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Tax Records in USERRA Cases: How Both Parties May Obtain Each Other's Private Financial Records

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1.4--USERRA Enforcement
6.0--Military Service and Tax Laws

Q: I represent a veteran in a USERRA case where the defendant is requesting discovery of my client's tax returns. I understand having to provide pay stubs to support the claim for damages, but are tax returns discoverable? Can I assert a privilege to protect the veteran's private financial records? Even if those are discoverable, does that mean I can request the same records from the defendant?

A: The short answers are: Yes, tax returns and other private financial record can be discoverable. Yes, you could assert a privilege, but it is not an absolute privilege.[2] And, for the same reasons, plus a few more, yes, you actually could obtain defendant's financial records too.

For the sake of other readers: A plaintiff's financial records are often discoverable under the rules that govern federal cases. The Federal Rules of Civil Procedure permit broad discovery of information "reasonably calculated to lead to the discovery of admissible evidence." Fed. R. Civ. P. 26(b)(1). Under the rule, a "party may obtain discovery regarding any non-privileged matter that is relevant to any party's claim or defense […] including any documents or other tangible things." *Id.* Fed.R.Civ.P. 33 authorizes a party to serve any party a written interrogatory relating to "any matter that may be inquired into under Rule 26." *Ibid.* Likewise, Fed.R.Civ.P. 34 provides that a party may, within the scope of Rule 26(b) serve on any party a request to produce copies of relevant documents that are in the responding party's "possession, custody or control." *Ibid.*

Q: Can I assert a privilege to protect the veteran's private financial records?

A: Even though financial records are somewhat private, copies of corporate financial records and tax returns held by the taxpayer are relevant and discoverable in private civil litigation. *St. Regis Paper Co. V. United States*, 368 U.S. 208, 218, 82 S. Ct. 289, 7 L. Ed. 2d 240 (1961); *Young v. United States*, 149 F.R.D. 199, 201 (S.D. Cal 1993). "Tax returns do not enjoy an absolute privilege from discovery" in the Ninth Circuit. *Premium Service Corp. v. Sperry & Hutchinson Co.,* 511 F.2d 225, 229 (9th Cir. 1975). Tax returns are subject to discovery when they are relevant and there is a compelling need for the returns because their information is not otherwise readily attainable from an alternative source. *Sneller v. City of Bainbridge Island*, No. 07-05338 RBL, 2008 U.S. Dist. LEXIS 83573 (W.D. Wash. Oct. 7, 2008). The party seeking discovery has the burden of showing relevancy, while the party resisting discovery has the burden of identifying the alternative source of information. *Melendez v. Gulf Vessel Mgmt.*, 2010 U.S. Dist. LEXIS 80713 (W.D. Wash. July 1, 2010).

In a typical USERRA case, both the plaintiff and defendant will attempt to use a plaintiff's financial records as evidence of damages because it is very likely that only the plaintiff (as well as a defendant) will have possession or custody of their own financial records. A plaintiff uses the records in support of their expert's report on damages. On the other hand, the defendant would obtain the records in an effort to show that the plaintiff failed to mitigate damages, or to undermine the amount that the plaintiff claims.[3] Thus, a plaintiff's financial records would be discoverable because they are relevant to damages.

Q: What about the defendant's financial records?

A: The answer is not as straight forward as it would be for a plaintiff's financial records. However, a defendant's wealth is relevant to the issue of the amount of liquidated damages for willful violation of USERRA.

A discrimination claim under USERRA, 38 U.S.C. § 4311 is a federal tort. *Staub v. Proctor Hosp.*, 131 S. Ct. 1186 (U.S. 2011)(Describing a USERRA discrimination claim under 38 U.S.C. § 4311 as a federal tort); When Congress creates a federal tort it adopts the background of general tort law. *Id.*; *See also Safeco Ins. Co. of America v. Burr*, 551 U.S. Further, a damage action for willful violations of USERRA is analogous to any number of tort actions recognized at common law, and "more important, liquidated damages is the traditional form of relief offered in the courts of law." *Maher v. City of Chicago*, 463 F. Supp. 2d 837, 844 (N.D. Ill. 2006) (citation omitted).

In tort law, evidence of a tortfeasor's wealth is traditionally admissible as a measure of the amount of punitive damages that should be awarded. *City of Newport v. Fact Concerts, Inc.*, 453 U.S. 270, 101 S.Ct. 2748 (1981); *see also*Restatement (Second) of Torts § 908 (1978). The Supreme Court has consistently held that broad discretion is accorded to juries in assessing the amount of punitive damages. *Electrical Workers* v. *Foust*, 442 U.S. 42, 50-51 (1979); *Gertz* v. *Robert Welch, Inc*., 418 U.S. 323, 349-350 (1974).

Right now you might be saying, "but liquidated damages are not punitive damages."

Liquidated damages under USERRA 38 U.S.C. § 4323 are punitive. *Maher,* 463 F. Supp. 2d at 844; *cf. Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742, 764, 118 S. Ct. 2257, 141 L. Ed. 2d 633 (1998). Punitive damages are intended to punish the wrongdoer in such a manner that they would be hesitant to engage in the wrongful conduct ever again. *See City of Newport*, 453 U.S. at 270. A jury is permitted to assess punitive damages in an action when it involves reckless or callous indifference to the federally protected rights of others. *Smith v. Wade*, 461 U.S. 30, 56 (U.S. 1983). Accordingly, when a USERRA plaintiff is seeking liquidated damages for a willful violation of the USERRA, they have just as much right to the defendant's financial records as the defendant would have to the plaintiff's.

There are a couple catches though. First, USERRA liquidated damages are limited to the amount the plaintiff is awarded for lost wages and benefits. So, if a plaintiff proves liability and a willful violation, the sum of the damages that they can receive is capped at two (2x) times the value of their lost wages and benefits. Second, the court has discretion in awarding liquidated damages. 38 U.S.C. §4323(d)(1)(C) states "the court **may** require the employer to […] pay liquidated damages." *Ibid.* That discretion allows the court to award partial or full liquidated damages. In other words, there is some wiggle room, and the plaintiff must be prepared to persuade the court why full liquidated damages are needed.

Although the USERRA limits liquidated damages and grants the court some discretion, this does not mean that a wrongdoer's wealth is not relevant to the court's consideration of liquidated damages. *C.f. City of Newport*, 453 U.S. 270. In fact, a court considering whether punitive damages are appropriate in a particular case may consider many factors which necessarily require disclosure of the defendant's financial records, including: the profitability to the defendant of the wrongful conduct; the desirability of removing that profit and of having the defendant also sustain a loss; and the financial position of the defendant. *See Martinez v. Tully*, 1994 U.S. Dist. LEXIS 20935, 36-37 (E.D. Cal. Sept. 23, 1994).

Using these factors to assess liquidated damages makes sense because, if liquidated damages are intended to curb future behavior, then there needs to be some sting associated with them. For example, if the profitability of a defendant's wrongful conduct is high, then full liquidated damages would help remove that profit. Similarly, if the financial position of the defendant really is not going to change under straight compensatory damages, then an award of full liquidated damages may cause the defendant to sustain a loss, and thereby serve as an incentive not to violate the USERRA in the future.

In sum, you know that the defendant's attorney is not going to just hand those records over without a fight. If you really want the defendant's private financial records then you are probably going to have to show the court why those records fit within the scope of discovery. Those records would be relevant, admissible, and helpful to the determination of willful/liquidated damages. But, plan on having to get over a couple hurdles; showing why liquidated damages under the USERRA are punitive, and how the principles of tort law apply equally in USERRA cases.

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[2] A privilege is special legal right that exempts a person from being compelled to do something. For example, the attorney-client privilege protects the client (and attorney) from being compelled to disclose information shared between them.

[3] If you are involved in a wrongful termination lawsuit, you should expect that the defendant will demand copies of your tax returns. When you file your income tax return, you have a legal duty to report ALL the income. If a defendant learns that you received income and did not report it on your taxes, you can be sure that they will try to use that information against you in the case. These are just a couple reasons why working off the books, or not reporting income, is not wise.