigorously than victim restitution.

Victims, then free of tax concerns, would have more incentive to be interested, and even aid the prosecutor in obtaining a conviction. While evidence of a defendant's acquittal is not admissible in a subsequent civil suit, evidence of a defendant's conviction is admissible. See id. at 213-14. Therefore, providing a section 104(a)(2) exclusion for victim restitution not only properly provides a gross income exclusion.
exclusion for all compensation recoveries, it also removes the tax disincentive that hinders a victim's proactive involvement in the prosecutor's criminal case. Absent a concern for the tax consequences of victim restitution received in the criminal proceeding, victims will then be uninhibited in zealously helping the prosecution obtain a conviction that will later be admissible in a civil action.

3. Compassion for the victim

More importantly, the plight of the victim cannot be forgotten. The policy justification for the section 104(a)(2) exclusion, compassion for the victim, has been an uncontested reason for excluding compensatory damages from taxable income and should be equally relevant to victim restitution. It cannot be denied that personally injured persons who receive victim restitution are not much different from plaintiffs who receive personal injury damages. Like the injured person suing for civil damages, victims of violent crimes who recover restitution in criminal court have suffered enough and ought not to be burdened with tax obligations. Unquestionably, the sexual assault victim and battery victim in the criminal setting does not suffer any less than the plain-vanilla tort victim injured, for example, by a fall to the ground after having her chair pulled out from under her.\textsuperscript{147} Therefore, on historical policy grounds, both victims should receive those recoveries tax-free.

Finally, victims of crime are too often plagued by problems beyond their control that prevent a successful victim restitution recovery. Seeking victim restitution in the criminal justice system has two main drawbacks. First and foremost, the defendant must be arrested, charged and convicted before the victim can recover.\textsuperscript{148} Second, asking for victim restitution may be futile unless the convicted criminal defendant has the means to pay and the restitution order is enforced.\textsuperscript{149} In light of the various arguments previously raised in this Comment for the excludability of victim restitution, in the narrow circumstances where victims are able to overcome those

\textsuperscript{147} See, e.g., Garratt v. Dailey, 304 P.2d 681 (1956) (exemplifying the similarity between a tort and a criminal victim).
\textsuperscript{148} See Roland, supra note 113, at 42.
\textsuperscript{149} See id.
stumbling blocks and are successful in recovering restitution, the fruits of such an effort should not be taken away by the Code.

C. Recommendations

The principal materials for the study of tax law—the Code and the Regulations—must provide uniformity and consistency in the taxation of recoveries received. Although it is apparent that damages may be excludible income under section 104(a)(2), nothing in the Code or Regulations address other recoveries such as victim restitution. Treasury rulings—both Revenue rulings and letter rulings—intermittently determine that certain payments to victims are nontaxable.\^150 There is, however, a need for more controlling authority on point. This Comment recommends that the primary sources of tax authority, the Code and the Regulations, be amended to reflect the Treasury rulings and Congress’ broad interpretation of section 104(a)(2) as extending to not only recoveries labeled damages, but to all personal injury recoveries that are compensatory in nature.

As mentioned earlier, Treasury rulings concluding the exclusion of victim compensation from gross income cannot be relied upon as precedent for the excludability of victim restitution under section 104(a)(2).\^151 These rulings, however, may be used as persuasive authority for the proposition that victim restitution should likewise be excludible under section 104(a)(2) and also for the adoption of a broader reading of the statute. Although not labeled as damages, rulings that victim compensation is nontaxable seem to indicate that section 104(a)(2) was intended to be construed broadly to encompass not only damages, but any personal physical injury recoveries which were compensatory.

Most recently, President George W. Bush signed the September 11th Victim Compensation Fund of 2001\^152 (the “Fund”) after the September 11 terrorist attacks on New York City and Washington,

\^151. See supra Part II.B.3.
The Fund is designed to provide compensation to eligible individuals who were physically injured as a result of the September 11th attacks. Kenneth R. Feinberg, the Special Master appointed by the Attorney General to administer the Fund, anticipated that under Code section 104(a)(2), “all awards from the Fund will be free of federal taxation.” One of the eligibility requirements for the Fund is that the individual “suffered physical harm or death as a result of one of the terrorist-related air crashes.”

Feinberg’s anticipation of the tax consequences to recipients of the Fund seems to suggest that Congress did not intend for section 104(a)(2) to only apply to receipts labeled damages. In a statement by Feinberg, he reiterated, “compensation will be provided ... for losses caused on account of personal physical injuries.” Receipts from the Fund are called compensation and not damages, and yet, there is anticipation that a non-damages recovery will enjoy section 104(a)(2) treatment.

This is a strong indication that Congress construes the term damages in section 104(a)(2) broadly, including both damages and damage-like recoveries. If in the coming taxable years we see receipts from the Fund being widely recognized within the applicability of section 104(a)(2), then it may be safe to infer that Congress has taken the broad view that the statute cannot be taken to be limited to recoveries literally named as damages. Therefore, to provide certainty in the application of section 104(a)(2) to all recoveries that are like damages—i.e., compensatory in nature—the Code and the Regulations must be revised to reflect more uniform laws on the taxation of recoveries.

153. On September 11, 2001, four American jetliners were seized by terrorists. Two of the jetliners were flown into the World Trade Center towers, the third crashed into the Pentagon, and a fourth plane went down in rural Pennsylvania. See Serge Schmemann, U.S. Attacked; President Vows to Exact Punishment for ‘Evil’, N.Y. TIMES, Sept. 12, 2001, at A1.
155. Id.
156. Id. at 66,276.
157. Id. at 66,275 (emphasis added).
1. Code section 104(a)(2)

The door to a section 104(a)(2) exclusion can be opened by amending the statutory language of the Code section itself. Section 104(a)(2) currently reads: Gross income does not include "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness."\(^{158}\)

The problem lies in the ambiguous reference to damages. One possible remedy is, following "damages (other than punitive damages)," Congress may insert the phrase, "compensation, or compensation-like recoveries." The amended statute would then read: Gross income does not include the amount of any damages (other than punitive damages), compensation, or compensation-like recoveries received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness.

In effect, the statutory exclusion would then apply to any amounts that are compensatory in nature irrespective of their name. Because victim restitution is measured by the plaintiff's loss, it is compensation-like and thus excludible from the recipient's gross income so long as it is received on account of personal physical injuries or sickness.

2. Treasury Regulation section 1.104-1(c)

The corresponding Treasury Regulation could also be revised to allow a section 104(a)(2) exclusion. Regulation section 1.104-1(c) currently reads:

Section 104(a)(2) excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term ‘damages received (whether by suit or agreement)’ means an amount received (other than workmen's compensation) 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.\(^{159}\)

\(^{159}\) Treas. Reg. § 1.104-1(c) (2002).
Regulations allow for more explanatory language and thus would be very effective in giving meaning to damages referred to under the statute. A sentence may simply be inserted at the end of the existing language as follows: “The term ‘damages’ is not exhaustive but includes any other amounts received which are compensation or compensation-like, whether received in a civil action or a criminal proceeding.” Under the same reasoning mentioned before, victim restitution would then be excludible under section 104(a)(2) according to the Regulation since victim restitution falls within the compensation-like category.

V. CONCLUSION

Since crime victim restitution emerged in the VWPA in 1982, the plight of victims has been heeded. Victims can recover not only in a civil judgment, but at last they are able to recover compensation from their offender as part of a criminal sentence. The contour of victim restitution is best viewed as a “compensatory remedy inserted into the penal framework of the federal criminal justice system.”\(^{160}\) Without regard to semantics, victim restitution is compensatory damages but with an independent basis in criminal punishment.

In light of victim restitution’s dual purpose in punishment and more importantly in compensation, a moment must be taken to reassess section 104(a)(2) and its isolated reference to damages. Recognizing that the statute was created with recoveries of compensation in mind, lawmakers must give effect to the fact that not only personal injury compensatory damages, but also personal injury victim restitution, is compensation. It would appear inequitable for section 104(a)(2) to apply to compensatory damages but not to victim restitution when the underlying nature of both recoveries is to compensate victims for loss.

In sum, there is a need for definitional precision in the Code. For equitable reasons, the Code must once and for all address victim restitution and give meaning to the term damages in section 104. I propose that Congress amend section 104(a)(2) to expressly include compensation and compensation-like recoveries such as victim restitution under its statutory exclusion from gross income. In the

160. Von Roeder, supra note 98, at 683 (examining the legislative history of the VWPA which supports this conclusion).
alternative, the IRS could prescribe a Treasury Regulation carving out a definition of damages under section 104(a)(2) to include victim restitution. Either method would equally serve to broaden the scope of section 104(a)(2) and allow crime victims the benefit of the statutory exclusion such that they would receive recoveries of victim restitution on account of personal physical injuries tax-free. To allow section 104 to remain in its current and unaltered form is basically acquiescing to an unjust penalty on the victim via tax imposition.

Linda Trang*