INCOME TAXES AND PERSONAL INJURY AWARDS

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> "It is doubtful that it is possible to fool juries into doing useful things when they are not apprised of the ends to be accomplished and are only given control of the means." Morris, Punitive Damages in Tort Cases, 44 Harv. L. Rev. 1173, 1203 (1931).

The last ten years have witnessed the rise of a new problem caused by federal income tax legislation—only this time the problem is caused because the tax does not have to be paid. Reference is made, of course, to the impact of the Internal Revenue Code of 1954, section 104, on personal injury awards. This section provides in part:

> (a) In General.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—
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> . . .
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> (2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. . . .

Thus, whenever a person receives an amount of money through the prosecution of a cause of action based upon tort (or upon "tort-type" rights) or through a settlement agreement entered into in lieu of prosecuting such a cause, that sum of money is not taxable to the recipient.[1]

For more than twenty-five years this section of the Code was not seriously pressed by the bar in connection with the actual trial of a personal injury case. Undoubtedly the lower rates and the limited incidence of the income tax made this decision understandable. However, the 1940's brought two extremely significant changes: a marked increase in the number of taxpayers and an even more marked tax burden on each taxpayer. These caused defense attorneys to begin pressing the court with the effect that section 104 of the Internal Revenue Code should have on the trial of personal injury cases.

These attempts have had two thrusts:[2]

1. Defense attorneys have sought to introduce evidence of the amount of federal income tax that the plaintiff was

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[1] Internal Revenue Regulations §1.104-1(c). For an excellent discussion of the problem of this article from the standpoint of the income tax policies, see Cutler, *Taxation of the Proceeds of Litigation,* 57 COLUM. L. REV. 470 (1957).

Punitive damages and interest on a personal injury judgment are generally taxable and thus fall outside the scope of this article. *Ibid,* 57 COLUM. L. REV. 470, 473 (1957), footnotes 12 and 13.

[2] Arguments made in this article apply also to the impact on tort damages of state and local income tax laws which contain an exclusion similar to I.R.C. §104(a)(2).

paying prior to his injuries. The purpose of such evidence is to decrease the "gross income" evidence introduced by the plaintiff and thus to decrease the amount of one of the principal factors which determine the size of the final award.

2. Defense attorneys have requested an instruction which states, in effect, that any award made to the plaintiff will not be subject to federal income tax. The avowed purpose of such a request is to prevent a jury from adding to an award (which has already been calculated in accordance with the general measure of damages) an amount which it erroneously believes that the plaintiff will be called upon to pay for income taxes.

In both instances these attempts have met with little success. To date, the majority of decisions has refused the evidence as well as the instruction.[3] The purpose of this article is to examine the principal cases in these areas and to suggest a confusion that has unnecessarily confounded the results. These two problems will be discussed separately and will then be contrasted at the close of this article.

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[3] *Refusing to allow evidence of income tax:* Briggs v. Chicago Great Western Railway Company, 248 Minn. 418, 80 N.W.2d 625 (1957) (dictum); Hall v. Chicago & North Western Ry. Co., 5 Ill. 2d 135, 125 N.E.2d 77 (1955); Leming v. Oil Fields Trucking Co., 44 Cal. 2d 343, 282 P.2d 23 (1955) (dictum); Texas & N.O.R. Co. v. Pool 263 S.W.2d 582 (Texas Civ. App. 1953); Pfister v. City of Cleveland, 96 Ohio App. 185, 113 N.E.2d 366 (1953) (dictum); Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952); Smith v. Pennsylvania Rd. Co., 59 Ohio L. Abs. 282, 99 N.E.2d 501 (1950); Stokes v. United States, 144 F.2d 82 (2d Cir. 1944); Combs v. Chicago, St. P., M. and O. Ry. Co., 135 F. Supp. 750 (N. D. Iowa 1955) (dictum); Runnels v. City of Douglas, Alaska, 124 F. Supp. 657 (D. Alaska 1954); O'Donnell v. Great Northern Ry. Co., 109 F. Supp. 590 (N.D. Cal. 1951); Chicago & N.W. Ry. Co. v. Curl, 178 F.2d 497 (8th Cir. 1949). *Allowing such evidence to be introduced:* British Transport Commission v. Gourley [1955] 3 All E.R. 796; Southern Pac. Co. v. Guthrie, 180 F.2d 295 (9th Cir. 1949), but see discussion in 186 F.2d 926 (1951); Armentrout v. Virginian Ry. Co., 72 F. Supp. 997 (S.D.W. Va. 1947) *rev'd on other grounds*, 166 F.2d 400 (4th Cir. 1948). Wrongful death cases present a different problem because they depend on statutes which often adopt a "contributions" or "savings" test. See OHIO REV. CODE §2125.02. Cf. De Vito v. United Air Lines, Inc., 98 F. Supp. 88, 98 (E.D. N. Y. 1951); Wetherbee v. Elgin, Joliet & Eastern Ry. Co., 191 F.2d 302 (7th Cir. 1951); Smith v. Pennsylvania Rd. Co., *supra*.

Refusing to allow instruction: Briggs v. Great Western Railway Co., 248 Minn. 418, 80 N.W.2d 625 (1957); Missouri-Kansas-Texas Railroad Company v. McFerrin 291 S.W.2d 931 (Tex. 1956); Maus v. The New York, Chicago & St. Louis Rd. Co., 165 Ohio St. 281, 135 N.E.2d 253 (1956); Highshew v. Kushto 235 Ind. 505, 134 N.E.2d 555 (1956); Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034 (1956) (pain and suffering); Atlantic Coast Line v. Brown, 93 Ga. App. 805, 92 S.E.2d 874 (1956); Atherly v. MacDonald, Young & Nelson, Inc., 142 Cal. App. 2d 575, 298 P.2d 700 (1956); Hall v. Chicago & North Western Ry. Co., 5 Ill. 2d 135, 125 N.E.2d 77 (1955) (comment to jury by counsel); Combs v. Chicago, St. Paul, Minnesota and Omaha Ry. Co., 135 F. Supp. 750 (N.D. Iowa 1955). *Allowing the instruction:* Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952), overruling Hilton v. Thompson, 360 Mo. 177, 227 S.W.2d 675 (1950); *Atherly* case, *supra*, where court indicated that "even though it would have been proper to give the proffered instruction, it was not reversible error to fail to do so."

Before doing this, however, it is interesting to notice how these problems have grown since 1944. The earliest reported American cases come one from Nebraska[4] and one from the Second Circuit.[5] The Second Circuit case involved an attempt by the defendant to introduce evidence of the amount of taxes that the libellant—who was suing for permanent injuries—would have had to pay had he not been injured and had he been able to go on working. This was refused by the trial judge, thus presenting a case of the first type mentioned above. Judge Frank, writing the Court's opinion, affirmed with one sentence:

> We see no error in the refusal to make a deduction for income taxes in the estimate of libellant's expected earnings; such deductions are too conjectural.[6]

In the Nebraska case, the jury during its deliberations inquired of the judge whether a recovery by the plaintiff was subject to income taxes. The trial judge stated that he would give no instruction on this subject, raising the second type of case. On appeal to the Supreme Court of Nebraska his position was affirmed, the court saying: "We observe nothing in this which could have prejudiced either one of the parties." However, it appears that this sentence refers, not to the failure to instruct the jury or to answer the jury's question, but to the method by which the judge informed the jury that he was refusing to answer its question.[7] Thus, the reviewing court (and probably the attorney for the defendant) did not think the problem serious enough that it be considered on its merits.

Compare these two brief references to the lengthy opinions that have recently been handed down by the Supreme Courts of Missouri,[8] Illinois[9] and Ohio,[10] as well as the numerous articles that have appeared in law reviews during the last five years.[11] Clearly this is an area of the law that is being subjected to increasing pressures. In these formative years the problems presented need to be closely scrutinized by the lawyers

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[4] Crecelius v. Gamble-Skogmo, Inc., 144 Neb. 394, 13 N.W.2d 627 (1944). The earliest case is Fairholme v. Firth & Brown, Ltd. [1933] 49 T.L.R. 470, an English case. The present United Kingdom law is ably discussed in 34 CAN. BAR REV. 940 (1956).

[5] Stokes v. United States, 144 F.2d 82 (2d Cir. 1944).

[6] 144 F.2d 82, 87. Cf. treatment of tax factor in alimony cases. 153 A.L.R. 1041.

[7] The statement was made to the jury through the bailiff.

[8] Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952) (evidence and instruction).

[9] Hall v. Chicago & North Western Ry. Co., 5 Ill. 2d 135, 125 N.E.2d 77 (1955) (comment to jury).

[10] Maus v. The New York, Chicago & St. Louis Rd. Co., 165 Ohio St. 284, 128 N.E.2d 166 (1956) (instruction).

[11] See, for example, DeParq and Wright, *Damages under the Federal Employers' Liability Act,* 17 OHIO ST. L.J. 430, 435, 466 (1956); 11 MIAMI L.Q. 304 (1957); 24 INS. COUNSEL JOUR. 70 (1957); 74 SO. AFR. L.J. 88 (1957); 26 FORD. L. REV. 98 (1957); 35 NO. CAR. L. REV. 401 (1957); 4 U.C.L.A. L. REV., 636 (1957); 10 S.W. L. J. 80 (1956); 69 HARV. L. REV. 1495 (1956); 9 VAND. L. REV. 543

and by the courts; poor analysis will lead only to meaningless distinctions and needless overruling in later years.[12]

I

MEASURE OF DAMAGES

When a plaintiff has been injured through the acts of the defendant in such a manner that the substantive elements of a tort exist, the law of damages strives to compensate him for those injuries.[13] Because of those injuries, certain elements have been *taken from* the plaintiff which he would have had had it not been for the injuries (e.g., his wages) and other elements have been *thrust upon* him which he would not have had had it not been for the injuries (e.g., his medical expenses). The law of damages attempts to compensate for both of these items. Typical language is found in an early Ohio case:

> . . . . It is a recognized and established principle of the law of torts, founded as we think in sound reason, that the compensation awarded to one who is injured, either in person or property, by the wrongful and unlawful act of another, shall at least be equivalent to, and should in all cases be commensurate with, the loss or injury actually sustained. . . .[14]

Items of recovery falling within these legally protected areas are limitless. Varying combinations of facts produce varying injuries. However, for the purpose of this article we can concern ourselves with the more typical situations, leaving the atypical for later discussion.[15]

In the vast number of tort recoveries, the measure of damages embraces these four categories: (1) the reasonable value of medical

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(1956); 25 U. CIN. L. REV. 385 (1956); 42 IOWA L. REV. 134 (1956); 44 KY. L.J. 384 (1956); 15 OHIO ST. L.J. 81 (1954); 11 WASH. & LEE L. REV. 66 (1954); 32 TEXAS L. REV. 108 (1953); 21 U. CHI. L. REV. 156 (1953); 42 GEO. L.J. 149 (1953); 8 ARK. L. REV. 174 (1953); 33 B. U. L. REV. 114 (1953); 32 NEB. L. REV. 491 (1953).

[12]See British Transport Commission v. Gourley [1955] 3 All E.R. 796 overruling Billingham v. Hughes [1949] 1 K.B. 643, 9 A.L.R.2d 311; Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952) overruling Hilton v. Thompson, 360 Mo. 177, 227 S.W.2d 675 (1950). Examples of this principle can be drawn from every newer area of the law. See expression of this idea in Cheatham and Reese, *Choice of the Applicable Law,* 52 COLUM. L. REV. 959 (1952).

[13]See cases cited in MCCORMICK, DAMAGES §1 and footnote 2 to §137 and p. 560 (1935).

[14] Mahoning Valley Railway Co. v. DePascale, 70 Ohio St. 179, 187, 71 N.E. 633 (1904). See also 4 RESTATEMENT, TORTS §924. But see the pointed challenge by Jaffe in his excellent article in 18 LAW & CONTEMP. PROB. 219 (1953).

[15] For example, see cases involving: disfigurement, Smith v. Pittsburgh & W. Ry. Co., 90 Fed. 783 (N.D. Ohio 1898) and Davis v. Zucker, 62 Ohio L. Abs. 81, 106 N.E.2d 169 (1951); fright and humiliation, MCCORMICK, DAMAGES §88 (1935); aggravation of injury through negligence of physician, Tanner v. Epsey, 128 Ohio St. 82, 190 N.E. 229 (1934); Loeser v. Humphrey, 41 Ohio St. 378, 52 Am. Rep. 86 (1884); duty to consult physician, Sette v. Dakis, 133 Conn. 55, 48 A.2d 271 (1946); 11 A.L.R.2d 230.

expenses, past and future;[16] (2) compensation for pain and suffering, past and future;[17] (3) the value of plaintiff's lost time prior to the action;[18] and (4) the value of the decrease in plaintiff's future earning capacity.[19] These are present in varying degrees in different cases and no attempt is made here to refine the distinctions. Our concern is limited to the tax consequences of recoveries for these items. However, a brief look at the theory underlying (3) and (4) is necessary before those tax aspects can be considered.

Value of lost time

This is not a recovery for lost income; it is a recovery for the value of the time that a person has already lost because of the injuries.[20] The time itself has a value to the plaintiff; it has been taken from him by the negligence of the defendant; thus, the defendant must make compensation to the plaintiff. When the plaintiff is gainfully employed the distinction between time and income is usually academic because the measure of that lost time generally becomes that income.[21] However, when an unemployed[22] or an "already-compensated"[23] plain-

[16] Hunt v. Boston Terminal Co., 212 Mass. 99, 98 N.E. 786 (1912); Birmingham R. Light & P. Co. v. Girod, 164 Ala. 10, 51 So. 242 (1909); 4 RESTATEMENT, TORTS §919; 82 A.L.R. 1325. The value of future expenses is compensated at present worth. Mintz v. Atlantic Coast Line R. Co., 233 N.C. 607, 65 S.E.2d 120 (1951); Bartlebaugh v. Pennsylvania R. Co., 78 N.E.2d 410 (Ohio App. 1948) *mod. in* 150 Ohio St. 387, 82 N.E.2d 853 (1948). See also 13 A.L.R. 2d 353 for cases dealing with recovery when the plaintiff has received hospitalization or surgical insurance.

[17] See Plant, *Damages for Pain and Suffering,* 19 OHIO ST. L. J. 200 (1958); Littman v. Bell Telephone Co. of Pennsylvania, 315 Pa. 370, 172 Atl. 687 (1934); Pennsylvania Co. v. Files, 65 Ohio St. 403, 407, 62 N.E. 1047 (1901); 81 A.L.R. 423; 115 A.L.R. 1149. Compensation for future pain and suffering limited to life expectancy after the injury. Prairie Creek Coal Mining Co. v. Kitrell, 106 Ark. 138, 153 S.W. 89 (1912). Generally compensation for future pain and suffering is not reduced to present value. 28 A.L.R. 1181. But see Bartlebaugh v. Pennsylvania R. Co., 78 N.E.2d 410, 414 (Ohio App. 1948), *mod. in* 150 Ohio St. 387, 82 N.E.2d 853.

[18] See Denco Bus Lines v. Hargis, 204 Okla. 339, 229 P.2d 560, 562 (1951) and discussion *infra.*

[19] See discussion *infra.*

[20] MCCORMICK, DAMAGES §87 (1935).

[21] Dickson v. Queen City Coach Co., 233 N.C. 167, 63 S.E.2d 297 (1951); MCCORMICK, DAMAGES §87 (1935).

[22] Ihrie v. Anthony, 205 Md. 296, 107 A.2d 104 (1954); Blacklin v. McCarthy, 231 Minn. 303, 42 N.W.2d 881 (1950); Fotter v. Butler, 145 Me. 266, 75 A.2d 160 (1950); Cincinnati N.O. & T.P. Ry. Co. v. Perkins, 205 Ky. 798, 266 S.W.2d 652 (1924). The amount must be made reasonably certain; Jackson v. Choquette & Co., 78 R.I. 164, 80 A.2d 172 (1951).

[23] Hayes v. Morris, 98 Conn. 603, 119 Atl. 901 (1923) (wages continued as a gratuity); Shea v. Rettie, 287 Mass. 426, 192 N.E. 44 (1934) (wages continued as a matter of right); Johnson v. Kellam, 162 Va. 757, 175 S.E. 634 (1934) (plaintiff received insurance on account of injury); Truscon Steel Co. v. Trumbull Cliffs Furnace Co., 120 Ohio St. 394, 160 N.E. 687 (1927).

tiff is involved, the distinction has practical meaning for it can result in requiring the defendant to respond in damages even though, in one sense, no income has been lost.[24]

Value of the decrease in future earning capacity

Whenever the injury has caused a disability that will extend beyond the date of the trial, it is possible that the plaintiff's earning power in the future will be affected. When this type of disability has been shown, the plaintiff is entitled to further compensation—for his capacity to earn in the future has been taken from him, either in whole or in part. This area of recovery is concerned with "what a man would be able to earn in the future and his capacity to 'make good.' "[25] In its broad sense it is no more than a logical extension of the recovery for the value of his time lost in the past, with the date of the trial serving only as a reference point.

The *measure* of this item is more difficult however, because it involves the uncertainties of the future. In the first place it requires a showing that the injury has some form of permanence.[26] Then the plaintiff must go on to show the court how to value the diminution in his earning capacity. That involves not only the difficulties of attempting to prove how much this person, with his education and personal traits, would probably have been making in the future but it also requires a showing of how long he could have been expected to have continued earning such an amount.[27] This usually brings the plaintiff's attorney to life expectancy tables and the defendant's attorney to a consideration of the plaintiff's health as well as an argument that it is *work* and not *life* expectancy that should be used.[28]

If this were the end of the problem, the tax considerations would be relatively simple of solution. However, the plaintiff is not entitled to have his annual earning capacity decrease multiplied by his life expectancy and the resultant figure given to him in dollars and cents.[29] He is entitled to his earnings only as they would have been distributed

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[24] Not all courts allow all unemployed or compensated plaintiffs to recover. For example, some courts draw a line between gratuities and payments as a matter of right, holding that the latter must be mitigated. See e.g., Moon v. St. Louis Transit Co., 247 Mo. 227, 152 S.W. 303 (1912). This distinction is questionable since it is arguable that the employee actually paid for his contract right to have his wages continued by taking a lesser salary during the time he was working. Rigney v. Cincinnati Street Ry. Co., 99 Ohio App. 105, 58 N.E.2d 202 (1954). On the problem generally, see 18 A.L.R. 678 and 95 A.L.R. 575.

[25] Shaw v. Pacific Supply Co-operative, 166 Ore. 508, 113 P.2d 627 (1941).

[26] McCormick, Damages §86 (1935).

[27] There appears some question as to whether the expectancy of the plaintiff before or after injury is to be used, although the better view supports the former measure. McCormick, Damages §86 (1935); Hallada v. Great Northern Railway, 244 Minn. 81, 69 N.W.2d 673 (1955).

[28] Immel, *Actuarial Tables and Damage Awards*, 19 Ohio St. L.J. 240 (1958).

[29] 32 Neb. L. Rev. 583 (1953).

over his lifetime.[30] In short, the compensation for the decrease in future earning capacity must be reduced to its *present value.* In theory—and this theory will be important in understanding the thesis of this article —this is an attempt to award plaintiff that amount of money which, if invested at a reasonable return,[31] would annually give the plaintiff the value of the decrease in his earning capacity and which would, at the end of the determined expectancy, be reduced to zero value.[32] Naturally this is much less than merely multiplying the two factors together for it takes account of the fact that the judgment money earns interest each year.

It is not suggested that plaintiffs actually invest their awards in this manner. What they do with their judgments after they receive them has, under the traditional notion, been of no concern to the court. However, this theory is important since it is the method by which juries are supposed to have arrived at their verdicts and it is only on this theory that the problem of income taxation can be considered. When a jury uses a method which produces an excessive award, courts have no difficulty in setting it aside.[33]

With these few generalities as background, we are ready to expand the impact of federal income taxation on these awards.

II

Evidence of Income Tax

During the course of the trial the plaintiff will have introduced evidence of his income at the time of injury. This, of course, is admissible to help measure the value of his lost time, as well as the value of the decrease in his future earning capacity. It is these two elements of damages that are of concern in this section since they are measured by lost *income.* In order to have some figures before us, let us assume that the evidence shows that plaintiff was earning $10,000 a year prior to the injury and that he will not be able to earn another

30 Theoretically, the plaintiff is entitled to his future income at the same periods (i.e., weekly, monthly, etc.) as he would have earned it had it not been for the injury. However, the practice has been to make computations on an annual basis only.

31 This phrase is expressed differently by various courts. It is not necessary in this article to attempt an analysis of the rates used by courts in this country. The problem is annotated in 105 A.L.R. 234.

32 Bartlebaugh v. Pennsylvania R. Co., 150 Ohio St. 387, 82 N.E.2d 853 (1948). See annotation on duty to instruct jury in 77 A.L.R. 1440, supplemented in 154 A.L.R. 800.

33 Annot., 16 A.L.R.2d 3. See also annotation dealing with the effect of counsel's mention of wealth or poverty of client, 32 A.L.R.2d 9. In these cases the court generally requires a new trial because the jury's award is based on something other than the law of damages. The same result should follow if erroneous notions as to taxes produce an award based on something other than the law of damages.

dollar as long as he lives.[34] Thus we have reduced his earning capacity in the future to zero.

This "$10,000 a year" was, however, his gross earnings. Each year the plaintiff was undoubtedly required to pay a substantial portion of those earnings as income taxes. How much he paid depended, of course, on his exemptions and deductions as well as the tax rates, but under present rates this amount may easily exceed $1500 a year. Since any judgment comes to the plaintiff free of taxes,[35] the defendant is eager to show the amount of taxes that plaintiff was paying and to urge to the court that the difference between these amounts should be used in determining the size of the award. The "savings" to the defendant can be considerable, amounting in the assumed case to $40,000 or more if the plaintiff's expectancy exceeded thirty days.

This evidence of the amount of taxes paid could be sought to be introduced in many ways. It could be asked of the plaintiff on cross-examination, it could be directed to the actuary who has testified on the present worth of future income, or it could come from introduction of the plaintiff's tax return.[36] However, each is aimed at the same thing: getting before the jury the amount of the plaintiff's *net* income.

There is logic behind this attempt. The difference between what the plaintiff would have earned and the taxes he would have had to pay is the amount that the plaintiff has actually lost. Had it not been for the injury, he would have had to go on paying taxes as long as his income deductions and family status brought him within the provisions of the Internal Revenue Code; the primary purpose of this kind of recovery is to *compensate*—it is not to punish the defendant for his negligence;[37] and therefore it would appear that the evidence should be admitted.

The holding of the courts

Despite the logic of this position, the courts are nearly unanimous in holding that the gross rather than the net earnings of the plaintiff after taxes are to be given to the jury in aiding it to compute the amount of the plaintiff's loss.[38] When an attempt is made to search out the reasons for this holding, difficulties are encountered. The chief cause of these difficulties is that courts have confused this problem of introduction of evidence with the seemingly related one of whether the jury should be instructed that the award is excluded from the year's gross

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[34] This assumes a complete disability for life. A partial disability would involve the same question as presented in the remainder of this article; the only change would be in the amounts involved. See Baker v. Norris, 248 S.W.2d 870 (Kans. City Ct. of App. 1952) where plaintiff was earning as much money after the injury as he was before the injury.

[35] INTERNAL REVENUE CODE OF 1954 §104 quoted *supra*.

[36] See Reeves v. Pennsylvania R. Co. 80 F. Supp. 107 (D.C. Del. 1948).

[37] See note 13, *supra*.

[38] See cases cited in first paragraph of note 3, *supra*.

income in computing federal income taxes.[39] Their relation is only "seeming;" on their face they *appear* to be the same because both deal with taxes and the personal injury award. However, once analyzed, they present different problems and, therefore, the policies behind one are not necessarily relevant to the other.[40] It is this confusion that makes the reasons which underlie each difficult to separate. Nevertheless, it would appear that the following are most often in the court's mind when it refuses to admit the evidence:[41]

1. The impact of federal taxes is a matter between the plaintiff and the taxing authorities. The defendant has no interest in whether or not a tax is levied.
2. To allow the introduction of such evidence would upset a well-established precedent.
3. The amount of federal income tax is too conjectural to be considered by the jury.

These are worthy of individual consideration.

1. *The impact of federal taxes is a matter between the plaintiff and the taxing authorities.* This type of language is found in early English decisions[42] and has recently found its way into the American

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[39] Hall v. Chicago & North Western Ry. Co., 5 Ill. 2d 135, 149-152, 125 N.E.2d 77. (1955); Maus v. The New York Chicago & St. Louis Rd., 165 Ohio St. 281, 135 N.E.2d 253 (1956) (especially the discussion of the *Stokes* and *Combs* cases on page 284 of the opinion in 165 Ohio State Reports); 33 B.U.L. REV. 114 (1953).

[40] If Congress were to amend the portions of I.R.C. §104 relevant to tort awards and were to require inclusion of the amounts received in lieu of lost income in the injured person's annual gross income, there would then be an overlap between the two problems of introduction of evidence and request for an instruction. In that event the measure of damages should be so cast that it would not result in double taxation of lost earnings. From this, 69 HARV. L. REV. 1495 (1956) argues the present existence of a Congressional intent not to have taxation considered in any aspect in the damage action.

[41] Other reasons have been advanced, but only in isolated cases. For example, in 8 ARK. L. REV. 174, 175 these additional reasons were advanced as having stemmed from English cases: (1) "conceding tax liability on future earnings, the plaintiff would, nevertheless, have the use of his earnings until the successive due dates of such taxes" and (2) "tortfeasors who confine their wrongs to plaintiffs in the upper income brackets would practically escape liability by a plea that any award would represent income confiscated by the tax." Notice the feeling that people who do "wrongs" must be made to pay a substantial sum. As with the true collateral source cases, a feeling that the civil law should be used to *punish* takes over this area of torts. Perhaps this is not wholly without reason, Spokane Truck & Dray Co. v. Hoefer, 2 Wash. 45, 25 Pac. 1072 (1891), but it would be better for courts to face the problem directly rather than to talk about tortfeasors who "confine" their wrongs to upper income plaintiffs. How about those who injure only the low income plaintiffs or business men who earn "profits"? See Slagle, *The Role of Profits in Personal Injury Actions,* 19 Ohio St. L.J. 179 (1958). Should the need for *punishment* be less in these cases?

[42] Billingham v. Hughes [1949] 1 K.B. 643, 9 A.L.R.2d 317; Fine v. Toronto Transp. Commission 1945 Ont. Week. N. 901, 1 D.L.R. 221 (1946).

cases.[43] It has also been picked up by law review writers.[44] Here is an example of how it has been written in what has become the leading case denying both the evidence and the instruction:

> It is a general principle of law that in the trial of a lawsuit the status of the parties is immaterial. Thus, what the plaintiff does with an award, or how the defendant acquires the money with which to pay the award, is of no concern to the court or jury. Similarily, whether the plaintiff has to pay a tax on the award is a matter that concerns only the plaintiff and the government. The tort-feasor has no interest in such question, and the jury were to mitigate the damages of the plaintiff by reason of the income tax exemption accorded him, then the very Congressional intent of the income tax law to give an injured party a tax benefit would be nullified.[45]

It is true that this was written by the court in a part of its opinion that was supposedly dealing with the impropriety of a remark by counsel for the defendant in his closing argument to the jury when he stated that "whatever amount he [the plaintiff] receives by way of a verdict in this case is not subject to Federal income tax." As will be pointed out in the next section of this article, language of the type quoted above can have nothing to do with the propriety (or impropriety) of such a remark or of a charge on this subject. At this point the court has confused the effect of the introduction of evidence of the amount of tax being paid with the effect of an instruction that no tax is going to be levied on the award. However, the philosophy behind such a quotation is directly applicable to this first branch of our problem. Thus it is discussed at this point.

Notice that this statement regarding the impact of taxes has two ideas included within it. First, there is the notion that what a plaintiff does with an award after he received it is of no concern to the court. This, of course, correctly reflects what many courts have held. The measure of damages merely gives to the judge and to the jury *the method* by which an award is to be reached—in this case by determining the value of the plaintiff's lost time and the present worth of the decrease in his future earning capacity. After he has that award, plaintiff may invest in stocks that double in value or he may buy a worthless uranium mine. In either case, our system of law has said that this is of no concern to the court. The defendant has paid what *in theory* is owing to the plaintiff and that is all he will be called upon to do.

However, such a statement has no application to the problem in this section of the article. The statement assumes that the award *in theory* correctly measures the plaintiff's loss; if it does, then what he does with the money is up to him. But the statement does not attempt to determine

[43] Hall v. Chicago & North Western Railway Company, 5 Ill. 2d 135, 125 N.E.2d 77 (1955).

[44] 69 HARV. L. REV. 1495 (1956); 33 B.U. L. REV. 114, 115 (1953).

[45] *Hall* case, *supra* note 43, 5 Ill. 2d at pages 151-52.

how such an award is measured—and how to measure the award is the problem of this section. For example, the reasonable value of medical expenses is a proper item of damages in a tort action.[46] Whether the plaintiff actually pays them is of no concern to the court in that tort action. The defendant's duty is only that of reimbursing the plaintiff for the fair amount of those expenses. However, it does not follow that because the *payment* of these bills is "of no concern" of the court, that those bills are not to be considered in measuring the *size* of the award.

In short, this type of statement begs the question. We are still left with the problem with which we began: should the fact that plaintiff had to pay taxes on his earnings before the injury be considered by the jury in arriving at the size of the award?

The last part of the quotation has within it what actually appears to be concerning the court—and here is the second idea it expresses: this is a matter between the plaintiff and the government and to let the jury consider the plaintiff's income after taxes in determining the size of the award would be to nullify "the very Congressional intent . . . to give an injured party a tax benefit." Here the court has tried to make this problem parallel to the collateral source cases. If the plaintiff's bills or wages are paid by an outside source (such as insurance), this is collateral to the defendant and generally cannot be taken advantage of by him.[47] This assumes that Congress intended to give injured persons a benefit by exempting these awards under section 104 of the internal Revenue Code of 1954. Consider, however, these two answers:

First, exempting the *award*, once obtained, from inclusion in gross income does not necessarily have anything to do with an intention that the amount of taxes that the plaintiff was paying prior to the injury should or should not be considered by the jury in arriving at the *amount of the award*. It merely says that once the proper measure of damages has been used to arrive at the award, it will not be included in gross income for this or any other taxable year.

Second, this was not the intent—let alone the "very intent"—of Congress when the predecessor of section 104 was enacted. This provision did not appear in our tax laws until the Revenue Act of 1918.[48] It was included at that time—not to benefit injured parties—but because Congress thought that it was doubtful that tort damages were income within the meaning of the Sixteenth Amendment.[49] The

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[46] See note 16, *supra*.

[47] See Wells v. Minneapolis Baseball & Athletic Association, 122 Minn. 327, 142 N.W. 706 (1913); 13 A.L.R.2d 355; 43 GEO. L. REV. 515 (1955).

[48] Revenue Act of 1918, §213(b)(6), 40 STAT. 1066. This exclusion was for "damages received whether by suit or agreement on account of such injuries or sickness." The present statute is set out, *supra*.

[49] Early regulations promulgated by the Commissioner sought to tax amounts "received as the result of suit or compromise for personal injury"—likening them to proceeds of insurance. U.S. Treas. Reg. 33 (rev.) art. 4 §25 (1918). However,

exclusion was added to remove these doubts.[50] Perhaps it could be argued that the section was continued out of some benevolent motives, but evidence of these motives is hard to find.[51] This appears to be but another example of attributing a non-existent intent to a legislature to reach an already-decided-upon result. If so, we are still left searching for the reasons that have caused the courts to reach these results.

2. *Introduction of this evidence would upset a well-established precedent.* This, of course, has already been shown not to be the fact. It has only been the past decade that has witnessed any real activity in this area. "Well established precedents" are not that easily built. Yet, we find courts remarking:

> In my opinion, the claim of the defendants that tax should be taken into consideration in assessing damages should be rejected. I do not think this court ought to alter what has been the recognized practice for so long.[52]

and:

> There is no authority for deducting income tax at an estimated liability, in determining present value of future earnings.[53]

There are also cases in a similar vein that are contented to reach the same decision by merely citing another case[54] or advancing no real reason at all for the result.[55] A law review writer summed it up thus:

> . . . [T]o take income tax liability into consideration

a few weeks later the Attorney General, in response to an inquiry by the Treasury Department, stated that insurance proceeds were " 'capital' as distinguished from 'income' receipts." 31 OPS. ATTY. GEN. 304, 308 (1918). In T.D. 2747 the Commissioner reversed himself by holding that insurance proceeds were not taxable as income and, consistently, that damages received from suit or settlement for personal injuries were also to be excluded. 20 TREAS. DEC. INT. REV. 457 (1918).

See 1 U.S. INT. REV. BULL. (Part 1) (1922) 94; 25 U. CIN. L. REV. 385 (1956).

[50] H. R. REP. No. 767, 65th Cong. 2d Sess. 9-10: "Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income."

[51] See argument in 69 HARV. L. REV. 1495, 1496 (1956).

[52] Billingham v. Hughes, [1949] 1 K.B. 643, 9 A.L.R.2d 311, 318. Six years later the *Billingham* case was overruled. British Transport Commission v. Gourley [1955] 3 All E.R. 796, commented on in 69 HARV. L. REV. 1495 (1956).

[53] O'Donnell v. Great Northern Ry. Co., 109 F. Supp. 590, 591 (N.D. Cal. 1951). In Chicago & N.W. Ry. Co. v. Curl, 178 F.2d 497, 502 (8th Cir. 1949) the court rejected the evidence of the defendant by saying: "Appellant offers no authority in support of this contention."

As to the authority that did exist at the time of the *O'Donnell* case, see Southern Pac. Co. v. Guthrie, 180 F.2d 295 (9th Cir. 1950) and Armentrout v. Virginian Ry. Co., 72 F. Supp. 997 (S.D.W. Va. 1947). The more serious objection to such statements is that they would result in preventing any growth in the common law.

[54] Runnels v. City of Douglas, Alaska, 124 F. Supp. 657 (D. Alaska 1954).

[55] Hall v. Chicago & North Western Railway Company, *supra* note 43.

would only upset the settled practice of courts not to do so.[56]

Certainly if the "settled practice" of courts is to deny the introduction of this evidence, changing the rule would upset that "settled practice." This no one would deny. However, this is not necessarily a reason to continue to cling to such a *practice*—if, indeed, this is what it is. Such an argument as this would defeat any overruling of precedents. It should be shown further that the practice should be continued either because it is sound or because it was relied upon by the parties. Therefore, there are at least these answers to such statements as those quoted above:

First, there has been no "settled practice"—no line of precedents on this subject. As pointed out, the great bulk of cases has been decided in the last four or five years. Of course, the practice might have preceded the decided cases by many years, but if so, it was without the sanction of appellate decisions. A statement by courts that "this is the way we have been doing it" has not prevented those same courts from overruling other practices when convinced that they are wrong.

Second, assuming that there is a long recognized practice, still no one has justifiably relied on it when he committed a tort. It becomes impossible to construct a reasonable argument in favor of continuing the practice solely on the basis of *stare decisis*.[57] Reasons must be looked for beyond these statements. However, for the court that somehow feels that the plaintiff does have an interest in having the rule continued, there is always the possibility of the prospective overruling that was followed in *Dempsey v. Thompson*.[58]

It is suspected once again that this argument about precedents and the lack thereof is not what is actually troubling the court. Instead, we may come closer with these sentences from a recent Indiana case:

> Inquiries at a trial into the incidents of taxation in damage suits of the character we have here, would open up broad and new matters not pertinent to the issues involved. Such subject matter would involve intricate instructions on tax and non-tax liabilities with all the regulations pertinent thereto. No court could, with any certainty, properly instruct a jury without a tax expert at its side.[59]

It is recognized that this paragraph comes from a case involving a requested charge.[60] However, if the language is restricted to that area,

[56] 33 B.U. L. Rev. 114, 116 (1953).

[57] An attempt to uphold a tort rule of law solely on the basis of *stare decisis* has always been difficult. Here the courts feel much less constrained to cling to old dogma because the justifiable reliance factor is reduced to the minimum. See, for example, Ray v. Tucson Medical Center, 72 Ariz. 22, 230 P.2d 220 (1951) which should be compared with Crowley v. Lewis, 239 N.Y. 264, 146 N.E. 374 (1925) and Treanor, 14 U. Cin. L. Rev. 221, 227-28 (1940).

[58] 363 Mo. 339, 347, 251 S.W.2d 42 (1952). The prospective overruling was limited to the instruction problem but could be applied to the introduction of evidence without difficulty.

[59] Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555, 556 (1956).

[60] The defendant had requested the court to charge that any award in favor

it can have no real meaning.[61] It is broader than the case in which it finds its setting; it represents an attitude—or a mind-set—by that court on the problem of inquiry into the effect that federal income taxation *should* have in determining the size of the personal injury award.

It must be granted that such an inquiry would "open up broad and new matters" in the trial of negligence cases; however, it cannot be accepted without question that these matters are "not pertinent to the issues involved." Why are they not pertinent? Why should we ignore the basic guide of tort law here and do something other than compensate the plaintiff? Are there some broader policies which are being effectuated by these holdings?

Thus far they have been hard to discover. Are we to be satisfied with the simple statement that if the court were to examine into these problems, it would need a tax expert at the side of the judge? What kind of justice are we "dispensing" when we tell a defendant that we would like to help him but to do so would require us to get an expert? The handwriting is beginning to appear on the court-house wall: unless the bar examines carefully the justice involved in automobile negligence cases, the same thing will happen to them that happened to cases of industrial injuries.[62] Legislatures soon provide an administrative agency to handle the problem. When these agencies are established the layman is often allowed to represent the injured party. This we should guard against—not just from a selfish vantage point, but also because lawyers by training are the group most sensitive to the meaning of justice and of client responsibility. It is doubtful that a mishandling of the tax problems in damage cases will result in an overthrow of the jury system for negligence cases. However, an accumulation of things like this may well have just this result.[63]

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of the plaintiff would not be subject to federal income taxes. The Appellate Court (131 N.E.2d 657) had approved the charge but found that the failure to give it was not prejudicial in this case. The Supreme Court of Indiana reversed the Appellate Court's statement that the instruction was proper.

[61] There would need to be no "intricate instruction"; nor would a tax expert be *necessary*. The judge would charge that no taxes are due on any award made the plaintiff. This does not involve the future of the tax laws; it considers only the present tax status of tort awards. See subdivision III, *infra*.

[62] Reference is made to the adoption of state workmen's compensation legislation.

[63] See DAVIS, ADMINISTRATIVE LAW §§3, 4; Marx, *A New Approach to Personal Injury Litigation*, 19 OHIO ST. L.J. 278 (1958); Greene, *Must We Discard Our Law of Negligence in Personal Injury Cases?*, 19 OHIO ST. L.J. 290 (1958). Saskatchewan has provided for compulsory insurance and for awards by a state commission for every person injured by an automobile, regardless of the question of fault. Automobile Accident Insurance Act of 1952, SASK. STAT. (1952) Ch. 23, as amended SASK. STAT. (1953) Ch. 18. See Jaffe, *Damages for Personal Injury: The Impact of Insurance*, 18 LAW & CONTEMP. PROB. 234 (1953).

Is there not some sound reason on which a decision can be reached in these cases?

3. *The amount of federal income taxes is too conjectural to be considered by the jury.* It is here that the rule of non-introduction of this evidence had its beginnings. In the *Stokes* case the court was contented to settle the problem with these five words:

. . . such deductions are too conjectural.[64]

It has been echoed in practically every other case that has decided to refuse the evidence.[65]

What is it that is conjectural? Certainly we are not concerned with the recovery for pain and suffering or the recovery for the reasonable value of the plaintiff's medical expenses. They are not measured by plaintiff's income. Also, they would not have been incurred except for the injuries and thus no tax would have been payable.[66] Nor is there much left to conjecture about the recovery for the value of the plaintiff's lost time. At the time of the trial this is in the past and we can now compute with near-exactness the precise amount of taxes that would have been owing to the government had the injured person been able to continue earning the income that is used to measure the value of that lost time.[67] The conjecture must, therefore, refer to the future. Specifically it applies to those cases where the plaintiff is seeking to recover for the injury to his future earning capacity.

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[64] Stokes v. United States, 144 F.2d 82, 87 (2d Cir. 1944).

[65] E.g., Briggs v. Chicago Great Western Railway Company, 248 Minn. 418, 80 N.W.2d 625 (1957) (dictum); Smith v. Pennsylvania Rd., 59 Ohio L. Abs. 282, 287, 99 N.E.2d 501, 504 (1950) ("such taxes are too speculative to be considered by the jury"); Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952) ("impossible to compute with reasonable accuracy the amount of income tax liability"). This last case is of further interest because plaintiff died from unrelated causes 13½ months after the trial. Defendant urged that this proved plaintiff did not have a life expectancy of 25 years. This, the court rejected saying: "Life expectancy is based on the law of averages." 363 Mo. at 350, 251 S.W.2d at 46. Could not income tax liability likewise be based "on the law of averages"?

[66] The author of 8 Ark. L. Rev. 174, 177 (1954) suggests that a tax would be due if the medical expenses had been deducted from gross income in a prior year and were recovered in this year. This is repeated in 42 Iowa L. Rev. 134, 137 (1956). Basically, this is merely a cancelling proposition.

[67] No case has distinguished past earnings and allowed introduction of evidence of income tax payable on these. Perhaps the court is afraid that the jury will not be able to limit its consideration of the tax problem to past earnings but will try to carry the computation to future loss of earning capacity. See Pfister v. City of Cleveland, 96 Ohio App. 185, 113 N.E.2d 366 (1953) where the court stated that the jury obviously had determined the injuries not to be permanent. Although the case involved remarks to the jury, the language is broad enough to indicate that the taxes were still considered "complicated." See 96 Ohio App. at 187. Accord: Combs v. Chicago, St. Paul, Minnesota and Omaha Ry. Co., 135 F. Supp. 750, 757 (N.D. Iowa 1955) (dictum). 16 NACCA L.J. 212, 215 (1955) argues "uncertainty" and "confusion" as to an example involving past injuries only.

This conjecture and speculation could be found in such things as: (1) the family status of the injured party in the years to come; (2) possible changes in the exemption and deduction provisions of the tax law; (3) possible changes in the rates of taxation; and (4) possible changes in the cost of living, thus reflecting itself on the income of the plaintiff. These items are speculative. But are they so speculative that we should refuse to let the defendant even try to show them? Indeed, which is more conjectural: the existence of income tax in this country along the pattern that we now know it, or the continuance of the plaintiff's salary during *exactly the same period?* Yet, we have no real difficulty in letting the jury speculate as to the existence of the latter. We will even let the plaintiff try to show that he might have earned *more* salary in the future.[68] If the plaintiff receives the advantage of the speculation in his favor, why do we bar the defendant from even trying to show what appears to be a smaller speculation in his favor?

A justification for the holdings of the courts

Perhaps we can find a justification for what the courts are doing when we recall the theory on which the measure of the decrease in the future earning capacity is based. It attempts to give the injured party annually that sum of money which is equal to the amount by which his capacity to earn income in the future has been lessened. This sum of money consists each year—in theory—of a portion of the principal that was received in the award *plus* the interest that this principal has earned during the year. Each year the amount of earned interest decreases because the principal has been invaded in the prior years. The size of the award, then, takes account of the fact that the award itself will earn interest during the life expectancy of the injured person—*and this interest is taxable.* Therefore, if the court were to use net income after taxes to compute the amount to which the plaintiff was entitled, the amount which he actually received would be lowered even further by the amount of tax on the annual earned interest. The jury (or the court) would be called upon to add back into the award that sum of money which would take care of the taxes due on the interest.

It is realized that this would be a smaller amount than the tax that would have been paid on the salary. In the case mentioned above of the person earning $10,000 a year, the first year's interest (if figured at 4%) would be slightly more than $6400. The tax would be on this amount—not on the $10,000. Each year this would become a smaller and smaller figure and the tax would be less and less, until during the last few years it would approach or reach zero. However, if we

[68] Turrietta v. Wyche, 54 N.M. 5, 212 P.2d 1041 (1949). Recent courts have also begun to consider it proper to allow a judge to admonish the jury to take into consideration the decreased value of the dollar. Burlington Transp. Co. v. Staltz, 191 F.2d 915 (10th Cir. 1951); 12 A.L.R.2d 611. These cases are not directly in point since the jury is not told to consider the dollar's *future* value.

were really trying to compensate, these two amounts would have to be considered.

Balancing these difficulties, perhaps we can say that the result reached by the majority is a fair one.[69] At least it may be as fair as we can be when we are trying to measure the imponderables (and unmeasurables) that exist in personal injury cases. Under our present system of trying cases, the introduction of evidence of net income *after taxes* to measure the size of the award for the loss in future earnings could result in turning every negligence case into a trial of the future of the federal income tax structure. This would call for a parade of tax experts on the stand, thus dragging out even longer the trial of these actions. This, then, could be the broader policy that the rule of excluding consideration of the impact of income taxes is effectuating: not extending even longer the time involved in negligence trials and making court dockets even more over-crowded. It can be rationalized by saying that the best we can do for the parties in a personal injury case is to estimate the amount which comes close to compensating the injured person. Since there is some tax which would have to be added back if we were to use net income, our present approach is coming "close enough."[70]

Although the strength of this last paragraph is recognized, it should be remembered that the job of the law is to come *as close as possible* based upon the evidence it has and not to be satisfied with merely being *close enough*. It is this latter approach that may mean the ultimate establishment of some other method of handling these cases. When an area becomes too difficult for a court to solve, there are always "experts" who can give us the solution. This idea that certain problems are too complex and require the solution of experts in the first instance, leaving courts merely the problem of review, has been the basis of the development of administrative law—both in the state and federal government.[71] The

[69] See 32 TEX. L. REV. 108 (1953).

[70] 16 NACCA L.J. 212, 215 (1955) also argues that taxes should not be considered because of the rule of "singleness of recovery." This rule requires plaintiff to recover all damages in one suit and "if the tax rates are reduced after plaintiff recovers his judgment, he could not return to court and ask for an offsetting increase in damages. . . ." See a similar argument in another area in Dempsey v. Thompson, 363 Mo. 339, 348, 251 S.W.2d 42 (1952). See also 20 NACCA L.J. 455 (1957). This is, of course, inherent in every tort recovery for future losses. The tax rate may be increased, the company for which plaintiff worked may declare bankruptcy, the plaintiff may die within or he may outlive his expectancy, etc. All these must be considered by the jury but the fact that one *might* happen in the future is no grounds for removing the problem from jury consideration. See the *Dempsey* case, *supra.*

[71] Any one of scores of agencies would document this point. Perhaps the most apt analogy is found in workmen's compensation. See discussion of reasons for this type of legislation in Marx, *"Motorism" not "Pedestrianism": Compensation for the Automobile's Victims,* 40 A.B.A.J. 421, 477 (1956).

opening phrase of these words from an Ohio Appeals Court should be heeded:

> . . . . *Perhaps for absolute exactitude and justice, the jury should be so told and instructed to make an allowance in its general verdict for such item,* but the formula for determining such tax element is so complicated that an instruction with respect to it would be most confusing to the jury and at best most difficult of ascertainment. As a practical solution, therefore, the tax factor is ignored by the trial court in charging the jury.[72]

This problem *could* be solved by requiring the jury to state separately the amount of its award for each element of damages claimed by the plaintiff.[73] As to those that reflect lost income, the judge (with the aid of that "tax expert") could then apply a formula which would reflect, *as close as possible* under all available evidence, the impact of income taxes. We are already letting juries use similar formulas with annuity and life expectancy tables[74]—except that here we would not be concerned with the fact that the injured party may be different from the "normal" person for whom those tables are made.

This solution is mentioned only to indicate that if the courts are refusing to receive evidence of income tax simply because it is too confusing for the jury to handle, there is a method which does meet the basic theory of torts (compensation) and which can be made a part of our jury system.[75] This suggested method formed the basis of the opinion in *Armentrout v. Virginian Ry. Co.,*[76] through which the district judge affirmed a jury's verdict. This same process could be handled mathematically without the use of pages of computation. If, as some of the courts are beginning to indicate, justice does require that the impact of income taxes be considered in determining the size of the award—then it is imperative that a method be devised to meet this "justice."

The cases discussed above have assumed that the plaintiff had but

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[72] Pfister v. City of Cleveland, 96 Ohio App. 185, 187, 113 N.E.2d 366 (1953). (Emphasis added.)

[73] One of the common features of American trials that makes it impossible to separate the amount allowed for each element of damages is the extensive use of a general verdict. Cf. British Transport Commission v. Gourley, *supra* note 52, where the verdict was as follows: £10,000 for pain and suffering, £15,220 for lost earnings and £22,500 for future loss of earnings. See also Durkee v. Commissioner, 162 F.2d 184 (6th Cir. 1947).

[74] See discussion of these in Dempsey v. Thompson, *supra* note 65.

[75] Another method would be the requiring of installment payments by the defendant. Cf. treatment of taxes in alimony cases, 153 A.L.R. 1041. This, however, is so radical a suggestion that it is mentioned only in a footnote to suggest that courts are not as powerless to adapt remedies as they would sometimes have lawyers believe. See alimony cases cited and discussed in 9 VAND. L. REV. 543, 547-8 (1956).

[76] 72 F. Supp. 997 (S.D.W. Va. 1947), *rev'd on other grounds,* 166 F.2d 400 (4th Cir. 1948).

the one source of income and that this source was taken from him through the tortious conduct of the defendant. Added problems are presented when the plaintiff has outside income which continues in spite of the injury. An example of this exists when the injured person has investments which earn dividends and interest even though he is unable to work at his job or profession. The added feature of outside income produces two further problems.

First, the court must decide whether the outside income is to be considered at all in determining the taxes to be paid in the future. For example, consider two persons: one is earning $10,000 a year and has no other income; the other is earning the same salary but also receives an additional $5,000 a year from investments which he has made during his life. If this outside income is considered and if both persons are injured by tortious conduct of the defendant, the recovery of the second plaintiff will be substantially less simply because he is receiving other taxable income.[77] This results in the tax being computed as of the highest rate that plaintiff is and in the future probably will be paying, because the earnings he has lost have reduced his *total* income. In effect, then, they have been taken from the "top" of his income where the rates are the highest. On the other hand the court may take the position that the injured person's income from his job or profession is being taxed first by the government and that the other earnings are not to be considered in fixing the size of the award. While there are equities favoring this approach, it certainly does not accord with the theory of the income tax laws or the basic notion of placing the plaintiff in the same financial position in which he would have found himself had it not been for the injury.

Second, should the court decide to consider the outside income, it would then face the task of determining also the probable size of that income during the time that the injuries to the plaintiff will continue. If those injuries will permanently decrease his earning capacities, this might mean predicting the stock market future for the next twenty-five years or longer.

Therefore, before a court allows evidence of the taxes that would have been payable had the plaintiff not been injured, it should examine carefully the difficulties that would be presented. There appears no single answer that solves all of them. The present approach has the merit of certainty but it violates the principle of attempting to *compensate* for injuries. It also runs the risk of contributing to a feeling that if these cases are too "hard" for a court to solve, perhaps there is another tribunal that can handle them.

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[77] This is apparently the position taken by British Transport Commission v. Gourley, *supra* note 52. A verdict of £37,720 was reduced to £6,695 because investment income of the plaintiff subjected him to a high rate of taxation. 34 CAN. BAR. REV. 940, 941 (1956).

III

Instruction re Income Tax

This problem has one more thrust that needs examination. Granted that the majority of American courts has refused to allow the introduction of *evidence* of the amount of taxes that the plaintiff was paying at the time of injury and granted that these same courts refuse *evidence* of the amount of taxes that might probably have been due on the income which is used to measure the decrease in future earning capacity, there is still the problem of whether the jury should be informed that the *award* is not taxable. The difference between these thrusts should be clear. As has already been pointed out, the *evidence* seeks to lower the amount of the award by decreasing the size of one of its primary factors; the *instruction* (or argument to the jury at the close of the case) attempts to prevent the jury from erroneously believing that the government will claim fifty per cent or more of the award made to the plaintiff and thereby increasing that award because of this mistaken belief.

The type of instruction most often asked is typified by the one suggested in the *Dempsey* case:[78]

> You are instructed that any award made to plaintiff as damages in this case, if any award is made, is not subject to Federal or State income taxes, and you should not consider such taxes in fixing the amount of any award made plaintiff, if any you make.[79]

Whether a court should give an instruction similar to this one involves different considerations than were found in the prior discussion. This instruction does not require any speculation as to the future tax structure of this country; it merely tells the jury that there will be no income tax levied on any award that is made to the plaintiff. This instruction, therefore, does not call into question the plaintiff's future marital status, the number of his exemptions, the size of his deductions, the amount of his outside income, or the future tax rates of this country. There can be no parade of tax experts across the stand, thus prolonging even longer the trial of negligence cases. It involves merely a simple statement of no longer than two or three sentences to the jury at the close of the trial.

Why then have most courts refused to give this instruction? If we answer this question on the basis of the words they have used in their opinions, that question must be answered thus: many courts have refused to give this instruction because they have confused the problem of the instruction with the problem of whether the evidence of the incidence of taxation should be admitted during the trial.[80] Once these are confused,

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[78] Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952).

[79] *Id.* at 346, 251 S.W.2d at 45.

[80] An example of this is Briggs v. Chicago Great Western Railway Company, 248 Minn. 418, 80 N.W.2d 625, 636 (1957): "We hold . . . that in a personal in-

the court can then point out how "confused" the jury would be with this added bit of information. For example, the Supreme Court of Indiana had the problem before it in a recent case.[81] The defendant had requested a charge which informed the jury that "in the event they found for the plaintiff any award made to him would not be subject to federal income taxes." The Court held that the giving of such a charge would have been improper and as authority cited a case from Illinois[82] and another from Ohio.[83] It then added this paragraph (a portion of which has already been quoted in this article):

> Inquiries at a trial into the incidents of taxation in damage suits of the character we have here, would open up broad and new matters not pertinent to the issues involved. Such subject matter would involve intricate instructions on tax and non-tax liabilities with all the regulations pertinent thereto. No court could, with any certainty, properly instruct a jury without a tax expert at its side. In our judgment such matters are not a proper subject for instruction on argument of counsel.[84]

The court has confused the two problems in this paragraph. All that it had to decide was whether the instruction should or should not have been given. The instruction is not "intricate" and no reference has to be made to the "regulations" promulgated under section 104 of the Internal Revenue Code of 1954. Above all, any court could give this instruction without resorting to a "tax expert." Here, then, is the confusion of the two problems—for this paragraph undoubtedly represents the attitude of the Supreme Court of Indiana when the defendant has requested that income taxes be considered to determine the amount of the award. That is where the attitude has been treated in this article.[85]

Not all courts have treated the problem of the instruction in this

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jury suit the incidence of Federal income taxation is not a proper factor to be considered by the jury in making an award of damages *and that it is therefore* improper to instruct the jury that an award for damages for impairment of earning capacity, whether past or future, is exempt from such taxation." (Emphasis added.) See also Maus v. The New York, Chicago & St. Louis Ry. Co., 128 N.E.2d 166, 167 (Ohio App. 1955), *aff'd,* 165 Ohio St. 281, 135 N.E.2d 253 (1956): "To permit an instruction, as requested herein, there should be an inquiry as to the amount allowed for actual loss of wages plus probable future loss of earnings, for, as to those matters, the injured person, if he had not been injured and had he continued to work, would have paid income taxes on all of his earnings . . . the result . . . would . . . complicate the trial. . . ."

This type of confusion prevents an intelligent handling of the problems involved.

[81] Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555 (1956).

[82] Hall v. Chicago & North Western Ry. Co., 5 Ill.2d 135, 125 N.E.2d 77 (1955).

[83] Maus v. The New York, Chicago & St. Louis Rd. Co., 165 Ohio St. 281, 135 N.E.2d 253 (1956).

[84] Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555 ,556 (1956). This same confusion is found in 33 B.U. L. Rev. 114 (1953).

[85] See subdivision II, *supra.*

manner. Undoubtedly the two best opinions, as far as meeting the question involved, come from Missouri[86] and Illinois[87] and reach opposite results. In the Missouri case, the court decided that the trial court was correct in refusing to allow the defendant to inquire of an actuary whether he "knew there is no income tax on awards for personal injury" (the evidence problem already discussed) but added:

> . . . . [I]t does not follow that defendant was not entitled to have the jury instructed that any amount awarded plaintiff was not subject to Federal or . . . State income tax.[88]

With this introductory thought the court then held that the instruction should have been given. Its reasoning took these steps:

> 1. Present economic conditions have made nearly all citizens aware of the impact of income taxes;
> 2. Few persons know of the special exception for personal injury awards; and
> 3. Failure to instruct the jury as to this exception may well enhance the award which the plaintiff is entitled to receive under the general measure of damages. "Surely, the plaintiff has no right to receive an enhanced award due to a possible and, we think, probable misconception on the part of a jury that the amount allowed by it will be reduced by income taxes."[89]

The Illinois case analyzed the problem in the same manner but came to a different result. It held that the trial judge had been correct in allowing evidence only of the plaintiff's gross income before taxes. It then went on to consider remarks made by defendant's counsel at the close of the trial to the effect that any award received by the plaintiff was not subject to federal income taxes. Holding these remarks to be improper, the court reasoned:

> 1. The jury was correctly instructed on the measure of damages, being "told specifically the elements that they should consider in awarding damages;"[90]
> 2. The court cannot assume that a jury will not follow these instructions—indeed, the presumption must be that those instructions will be followed; and
> 3. Since there is a possibility of harming the plaintiff by allowing an instruction on taxes, "it is better to instruct the jury on the proper measure of damage and then rely on the presumption. . . ."[91]

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[86] Dempsey v. Thompson, *supra,* note 78.

[87] Hall v. Chicago & North Western Ry. Co., *supra,* note 82. See also Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034 (1956).

[88] 363 Mo. 339, 346, 251 S.W.2d 42, 45.

[89] *Ibid.*

[90] 5 Ill. 2d 135, 150, 125 N.E.2d 77, 85.

[91] 5 Ill. 2d 135, 151, 125 N.E.2d 77, 86. Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034 (1956) reached a similar result on a requested charge that taxes were not due on an award for pain and suffering. "We would prefer to assume that the jurors to the best of their ability will follow the instruction given and

Here, then, is the issue which is presented by this half of the problem. It involves deciding an almost "un-decidable" problem: what goes on in the jury room? Assume that the jury has followed the court's instructions carefully. It has found that the substantive elements of a tort exist and has turned its attention to the measure of damages. Pain and suffering have been measured. Medical expenses have been considered. Lost time and the decreased earning capacity have been determined. The jury has arrived at a sum of $150,000. What happens next?

If—as the Missouri court assumed—taxes are so commonly known to the average juror that his reaction would be to add (say) $75,000 to the $150,000 to cover those non-existent taxes, then the plaintiff is getting more than he deserves and the courts should do something about keeping the verdict within the rules of damages.[92] A charge similar to the one announced in the Missouri case[93] would appear to do this.

If—as the Illinois court assumed—the charge would cause the jury to react by reducing the $150,000 on the feeling that "that's a large sum of money to be getting tax free and we had better cut it back (say) $50,000," then the plaintiff is getting less than he deserves and the courts have an equal obligation to keep the verdict within the rules of damages.[94] In either case, the job of the courts is to charge the jury in such a way that it is reasonably certain that the award conforms to the rules of damages.

will not depart from the issues and the law as announced." 282 P.2d 1034, 1038. Is this a question of what a court *prefers* to assume? Or is it a question of what the jury, *in fact,* does assume?

[92] By the words "getting more than he deserves" it is meant that the *rules* of tort and damage law would result in awarding plaintiff one amount of money and the jury is returning an award of a larger amount. It is not meant that these *rules* of tort and damage law necessarily are accurate measures of plaintiff's injuries. Continual study must be made of these rules as medical science advances. However, they should not be subverted by exceptions that have not been the result of this careful study.

Wagner v. Illinois Central Railroad Co., 7 Ill. App. 2d 445, 129 N.E.2d 771 (1955) bears on this problem. The first trial in this case resulted in a verdict of $130,000 for the plaintiff. On a new trial a verdict of $80,000 was returned. At the second trial the court charged the jury that any award given plaintiff was not subject to income taxes. The plaintiff appealed. Pending the appeal the Illinois Supreme Court decided the *Hall* case, *supra* note 82. The Appellate Court distinguished the *Hall* case but reversed the lower court on the theory that the instruction possibly entered into the jury's award, thus harming the plaintiff. It is equally possible that the first jury added $50,000 believing that it would be needed for income taxes.

[93] Text accompanying note 79, *supra.*

[94] It has also been argued that the instruction might cause the jury to decide that the award should have been computed on net income after taxes rather than gross income before taxes, this being contrary to the general measure of damages. 21 U. CHI. L. REV. 156, 157 (1953). It is difficult to believe that it is impossible to draft a charge which would tend to prevent this type of mistake. When we recall that the original decision was made by some courts, not on the basis of justice,

Thus, the question becomes easy to state but hard to answer. It is hard to answer because, as yet, no good system has been devised to determine just how a jury reacts.[95] Until this is done, it is perhaps true that courts must assume that juries follow the instructions given them. However, this does not mean that the answer of the Illinois court is necessarily correct.[96] If that court had really meant what it said, it could have been satisfied with a charge to the jury that read like this: "You are hereby charged to bring in a just verdict." That is all that would have been needed if it is to be presumed that juries follow the instructions given them.

It has been a long time since courts have been satisfied with this approach to the jury system. Instead, the judge goes further and spells out in some detail what the law means by a *just* verdict. Certainly the English language is both broad enough and precise enough to be able to form the basis of an instruction that makes it clear that the jury should not add an amount to a verdict for the payment of non-existent taxes and at the same time that it should not subtract an amount because the award comes to the plaintiff tax-free.[97] Perhaps it will take a sentence or two more than that suggested by the Missouri court; perhaps it could be framed along these lines:

> You are instructed that any award made to the plaintiff in this case, if any award is made, is not as an award subject to federal (or state) income taxes. Should you find that plaintiff is entitled to an award of damages, then you are to follow the instructions already given by this court in measuring those damages and in no event should you either add to or subtract from that award on account of federal or state income taxes.[98]

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but on the grounds of expediency, Southern Pac. Co. v. Guthrie, 186 F.2d 926, 927-28 (9th Cir. 1951) on rehearing of 180 F.2d 295 (1949), *cert. denied,* 341 U.S. 904 (1951), and Pfister v. City of Cleveland, 96 Ohio App. 185, 187, 113 N.E.2d 366, 368 (1953), it is clear that such an argument is searching far afield to discover a basis for saying that the instruction "might well be prejudicial to the plaintiff."

[95] See Kalven, *The Jury, the Law, and the Personal Injury Damage Award,* 19 OHIO ST. L.J. 158, 163 (1958).

[96] The *Hall* case, *supra* note 82, also refused to allow the instruction despite defendant's argument that it correctly stated the law. It analogized this instruction to one which might be requested by the plaintiff that the expenses of the trial—including the attorney's fee—were not recoverable or that defendant railroad could use the award as an expense in providing for increased fares. However, these instructions are designed to increase the amount of an already determined award or even toward finding liability when none exists. See 21 U. CHI. L. REV. 156, 158 (1953). The requested instruction on income tax merely defines the allowable elements of the award.

[97] 42 GEO. L.J. 149, 151 (1953).

[98] This instruction strikes the last portion of the Missouri-approved charge since it was read by the Illinois court in the *Hall* case, *supra* note 82, to allow the jury to reduce the award otherwise reached by following the general measure of damages. It is realized that a court does not, as a general rule, charge a jury on

The question raised by this part of the article is whether an instruction which has been properly phrased should in fact be given. When analyzed, it cannot properly be refused because juries will be "confused"; the instruction is not that complicated. In fact, it appears rather simple when compared to a charge on measuring the decrease in the plaintiff's future earning capacity. Nor can the refusal be bottomed on a presumption that juries follow instructions; we are still left with the problem of whether further definition is desirable. However, one possible justification (or rationalization) of the cases that refuse to allow an instruction on the impact of income taxes on the personal injury award could be a belief that verdicts today are not, in general, overcompensating plaintiffs. Therefore, the practical solution would be not to change the components of the system reaching those verdicts.

There is much to be said for this. The thing of final importance in damage actions is the sum of money that is or is not awarded to the plaintiff. It is toward this that our theory of compensation builds, that our substantive rules of law aim, and that the measure of damages is cast. If our present result is substantially correct, then this justification urges that the factors which have gone into its determination should not be changed unless it is shown that those results will not be materially altered. This may be what the Ohio Court of Appeals had in mind (in the quotation already included in this article) when it observed that "perhaps for absolute exactitude and justice, the jury should be so told . . . to make an allowance in its general verdict for such item, but the formula for determining such tax element is so complicated that an instruction with respect to it would be most confusing to the jury and at best most difficult of ascertainment." The court's conclusion was that as "*a practical situation* . . . the tax factor is ignored by the trial court in charging the jury."[99] The reasons given for this "practical" result were manifestly erroneous; there is no formula involved and there is nothing complicated in such an instruction. Still it might be that the court *felt* that this was the best practical solution since awards in Ohio were, as a general proposition, not overcompensating plaintiffs. Thus there was no reason—other than a theoretical and maybe academic one—to lower these verdicts with an instruction on income taxes.

While this may be a practical answer, it is not the suggested one. One of its faults lies in the fact that it assumes the correctness of the end product and then proves the end product by the assumption. This "practical" solution has been rested on some inherent feeling on the part of courts that personal injury verdicts are, in general, not overcompensating plaintiffs. This may or may not be true. The measuring stick that is used to test its truth is the verdicts themselves, and these are the

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what not to do. In this case it is felt that a court would be justified in adding the last sentence, above, to support the giving of the positive statement in the first sentence of the proposed charge.

[99] Pfister v. City of Cleveland, *supra* note 72. (Emphasis added).

very things we are testing. They have been given following instructions which contain no statement regarding the impact of income taxes; they have also been general in form so that there is no way of determining just how much of the final amount is attributable to lost income and how much has been awarded for such items as pain and suffering. In affirming verdicts it *may* be that upper courts have been assigning a much greater compensation for pain, fright and humiliation than juries have awarded. The difference in the two sums *might* be an amount which was mistakenly added for income taxes. Can we say that verdicts today are not—in the main—overcompensating plaintiffs? We cannot answer this by stating that verdicts in general are fair because verdicts in general are this size.

Another of its faults lies in the fact that it emphasizes the correctness of the end product without considering the means by which that end product was reached. Even if our awards today are generally fair, this is no reason for refusing to give the instruction. It would merely mean that in most of the cases some other part of the measure of damages needs re-working. It is unsafe to assume that this other element which needs to be re-defined—whatever it may be—is balanced by the present status of what twelve people erroneously believe—and this could vary from case to case—about the impact of income taxes on the award they make. It is essential that there be worked out a measure of damages which is as fair to all parties as is possible; the author believes that this should include an instruction which leads the jury to an understanding of the effect which section 104 of the Internal Revenue Code of 1954 has on the award it makes. The words of Professor Morris with which this article began appear particularly applicable here: "It is doubtful that it is possible to fool juries into doing useful things when they are not apprised of the ends to be accomplished and are only given control of the means."[100]

This much is clear: if an attorney seeks to have such an instruction given at the close of the trial of a personal injury case, that instruction should be carefully framed. It should be framed carefully, keeping in mind that the basic problem here is that of assuring the reviewing court that no harm has resulted to the plaintiff by decreasing the verdict to which he otherwise would be entitled.

An example of a charge that should have been more carefully framed appears in *Maus v. The New York, Chicago & St. Louis Rd. Co.*,[101] where the requested charge pointed out the exclusion allowed by section 104 of the Internal Revenue Code of 1954 and added that "you must take this fact in consideration in arriving at the amount of your verdict in this case."[102] The Supreme Court of Ohio upheld the trial court's refusal to give *this* charge on the theory that the court's general

[100] 44 HARV. L. REV. 1173, 1203 (1931).
[101] 165 Ohio St. 281, 135 N.E.2d 253 (1956).
[102] *Id.* at 282, 135 N.E.2d at 254.

instruction to the jury correctly stated the law as to how damages were to be computed; therefore there was "no reason why the charge requested by the defendant should have been given, since the effect would be to give the jury license to disregard the charge on the measure of damages already given."[103] The only way that the jury would have such a license is if the charge made it consider the tax exclusion in arriving at a verdict, thereby lowering the award to which the plaintiff was otherwise entitled under the law of damages. In this connection, notice that the charge requested stated that the exclusion *must* be taken into account. While this is explainable on another ground,[104] still the confusion that could result is a justifiable reason for refusing it.

Especially interesting in this connection is the concurring opinion written in this case. Emphasizing the distinction already drawn above, the judge remarked:

> . . . . I concur in the syllabus and judgment in this case. However, I think it should be pointed out that it is not our purpose here to rule out any charge on the subject of federal income tax. We believe the requested charge is erroneous in that it requires the jury to take this subject into consideration in arriving at its verdict. We concede that a proper charge on this subject could be drawn and properly given if it went only to the extent of warning the jury not to consider income tax liability on the award which it might make.
>
> Under the present income tax law, an award of damages on account of personal injuries is not to be included in gross income. As long as this remains the law, it would not be improper for a trial court to say so in response to a jury's inquiry or to give a special instruction when properly prepared in conformance with this federal law.[105]

IV

Conclusion

The final answer has not as yet been recorded to the problem of the manner in which income taxes are to be treated in assessing damages for personal injuries resulting from tortious conduct on the part of the defendant. However, before an intelligent approach to a solution can be attempted, the courts must distinguish between the questions involved when the defendant seeks to introduce evidence of tax liability as affecting the size of the award and those involved when he seeks merely to have the jury instructed that any award given will not be subject to income taxes now. The present approach of the majority in denying both

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[103] *Id.* at 285, 135 N.E.2d at 256.

[104] That is, the fact that the award is not taxable *must* be taken into account by not allowing that factor to cause an increased award.

[105] 165 Ohio St., 281, 285-86, 135 N.E.2d 253, 256 (1956). Three of seven judges concurred in this opinion.

requests can possibly have the effect of giving the plaintiff his taxes twice: once when gross income is used as the measure of loss and once when the jury adds a sum to the award, otherwise properly determined, on the erroneous notion that this is needed to compensate for taxes due now. The argument that this comes "close enough" since there is no dollar method by which law can *really* measure plaintiff's injuries overlooks the theory underlying the measure of tort damages. Carried to its logical extension, it would result in no dollar-compensation for plaintiffs; here, however, it is used to reach quite the opposite result: possibly doubly-overcompensating him for the same item.

On the other hand, the first few attempts by defense attorneys to draft these requested instructions have not convinced the reviewing courts that the jury might not reasonably have understood them to mean that it should *reduce* the award because no income taxes were due. Viewed thus, these attorneys have attempted to do through instructions what they could not do in introducing evidence. However, if these problems are separated, it is hard to believe that the English language is not broad enough and precise enough to make the jury understand the impact on personal injury awards of section 104 of the Internal Revenue Code of 1954.