Utilizing Net Income as the Basis for Calculating Damages for Lost Earnings in Personal Injury and Wrongful Death Actions: A Case for Creating Consistency and Fairness in Louisiana

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INTRODUCTION

The issue of whether to consider income tax liability when calculating the quantum of damages in personal injury or wrongful death actions has long been a matter of contention in American jurisprudence.[1] Case law on the subject has developed mainly since World War II and is generally thought to be the result of the onerous levels of income tax and the increasingly large amounts of damages awarded to tort victims.[2]

There are two predominate views on using either gross income or net after-tax income.[3] The traditional, majority view is that in fixing damages for the loss of future earnings due to personal injuries or wrongful death, the income tax consequences should not be considered.[4] This is despite that fact that the victim's damages are generally exempt from federal taxes.[5]

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1. See generally Annotation, Propriety of Taking Income Tax into Consideration in Fixing Damages in Personal Injury or Death Action, 63 A.L.R.2d 1393 (1959).

2. Id. at 1395.

3. See id.

4. Id. at 1395-96.

5. Id.; see also 26 U.S.C. § 104(a)(2) (1988); Byrne v. Commissioner of Internal Revenue, 883 F.2d 211 (3d Cir. 1989); Threlkeld v. Commissioner of Internal Revenue, 848 F.2d 81 (6th Cir. 1988); Bent v. Commissioner of Internal Revenue, 835 F.2d 67 (3d Cir. 1987); Roemer v. Commissioner of Internal Revenue, 716 F.2d 693 (9th Cir. 1983). See generally Morgan, Old Torts, New Torts and Taxes: The Still Uncertain Scope of Section 104(a)(2), 48 La. L. Rev. 875 (1988).

The courts have given several reasons justifying the majority approach. One reason is that future tax liability is too conjectural.[6] Some courts, for example, have stated that even a person's monthly deductions taken by his employer do not accurately reflect the actual tax he will end up paying.[7] Such a limitation only underscores the uncertainty which would arise in attempting to predict future tax liability. Another rationale submitted is that tax liability of a tort victim is an extraneous issue which only concerns the government taxing authority and the plaintiff.[8] This line of reasoning is analogous to the collateral source rule, the well settled concept of American jurisprudence that compensation from such a source should not diminish the amount recoverable by the injured party.[9] Moreover, some courts have expressed a reluctance to inject the issue of income taxes because they felt it would unduly complicate the trial and even create more problems than it was worth.[10]

The minority view in favor of deducting taxes to determine damages for lost or diminished earnings has found some strong judicial and scholarly authority as well.[11] One compelling reason advanced in favor of this position

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6. See, e.g., Stokes v. United States, 144 F.2d 82 (2d Cir. 1944); Hall v. Chicago & N.W. Ry., 5 Ill. 2d 135, 125 N.E.2d 77 (1955); Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42 (1952); Texas & N.O. R.R. v. Pool, 263 S.W.2d 582 (Tex. Civ. App. 1953).

7. See Texas & N.O. R.R., 263 S.W.2d at 591.

8. See, e.g., Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034 (1956); Atlantic Coast Line R.R. v. Brown, 93 Ga. App. 805, 92 S.E.2d 874 (1956); Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555 (1956); Bergfeld v. New York, C. & St. L. R.R., 103 Ohio App. 87, 144 N.E.2d 483 (1956).

9. Annotation, supra note 1, at 1401.

10. See, e.g., Combs v. Chicago, St. P., M. & O. Ry., 135 F. Supp. 750 (N.D. Iowa 1955); Briggs v. Chicago Great W. Ry., 248 Minn. 418, 80 N.W.2d 625 (1957).

11. See, e.g., Culver v. Slater Boat Co., 722 F.2d 114 (5th Cir. 1983) (en banc) (*Culver II*), cert. denied, 467 U.S. 1252, 104 S. Ct. 3537 (1984); see also infra text accompanying notes 117-21 for a discussion on why the *Culver II* case presents a particularly good method for utilizing net income as a just and equitable means of calculating lost earnings. See also Norfolk & W. Ry. v. Liepelt, 444 U.S. 490, 100 S. Ct. 755 (1980) (holding that juries in FELA action should be allowed to take into account the effect income taxes have on computing damages for lost future earnings despite the complexity of the issue and that there may be a need for protracted expert witness testimony and debate); Portier v. Texaco, Inc., 426 So. 2d 623 (La. App. 1st Cir. 1982); and Fanetti v. Hellenic Lines Ltd., 678 F.2d 424 (2d Cir. 1982), cert. denied, 463 U.S. 1206, 103 S. Ct. 3535 (1983) (awarding damages on after-tax earnings in actions under the Jones Act, 46 U.S.C. § 688 (1982), and the Longshore and Harbor Workers' Compensation Act, 33 U.S.C. §§ 901-950 (1988) respectively). See generally Brady, Brookshire & Cobb, The Development and Solution of a Tax-Adjusted Model for Personal Injury Awards, 51 J. Risk & Ins. 138 (1984); 2 Harper & James, The Law of Torts § 25.12 (1956); Nordstrom, Income Taxes and Personal Injury Awards, 19 Ohio St. L.J. 212 (1952); Annotation, supra note 1, at 1404.

has been that if the plaintiff's damages are based on gross income, she would receive more than she actually ought to receive since had she continued to work earning her salary, she would have had to pay income taxes.[12] One court justified this approach by stating that the ultimate purpose of awarding tort damages is to place the injured party in as favorable a position as though no wrong had been committed. However, the rule should not allow a plaintiff to recover *more* than had been lost.[13] Other courts have adopted the use of net income and in so doing have repudiated the majority's contention that estimating future tax liability is too conjectural.[14] Indeed, if courts can fix damages for such variables as life expectancy, future income and the future value of the dollar, estimating future tax liability would be no less speculative.[15]

In Louisiana, the appellate courts have been divided on whether to compute damages based on gross or net income. Indeed, *within* the circuits themselves, there have been inconsistencies in the treatment of the issue.[16]

The approach taken in this article is two-fold. The first part will examine and discuss the Louisiana jurisprudence on this issue. The second section will consist of an economic analysis of the problem based on the use of both gross and net income. The ultimate goal of this article is to demonstrate clearly that the use of net or after-tax income is the fairest jurisprudential approach and is the most consistent with economic realities.[17]

LOUISIANA JURISPRUDENCE: DIVISIONS BETWEEN THE CIRCUITS, DIVISIONS WITHIN THE CIRCUITS

As stated, the approaches taken by the Louisiana courts of appeal have been inconsistent. The breakdown generally exhibits the following

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12. See, e.g., Floyd v. Fruit Indus., Inc., 144 Conn. 659, 136 A.2d 918 (1957); Moffa v. Perkins Trucking Co., 200 F. Supp. 183 (D. Conn. 1961).

13. See, e.g., Adams v. Deur, 173 N.W.2d 100 (Iowa 1969).

14. See, e.g., Tenore v. Nu Car Carriers, Inc., 67 N.J. 466, 341 A.2d 613 (1975).

15. See Annotation, Propriety of Taking Income Tax Into Consideration in Fixing Damages in Personal Injury or Death Actions, 16 A.L.R. 4th 589, 612 (1982).

16. Id. at 614-16. The Louisiana Supreme Court in Martinez v. United States Fidelity & Guar. Co., 423 So. 2d 1088, 1091 (La. 1982) declined to consider the issue of whether income taxes should be used when calculating damage awards, but acknowledged it was an "important" issue. Another reason for the inconsistencies is La. Civ. Code art. 2324.1 which allows the trier of fact a great deal of discretion, such as taking into account an attorney's contingency fee, when fixing damages. See also Cheatham v. New Orleans, 378 So. 2d 369 (La. 1979); and infra text accompanying notes 43-48 (discussing other "offsetting considerations").

17. One Louisiana commentator, for example, has stated that "despite the apparent common sense of using net earnings, a number of courts have determined that awards for loss of income should be based on gross income, regardless of tax consequences." Veron, Evaluating the Economic Impact of Personal Injuries, 31 Loy. L. Rev. 825, 847 (1986).

pattern. The first, third, and more recently the fifth circuits have somewhat consistently based the loss of future wages on gross (before tax) income, with some deviations from this rule in all of those circuits. The second and fourth circuits have traditionally utilized net (after-tax) income, but with some notable exceptions as well.[18] Moreover, in several cases construing Louisiana law, the federal courts have used the net income approach.[19] The following will examine the Louisiana jurisprudence by circuit in an attempt to understand this complex jurisprudential evolution.

First Circuit Court of Appeal

The first circuit, starting with *Reeves v. Louisiana & Arkansas Railway Co.*, has consistently held that gross income should be used as the standard for computing lost income.[20] In *Reeves*, the court held that the taxability or nontaxability of such earnings should not even be considered when computing damages for their loss.[21] The court justified its holding by pointing out that assessing the effects of taxes in lost earnings is too uncertain and speculative and that a tortfeasor should not benefit from an advantage which accrues to a tort victim from a collateral source.[22] The court furthermore cited three other Louisiana cases which used net earnings, *Frye v. Joe Gold Pipe & Supply Co.*[23] and *Jones v. Rodgers*,[24] both from the second circuit, and *Breaux v. Valin*,[25] from the third circuit. The court distinguished these cases by emphasizing that the claimants were all engaged in a business where expenses were obviously deductible from gross income when determining taxable income or wages.[26] Apparently the court did not take the view that the plaintiff injured in the instant case shared those characteristics even though he was employed as a truck driver.

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18. See Domangue v. Eastern Airlines, Inc., 542 F. Supp. 643, 651 (E.D. La. 1982) (attempting to construe Louisiana law concerning the issue of whether to use gross or net income in computing damages by articulating what the court saw as the general breakdown among the five state circuit courts of appeal).

19. See infra text accompanying notes 95-105.

20. 304 So. 2d 370 (La. App. 1st Cir.), writ denied, 305 So. 2d 123 (1974). See generally Schwamb v. Delta Air Lines, Inc., 516 So. 2d 452 (La. App. 1st Cir. 1987), writ denied, 520 So. 2d 750 (La. 1988); Harper v. Liggett Group, Inc., 459 So. 2d 1260 (La. App. 1st Cir. 1984); Black v. Ebasco, 411 So. 2d 1159 (La. App. 1st Cir. 1982); Annotation, supra note 15, at 614-15.

21. *Reeves*, 304 So. 2d at 377.

22. Id.

23. 50 So. 2d 38 (La. App. 2d Cir. 1951).

24. 179 So. 2d 674 (La. App. 2d Cir. 1965).

25. 138 So. 2d 405 (La. App. 3d Cir. 1962).

26. Reeves v. Louisiana & Ark. Ry., 304 So. 2d 370, 377 (La. App. 1st Cir. 1974).

In *Johnson v. International Insurance Co.*,[27] a wrongful death suit, the first circuit followed the *Reeves* precedent and apparently accepted the use of gross income as well.[28] The *Johnson* case was cited a year later in *Greene v. Wright*,[29] when the first circuit found no error by the trial court in assessing damages using gross rather than net income when calculating the lost future income of a mine worker.[30]

In two quite recent personal injury cases, *Moran v. Canal Indemnity Insurance Co.*[31] and *Rose v. State Farm Mutual Automobile Insurance Co.*,[32] the first circuit similarly computed damages by using gross income. In *Moran*, the court cited *Reeves* as authority and stated that the defendants were incorrect in asserting that deductions should be made for income taxes.[33] In *Rose*, the court by implication upheld the damage amount, stating that damages should be computed based on lost wages, and concurred with the expert witness who deducted only the amount of disability benefits paid to the plaintiff.[34]

Second Circuit Court of Appeal

The second circuit, which has traditionally used net income for calculating lost earnings, first enunciated this approach in *Frye v. Joe Gold Pipe & Supply Co.*[35] In *Frye*, the issue arose of how much the plaintiff should receive for lost wages for a six month period. Since the plaintiff had not worked during that time due to his injury, the court assumed that his earnings would have been the same as what he earned before the accident.[36] The court also stated that the "safest course to follow" would be to use the victim's net monthly earnings as stated on his income tax return.[37]

In *Jones v. Rodgers*,[38] the court refused to award damages for loss of earnings since the only evidence offered was a sum which presumably represented the plaintiff's gross receipts as a water well driller. The refusal by the court to award damages based on the gross figure indicates by

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27. 347 So. 2d 1279 (La. App. 1st Cir.), writ denied, 350 So. 2d 1225 (La. 1977).
28. Id. at 1284.
29. 365 So. 2d 551 (La. App. 1st Cir. 1978).
30. Id. at 562.
31. 387 So. 2d 1243 (La. App. 1st Cir. 1980).
32. 468 So. 2d 833 (La. App. 1st Cir.), writ denied, 474 So. 2d 1307 (1985).
33. *Moran*, 387 So. 2d at 1245.
34. *Rose*, 468 So. 2d at 839.
35. 50 So. 2d 38 (La. App. 2d Cir. 1951).
36. Id. at 46.
37. Id.
38. 179 So. 2d 674 (La. App. 2d Cir. 1965).

implication that the court would have based its damage amount on net income. However, the court did not explicitly state how it would handle that issue, nor did it cite *Frye*.[39]

The 1979 case of *Hardie v. Pylant*[40] touched on the issue of whether the plaintiff's failure to produce tax returns should preclude him from asserting a lost wage claim. The court settled the issue by stating that "net wage" is the proper guideline when computing lost wages, but that failure to establish that tax returns were filed should not result in the rejection of such a claim.[41]

The three second circuit cases above have, more or less, adhered to the position that net income should be used in calculating lost wages. However, two subsequent cases from that circuit have clouded the issue. In *Hunter v. Office of Health Services*,[42] the plaintiff's expert witness used an analysis based on gross income instead of net income. In upholding the use of the gross income figure, the court relied on the Louisiana Supreme Court case of *Cheatham v. City of New Orleans*.[43] In *Cheatham*, the second circuit noted, the high court reinstated an award that had been reduced by the court of appeal. In justifying its position, the supreme court had stated that even though the economist in *Cheatham* had not taken into account the difference between gross and net income, there were "offsetting considerations" for the jury such as a mere 3% inflation increase factor, as well as other factors.[44] In *Hunter*, the second circuit made no mention of the prior decisions in that circuit concerning this issue.

In the 1982 case of *Green v. Farmers Insurance Co.*,[45] the second circuit again upheld the use of gross instead of net income. In *Green*, the court noted that there is no "right formula for establishing loss," emphasizing that net income is sometimes the appropriate measure instead of gross income.[46] As authority for this "flexible" approach, it relied on the recently decided and often cited case of *Lute v. City of Lake Charles*[47] from the third circuit. The court also cited *Hunter* which had, as stated, recently used gross income for determining lost income.[48] The *Green* court's justification was that since there is no "absolutely right" formula for

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39. Id.
40. 375 So. 2d 189 (La. App. 2d Cir. 1979).
41. Id. at 196.
42. 385 So. 2d 928 (La. App. 2d Cir. 1980).
43. 378 So. 2d 369 (La. 1979).
44. Id. at 378.
45. 412 So. 2d 1136 (La. App. 2d Cir. 1982).
46. Id. at 1142.
47. 394 So. 2d 736 (La. App. 3d Cir. 1981).
48. See supra text accompanying notes 42-44.

computing loss, the trial court did not abuse the discretion it has in awarding amounts for the loss of past and future earnings.[49]

Third Circuit Court of Appeal

The third circuit in Louisiana has generally used gross income in computing lost wages.[50] However, there is authority for using net income if the court feels it is warranted. In two cases from the early 1970's, *Menard v. Travelers Insurance Co.*[51] and *Duplechin v. Pittsburgh Plate Glass Co.*,[52] gross income was applied as the correct standard. In *Menard*, the trial court had deducted 20% from the plaintiff's damages for social security, income tax withholding, and the expense of driving to work.[53] On appeal, the third circuit stated that there was no cited authority to buttress this reduction and accordingly ruled that gross income should be used.[54] In support of this ruling, the court cited the fourth circuit case of *Adams v. Allstate Insurance Co.*[55] Similarly, in *Duplechin*, the third circuit held that the trial court was not in error when it failed to consider and adjust for both withholding and FICA taxes when computing lost earnings.[56] The *Duplechin* court cited both *Adams* and *Menard* to justify its ruling.[57]

In the 1981 case of *Lute v. City of Lake Charles*,[58] the third circuit injected a more flexible rule regarding the use of gross or net income in calculating lost wages. In *Lute*, the defendant contended that the plaintiff's net wages, rather than gross wages, should be used.[59] The third circuit, upholding the trial court's use of gross income, maintained that there is no "right" formula for establishing lost wages.[60] In support of its position,

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49. *Green*, 412 So. 2d at 1143; see also Spangler v. North Star Drilling Co., 552 So. 2d 673 (La. App. 2d Cir. 1989) (a recent second circuit case utilizing the net income approach in an action under the Jones Act, 46 U.S.C. § 688 (1982)).

50. See generally Jaffarzad v. Jones Truck Lines, Inc., 561 So. 2d 144 (La. App. 3d Cir. 1990); Montgomery v. Opelousas Gen. Hosp., 546 So. 2d 621 (La. App. 3d Cir. 1989); Breshers v. Department of Transp. & Dev., 536 So. 2d 733 (La. App. 3d Cir. 1988); LeBleu v. Dynamic Indust. Constructors, Inc., 526 So. 2d 1184 (La. App. 3d Cir.), writ denied, 528 So. 2d 154 (La. 1988). But see Breaux v. Valin, 138 So. 2d 405 (La. App. 3d Cir. 1962).

51. 240 So. 2d 390 (La. App. 3d Cir. 1970).

52. 265 So. 2d 787 (La. App. 3d Cir. 1972).

53. *Menard*, 240 So. 2d at 395.

54. Id.

55. 212 So. 2d 204 (La. App. 4th Cir. 1968).

56. *Duplechin*, 265 So. 2d at 794.

57. Id.

58. 394 So. 2d 736 (La. App. 3d Cir. 1981).

59. Id. at 739.

60. Id.

the court stated that the Louisiana Supreme Court has ascertained that future loss of earnings cannot be calculated with certainty, thus rendering the computation of the loss speculative.[61] Consequently, the court continued, net income can sometimes be used, while gross can be the appropriate standard at other times.[62] The court also noted that the defendant, Aetna, had not produced an expert to contradict the way in which the plaintiff's future wage losses were computed.[63]

In two quite recent cases, *Andrews v. Mosley Well Service*[64] and *Pitts v. Bailes*,[65] the third circuit relied on the flexible approach enunciated in *Lute*. Both cases, moreover, calculated lost earnings based on gross income. In *Pitts*, the court deferred to the trial court's decision to use gross income, reasoning that the trial court had exercised sound judgment and was fair to the litigants in arriving at a figure that was unavoidably speculative and for which there is no right formula.[66]

Fourth Circuit Court of Appeal

The fourth circuit, until very recently, generally applied the net standard, but also utilized the plaintiff's gross income if the particular facts of the case justified its use.[67] In the 1974 case of *Edwards v. Sims*, the court stated that damages for loss of income should be based on net income.[68] The reasoning employed by the court was that a plaintiff's gross earnings are never actually available to him. Thus, the court noted, if only net income figures are taken into account when computing damages, the amount excluded from gross income is irrelevant since it would not have been received anyway.[69] The influence of *Edwards* on future cases, however, is limited because the court's statement on this issue is dictum, since the actuary in *Edwards* used the difference between the plaintiff's gross and net income in arriving at his figure.[70]

Scarcely one year later, the *Edwards* case was cited and distinguished in *Morgan v. Liberty Mutual Insurance Co.*[71] The court, acknowledging

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61. Id.
62. Id.
63. Id.
64. 514 So. 2d 491 (La. App. 3d Cir. 1987).
65. 551 So. 2d 1363 (La. App. 3d Cir.), writ denied, 553 So. 2d 860 (La. 1989).
66. Id. at 1378.
67. See, e.g., LaLone v. Weaver, 360 So. 2d 542 (La. App. 4th Cir. 1978); Potts v. Hollier, 344 So. 2d 70 (La. App. 4th Cir. 1977); Adams v. Allstate Ins. Co., 212 So. 2d 204 (La. App. 4th Cir.), writ denied, 214 So. 2d 716 (La. 1968). See generally Annotation, supra note 15, at 615-16.
68. 294 So. 2d 611 (La. App. 4th Cir. 1974).
69. Id. at 616-17.
70. Id. at 617.
71. 323 So. 2d 855, 862 (La. App. 4th Cir. 1975).

the *Edwards* court's position that net income should be used in computing damages, asserted that tax liability varies with changing circumstances and individuals, hence making gross income sometimes the more appropriate measure.[72] The court noted that the instant case constituted such a circumstance. The plaintiff was rendered a paraplegic and mentally incompetent due to an industrial accident.[73] As a result of his grievous injuries, the court maintained that his radically altered circumstances should be taken into account.[74] In its reasoning, the court pointed out that while the plaintiff's award would be tax-free, the income from his investments would not be.[75] Moreover, the plaintiff's medical expenses would probably create a deduction significant enough to relieve him of all tax liability.[76]

Two years later, in *Teal v. Allstate Insurance Company*[77] the fourth circuit, relying on *Morgan*, apparently decided that the circumstances of that case were appropriate for the use of net income in computing lost earnings. In upholding the trial court's use of net income, the appellate court reasoned that deducting taxes was correct since the plaintiff would have been required to pay them had he not been injured.[78] One should note that the injured party in *Teal* did not suffer the life altering effects of the plaintiff in *Morgan*, but instead sustained various broken bones, contusions, lacerations, and abrasions as a result of a motorcycle accident.[79] The distinguishing facts of these cases, therefore, may have been decisive.

The vacillating approach taken by the fourth circuit on this issue continued a year after *Teal* in *Roundtree v. Technical Welding & Fabrication Co.*[80] In *Roundtree*, a wrongful death suit, the court rejected the defendant's argument that there should be a deduction for future income tax from future wages that would have been earned by the decedent.[81] Acknowledging the fact that the fourth circuit had, in the *Edwards* case, stated in dictum that net income is the appropriate measure, the *Roundtree* court relied instead on *Morgan* pointing out that courts have the *option* of using gross income in awarding loss of future wages.[82] Hence, the trial court had not erred in using the gross income figure. The fourth circuit's "flexible" approach in the use of either net or gross income was recently repudiated in *Harris v. Tenneco Oil Co.*[83] In *Harris*, the court stated that

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72. Id. at 862.
73. Id. at 856.
74. Id. at 862.
75. Id.
76. Id.
77. 348 So. 2d 83 (La. App. 4th Cir. 1977).
78. Id. at 86.
79. Id. at 85.
80. 364 So. 2d 1325 (La. App. 4th Cir. 1978).
81. Id. at 1334-35.
82. Id.
83. 563 So. 2d 317 (La. App. 4th Cir. 1990).

the "more equitable rule is to use gross wages."[84] Accordingly, the *Harris* court overruled *Edwards, Morgan,* and *Roundtree.*[85]

Fifth Circuit Court of Appeal

The fifth circuit applies, in general, gross income when computing lost earnings. However, in at least one case, *Poynor v. Cure,*[86] that circuit expressed the position that there is also the option to use net income. In *Poynor,* the court grappled with the issue of whether the judge erroneously instructed the jurors when he told them they could use either gross or net income, or any figure in between, in determining damages. The court dismissed the defendant's contention that *Edwards* represented the current rule and instead relied on the *Morgan* case.[87] Quoting directly from *Morgan,* the fifth circuit agreed that "[b]ecause tax liability varies with the individual and is altered with changing circumstances, in some cases it is more appropriate to project future lost earnings on a figure near the gross income,"[88] thus acknowledging that there should be a choice of using either figure.

On the other hand, in at least three other cases, the fifth circuit has ruled that gross income is the proper measure. In *Landaiche v. Lou-Con,* a 1984 case, the plaintiff was awarded lost wages after the deduction of income taxes.[89] On appeal, the plaintiff argued that even though the Louisiana Supreme Court had not directly addressed the issue, the high court had reinstated in *Cheatham*[90] a trial court's award based on gross income.[91] The plaintiff also quoted from the *Morgan* case and cited decisions from the second, third, fourth, and fifth circuits in support of plaintiff's contention that gross income is the proper standard.[92] The fifth circuit in *Landaiche* agreed with the plaintiff and the correctness of the foregoing jurisprudence, stating that the trial court's application of the net figure was erroneous.[93] The court further noted that the economist had testified that the calculation of income tax factors would require a computer to assure any degree of precision.[94] His calculations, however, were made in the trial court at the request of defendant's counsel, but

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84. Id. at 326.
85. Id.
86. 443 So. 2d 1151 (La. App. 5th Cir. 1983).
87. Id. at 1159-60.
88. Id. at 1160.
89. 461 So. 2d 1107 (La. App. 5th Cir. 1984).
90. Cheatham v. City of New Orleans, 378 So. 2d 369 (La. 1979).
91. *Landaiche,* 461 So. 2d at 1114.
92. Id.
93. Id.
94. Id.

the trial judge used the gross income figure, apparently implying that the figures were not sufficiently precise.[95]

Two more fifth circuit cases have also ruled that gross income is the proper measure. In the 1982 case of *Holmes v. Texaco, Inc.*,[96] the court, citing a first and second circuit case, stated that gross income should be utilized in computing wage loss. Four years later in *Riley v. Winn-Dixie Louisiana, Inc.*, the court relied on *Holmes* echoing that gross income should be used.[97]

Federal Cases Construing Louisiana Law

Federal courts in at least three cases have been called upon to determine how the Louisiana state courts would decide the issue of whether to use gross or net income in computing lost wages. Not surprisingly, there has again been no consistency. In *Wright v. United States*,[98] the Eastern District of Louisiana was asked to decide, *inter alia*, whether a patient negligently injured in a VA hospital should, under Louisiana law, be awarded net or gross income when calculating past and future lost wages. The court, citing numerous cases, held that the "weight" of state law requires that net income should be applied.[99] Similarly, in *Domangue v. Eastern Airlines, Inc.*,[100] a wrongful death suit in which the United States was one of the defendants, the Eastern District ruled that there was no abuse of discretion in utilizing net income.[101] The court, however, did correctly acknowledge that the Louisiana circuits are divided on the issue.[102]

In *Fenasci v. Travelers Insurance Co.*,[103] a diversity of citizenship case brought about by a truck accident victims' survivors, the Fifth Circuit ruled that the district court's refusal to allow evidence of net income during the trial was not erroneous.[104] In *Fenasci*, the court stated that it is well settled in Louisiana law that a trial judge should be granted much discretion in determining the quantum of damages.[105] Citing both the *Roundtree* and *Morgan* cases from Louisiana's fourth circuit,[106] the court maintained that the trial court can apply gross or net income or any figure in between.[107] Its reasoning, quoting from the *Morgan* case, was that "tax

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95. Id.
96. 422 So. 2d 1302, 1304 (La. App. 5th Cir. 1982).
97. 489 So. 2d 931, 937 (La. App. 5th Cir. 1986).
98. 507 F. Supp. 147 (E.D. La. 1981).
99. Id. at 161.
100. 542 F. Supp. 643 (E.D. La. 1982).
101. Id. at 652.
102. Id. at 651.
103. 642 F.2d 986 (5th Cir. 1981).
104. Id. at 989.
105. Id.
106. See supra text accompanying notes 71-82.
107. *Fenasci*, 642 F.2d at 989.

liability varies with the individual and is altered with changing circum-
stances."[108]

In view of the inconsistent and often confusing treatment by the
Louisiana circuits concerning the issue of whether to use gross or net
income when computing damages in personal injury and wrongful death
suits, it is the contention of the authors that the net income approach,
presented below, is the fairest and most economically sound. Moreover,
utilizing the net income approach would create a consistency and pre-
dictability that is sorely lacking in Louisiana jurisprudence.

THE PROPRIETY OF USING NET INCOME IN CALCULATING DAMAGES: AN ECONOMIC ANALYSIS

The purpose of an award for the loss of future wages is to make a
person economically whole.[109] Presumably, this entails replacing what the
person could be expected to have earned as take-home pay over an expected
work-life.[110] At the end of that period, a fund established to replace these
earnings should have declined to a zero value, leaving no principal, or
the earnings it would generate.[111] Neither should a shortfall occur, leaving
the recipient of an award without income for a period during which wage
earnings otherwise would have been received.

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108. Id.
109. Statutory authority in Louisiana for the recovery of damages is based on La.
Civ. Code art. 2315, which states in pertinent part, "Every act whatever of man that
causes damage to another obliges him by whose fault it happened to repair it." See
generally Henderson, Restoring the Tort Victim to Pre-injury Position, 67 A.B.A. J. 301
(1981).
110. See generally G. Martin, Determining Economic Damages § 1010 (1988); M. Seck,
Determining Economic Loss in Injury and Death Cases 55 (1987); Franz, A Solution to
Problems Arising From Inflation When Determining Damages, 45 J. Risk & Ins. 323
(1978); Schilling, Estimating the Present Value of Future Income Losses: An Historical
Simulation 1900-1982, 52 J. Risk & Ins. 100 (1985); Smith, The Use of Inflation Factors
in Determining Settlements in Personal Injury and Death Suits, 43 J. Risk & Ins. 369
(1976); Veron, supra note 17, at 838; Comment, Inflation and Future Loss of Earnings,
27 Baylor L. Rev., 281 (1975).
111. See generally Edwards, Selecting the Discount Rate in Personal Injury and Wrong-
ful Death Cases, 42 J. Risk & Ins. 342 (1975); Hamilton & Cornwell, The Appropriate
Discount Rate in Personal Injury Cases, 29 La. B.J. 184 (1981); Harris, Bell, Taub &
Hickman, Selecting Income Growth and Discount Rates in Wrongful Death and Injury
Cases: Comment, Additional Comment, and Further Comment, 44 J. Risk & Ins. 117
(1977); Harris, Inflation Risk as Determinant of the Discount Rate in Tort Settlements,
50 J. Risk & Ins. 265 (1983); Henderson, The Consideration of Increased Productivity
and the Discounting of Future Earnings to Present Value, 20 S.D.L. Rev. 307 (1975);
Veron, supra note 17, at 840-50; Wolfson, Economic Variables in Recent Louisiana
Personal Injury and Wrongful Death Actions, 28 La. B.J. 135 (1980); Note, Loss of
Future Earnings: Present Worth Versus Wage Growth, 35 Mont. L. Rev. 354 (1974).

Although using net income to make such calculations would seem to be obviously preferred to using gross, the preceding paragraphs have indicated that the matter of using gross versus net wages has obviously not been settled in Louisiana. As this article will show, the use of gross income and taxable instruments to establish a fund almost always yields widely inappropriate results, and the errors generated are frequently substantial. Further, an award made on the basis of gross income is too large in the majority of the cases, providing an injustice to the defendant and a windfall to the recipient; although in some cases, the situation is reversed. An appropriate award will almost never be made if gross income and taxable investment instruments are used without reference to tax consequences.[112] Beyond that, the richer the recipient, the greater the windfall tends to be.

PRESUMED REASONS FOR USING GROSS INCOME

Three primary reasons may be advanced to support the use of gross income in making lost future income calculations. Perhaps these reasons help to explain why gross figures have been used, even though the reasons can be refuted fairly easily.

First, tax rates can be expected to change over time, in ways not readily foreseeable at the time a judgment must be rendered. If that is so, then the use of some posited tax rate might be expected to yield more uncertainty than less.[113] Second, the use of tax rates may make the calculation of damages unnecessarily complex.[114] Finally, and perhaps most importantly, if taxable instruments are used to replace lost gross earnings, then taxes on the earnings of those instruments through time might be roughly equivalent to what they would have been on gross wage earnings, with the net result being at least a rough parity between the two, leaving the recipient with the same taxes and net income in either case.[115]

In answer to the first argument in favor of the use of gross earnings, it should be noted that average federal tax rates on personal income have not changed radically over time, as may be seen in Table 1 and Figure 1. While marginal tax rates have changed, and while legislators do seem to make changes in the tax structure on a fairly frequent basis, changes in terms of the total tax burden are less volatile, and the total tax burden is more stable than one might initially presume.

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112. Calculations and procedures employed in this article apply to lost wage calculations and may not be directly applicable to the determination of business losses.

113. See supra text accompanying notes 6-7.

114. See supra text accompanying note 10.

115. See Morgan v. Liberty Mut. Ins. Co., 323 So. 2d 855, 862 (La. App. 4th Cir. 1975); see also supra text accompanying notes 71-76.

Secondly, future tax rates are capable of estimation.[116] In that sense, they are like many other economic variables, including future interest rates, workforce participation rates, and the like. While their future values cannot be determined with certainty, estimates should be accurate within reasonable bounds, and no more likely to be wrong on the high side than on the low, unless faulty procedures are used in the estimation. In any case, tax rates are taken into account continuously as an every day matter by participants in financial markets. Expected future tax rates, along with all relevant factors affecting them, are incorporated within the structure of interest rates paid on both taxable and non-taxable financial instruments, which reflect a general consensus of the financial community. The reason a differential between taxable and non-taxable instruments usually exists is because taxes can be expected to be paid on taxable earnings in the future. The reason the differentials are as large or as small as they are is because of the anticipated size and timing of those expected tax rate differentials. The only tax rate certain to be wrong would be a tax rate of zero, the implicit choice when tax effects are not considered.

The answer to the argument concerning complexity is brief. The use of tax rates and incremental after-tax cash flows is the stuff of elementary college finance courses, where the means of dealing with those concepts is taught to every business student by their junior year. The techniques employed in performing the calculation have provided little mystery for many years running. Although some problems concerning the effects of taxes upon cash flows can prove very complex and challenging, most problems, including those involved in determining lost income awards, can be handled readily without resort to esoteric procedures. The ready availability of computers has made this especially true.

The answer to the third argument in favor of using gross figures, that taxes would offset one another, will be provided by reference to the tables shown below. Tax burdens on fund earnings are not equal to what they would have been on earned income, and very rarely do they balance out over time. Further, the errors introduced by using gross earnings and taxable yields are different in kind from those that would result from the use of future tax estimates. While estimates of future tax rates would tend to produce errors that are unbiased, the use of gross earnings and taxable yields produces a consistent bias that can and should be avoided.

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116. See generally Brady, Brookshire & Cobb, supra note 11; Brady, Brookshire & Cobb, Calculating the Effects of Income Taxes on Lost Earnings, Trial, Sept., 1982, at 65; Franz, Should Income Taxes be Included When Calculating Lost Earnings?, Trial, Oct., 1982, at 53; Ward & Olson, The Economic Impact of Tax on Damage Awards, Trial, Aug., 1981, at 47.

- Table 1 -

PERSONAL INCOME AND INDIVIDUAL INCOME TAXES
(Millions of Dollars)

Year:	Personal Income:	Income Taxes:	Percent:
1961	426.0	41.3	9.7%
1962	453.2	45.6	10.1%
1963	476.3	47.6	10.0%
1964	510.2	48.7	9.5%
1965	552.0	48.8	8.8%
1966	600.8	55.4	9.2%
1967	644.5	61.5	9.5%
1968	707.2	68.7	9.7%
1969	772.9	87.2	11.3%
1970	831.8	90.4	10.9%
1971	894.0	86.2	9.6%
1972	981.6	94.7	9.7%
1973	1,101.7	103.2	9.4%
1974	1,210.1	119.0	9.8%
1975	1,313.4	122.4	9.3%
1976	1,451.4	131.6	9.1%
1977	1,607.5	157.6	9.8%
1978	1,812.4	181.0	10.0%
1979	2,034.0	217.8	10.7%
1980	2,258.5	244.1	10.8%
1981	2,520.9	285.9	11.3%
1982	2,670.8	298.1	11.2%
1983	2,838.6	288.9	10.2%
1984	3,108.7	296.0	9.5%
1985	3,325.3	334.6	10.1%
1986	3,526.2	349.0	9.9%
1987	3,777.6	392.6	10.4%
1988	4,064.5	401.2	9.9%

Business Statistics, 1961-88, U.S. Department of Commerce, Bureau of Economic Analysis, December 1989, p. 1 and p. 68.

figure 1
Individual Income Taxes
as a Percent of Personal Income
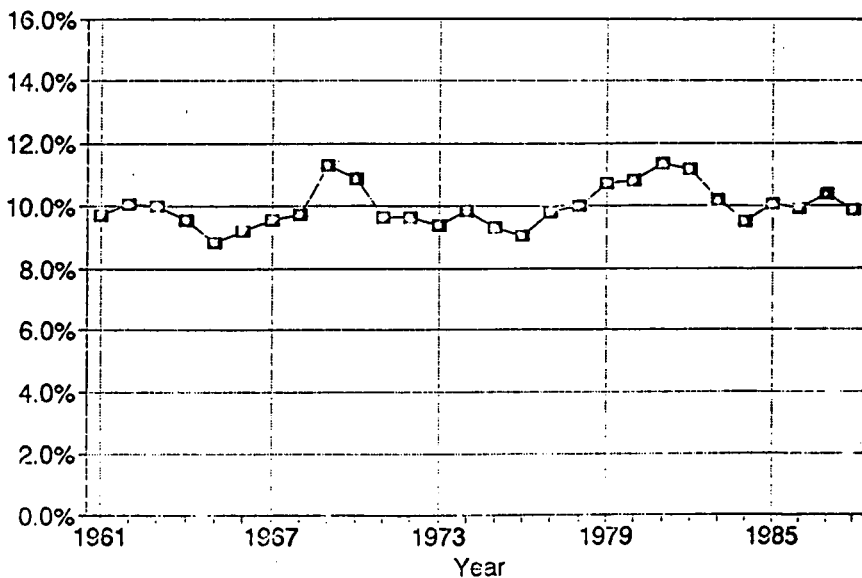
ILLUSTRATIVE EXAMPLES

Sample calculations shown in Table 2 below illustrate the different values that would result from using various procedures to calculate lost future income awards. In this first example, net earnings are assumed to be provided by a gross income of $20,000 per year for ten years, with a presumed tax rate of 20%. After-tax net income would be $16,000 per year ($20,000 less 20%), and the after-tax yield on taxable instruments would be 8%, given a posited pre-tax yield of 10% (for each $10 of interest, a recipient would retain $8 after taxes). These rates have been chosen so that the figures shown in the table can be easily verified by using a hand calculator. A growth rate of 0% in gross annual wages has been assumed to further ease calculation. For comparison purposes, a yield of 7% on non-taxable, high-grade municipal securities has been assumed.

As can be seen and readily verified, the present value of lost gross income of $20,000 for ten years at a 10% discount rate (the pre-tax yield on taxable instruments) would be $122,891. If the same calculations were performed by using the $16,000 after-tax earnings and the 8% after-tax yield, the present value of future earnings would be $107,361, which again can be readily verified.

Table 2 -

Tax Rate:	20.0%		Pre-Tax Yield:	10.0%
			After-Tax Yield:	8.0%
First Year's				
			Tax-Free	
Gross Cash Flow:	$20,000		Municipal Yield:	7.0%
Net Cash Flow:	$16,000			
Growth Rate:	0.0%			
Number of Periods:	10			

CALCULATED PRESENT VALUES: Over or Under Value
On Gross, No Taxes: (1) $122,891   14.5%

On Net, After-Tax Treasuries

WITHOUT Regard to Taxes: (2) $98,313   -8.4%
WITH Regard to Taxes: (3) $107,361 .   0.0% <====

On Net, using Munis: (4) $112,377   4.7%
= =

| Sum Invested | (1,2,3, or 4 from above) | 3 |
| Invested In | (Treas or HgMu): | Treas |

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	107,361	10,736	2,147	16,000	99,950
2	99,950	9,995	1,999	16,000	91,946
3	91,946	9,195	1,839	16,000	83,302
4	83,302	8,330	1,666	16,000	73,966
5	73,966	7,397	1,479	16,000	63,883
6	63,883	6,388	1,278	16,000	52,994
7	52,994	5,299	1,060	16,000	41,234
8	41,234	4,123	825	16,000	28,532
9	28,532	2,853	571	16,000	14,815
10	14,815	1,481	296	16,000	0

The way in which a fund based upon net earnings and after-tax yields would pay out is shown toward the bottom of Table 2. In the first year, the $107,361 fund noted above would earn 10%, or $10,736. Taxes of 20% would take $2,147 of those earnings, leaving the rest, along with some principal, to pay the first year's net cash flow of $16,000, which would be free of further taxes. Because of the removal of some of the principal, the value of the fund would decline to $99,950, which then would become the beginning balance of the fund for the second year.

It should be noted that earnings of $20,000, if obtained from employment, would have been taxable in total, yielding a tax burden of $4,000. Because income is being replaced from a fund, however, and because only the earnings of the fund and not withdrawals of principal are taxable, the smaller tax burden of $2,147 would result. The lower relative tax burden on the fund explains why the fund's initial value would have to be lower once taxes were taken into account.

Successive years would yield progressively smaller tax burdens as more and more of each year's cash flows came from non-taxable principal, and less and less from fund earnings. In the end, the fund balance would be reduced to zero, as it should be, with the fund having provided its required net annual $16,000 cash flows throughout.

This situation may be contrasted with the payout pattern depicted in Table 3. As can be seen there, the fund of $122,891, which resulted from calculations using gross income and pre-tax yields, would leave a remaining balance $33,528 at the end of the tenth year, a sizable windfall. The reason this windfall exists is because of the differential between fully taxable wage earnings and partially taxable fund withdrawals. Because each year yields a progressively smaller tax burden on the fund than what the tax burden would have been from earned wages, *and because the initial calculations will not have taken the fact into account*, the initial fund balance will be artificially high, in this case by 14.5%.

Further inspection will reveal that neither net wage earnings discounted by using pre-tax yields, shown on Table 4, nor (in this instance) net earnings discounted by using tax-free municipal yields, shown in Table 5, would generate accurate results either. In the first instance, although taxes on wages are accounted for, the taxes that would have to be paid on the fund's earnings are not, so the initial fund value is underestimated. In essence, this sort of calculation assumes that net earnings flows of $16,000 per year would be replaced, but that nothing would have to be paid to cover taxes generated by the fund itself. This obviously is in error. Without enough earnings to meet taxes and withdrawals, the fund would be exhausted part way through the ninth year.

In the case of high grade municipals, the rate of return shown in the example is lower than the after-tax yield of the taxable instruments.

- Table 3 -

Fund Value Calculated by Using Gross Wages and Pre-Tax Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	122,891	12,289	2,458	16,000	116,723
2	116,723	11,672	2,334	16,000	110,060
3	110,060	11,006	2,201	16,000	102,865
4	102,865	10,287	2,057	16,000	95,095
5	95,095	9,509	1,902	16,000	86,702
6	86,702	8,670	1,734	16,000	77,638
7	77,638	7,764	1,553	16,000	67,849
8	67,849	6,785	1,357	16,000	57,277
9	57,277	5,728	1,146	16,000	45,859
10	45,859	4,586	917	16,000	33,528

- Table 4 -

Fund Value Calculated by Using Net Wages and Pre-Tax Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	98,313	9,831	1,966	16,000	90,178
2	90,178	9,018	1,804	16,000	81,392
3	81,392	8,139	1,628	16,000	71,904
4	71,904	7,190	1,438	16,000	61,656
5	61,656	6,166	1,233	16,000	50,589
6	50,589	5,059	1,012	16,000	38,636
7	38,636	3,864	773	16,000	25,726
8	25,726	2,573	515	16,000	11,785
9	11,785	1,178	236	16,000	(3,273)
10	0	0	0	0	0

- Table 5 -

Fund Value Calculated by Using Net Wages and Tax-Free Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	112,377	11,238	2,248	16,000	105,367
2	105,367	10,537	2,107	16,000	97,797
3	97,797	9,780	1,956	16,000	89,621
4	89,621	8,962	1,792	16,000	80,790
5	80,790	8,079	1,616	16,000	71,254
6	71,254	7,125	1,425	16,000	60,954
7	60,954	6,095	1,219	16,000	49,830
8	49,830	4,983	997	16,000	37,817
9	37,817	3,782	756	16,000	24,842
10	24,842	2,484	497	16,000	10,829

The result is a fund value that would yield a net end of period windfall
to its recipient, if an award so determined were invested (as it properly
should be) in taxable instruments. In this instance, it would benefit the
recipient to pay the taxes that the taxable instruments would generate.
Enough income would still be left after taxes to exceed what would
have been earned from an investment in lower yielding tax-free muni-
cipals.

WHICH AFTER-TAX YIELD?

Had tax-free municipal rates been closer to pre-tax rates for taxable
instruments, then investment in a fund consisting of such municipals
might have been preferred. An example of this sort of situation is shown
in Table 6, where the tax-free rate has been assumed to be 9%, a full
percent higher than the after-tax rate on taxable instruments. In this
instance, the yield would be high enough to justify going with the high
grade municipal rate applied against net wages. Interestingly, in this
situation, the use of after-tax yields on taxable securities to replace
future net income would result in an initial fund value that is too high.
Further, a fund of $122,891, determined by using gross income and pre-
tax yields, would produce a $47,842 end-of-period windfall.

In any case, one or the other of the after-tax yields will provide
the lowest, and correct, present value estimate of lost future wages. In
the instances shown, the use of gross income and pre-tax yields always
would generate windfalls to recipients and undue expenses to those who
provided such funds.

- Table 6 -

Tax Rate:	20.0%		Pre-Tax Yield:	10.0%
			After-Tax Yield:	8.0%
First Year's				
			Tax-Free	
Gross Cash Flow:	$20,000		Municipal Yield:	9.0%
Net Cash Flow:	$16,000			
Growth Rate:	0.0%			
Number of Periods:	10			

CALCULATED PRESENT VALUES: Over or Under Value
On Gross, No Taxes: (1) $122,891   19.7%

On Net, After-Tax Treasuries

WITHOUT Regard to Taxes: (2) $98,313   -4.3%
WITH Regard to Taxes: (3) $107,361   4.6%

On Net, Using Munis: (4) $102,683   0.0% <====
= =
Fund Value Calculated by Using Gross Wages and Pre-Tax Yields
Invested in Tax-Free Instruments
— —

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	122,891	11,060	0	16,000	117,952
2	117,952	10,616	0	16,000	112,567
3	112,567	10,131	0	16,000	106,698
4	106,698	9,603	0	16,000	100,301
5	100,301	9,027	0	16,000	93,328
6	93,328	8,400	0	16,000	85,728
7	85,728	7,715	0	16,000	77,443
8	77,443	6,970	0	16,000	68,413
9	68,413	6,157	0	16,000	58,570
10	58,570	5,271	0	16,000	47,842

TAX BURDEN REVERSALS

The relationship between after-tax and pre-tax yield calculations will sometimes be reversed when wage growth rates are considered and when cash flows can be expected to continue for a long period of time. Reference to Table 7 will show that net earnings and after-tax yields

will generate a correct fund value that is higher than the incorrect value obtained by using gross earnings and pre-tax yields. The example shown here employs all of the same assumed values as the first example, except for a 5% annual growth in gross wage earnings, and a thirty-five year time period.

Fund values determined by using net income and net yields will be higher in cases like this for good reason. An analysis of the payout of this fund shows that fund earnings in the first years exceed what gross wages would have been. Therefore, higher tax burdens are incurred by the fund in those years than would have been incurred by the recipient from earned wages.

Fund earnings in the early years must be high enough both to meet annual withdrawals and enhance the fund so that it can maintain its purchasing power and meet the progressively higher demands placed upon it during succeeding years. As a consequence, the fund balance grows for some period, in this case until the twentieth year. After that year, fund withdrawals plus taxes exceed fund earnings, and each subsequent year's withdrawal of principal depletes the fund further. Finally, the fund's value is reduced to zero at the end of the thirty-fifth year.

During the latter years, when withdrawals are made largely from principal, the tax burden on the fund will be less than the burden on wage earnings would have been. For those years the recipient will obtain a relative tax benefit. Such years are fewer in number and further removed in time than the early years, however, when increased tax burdens would be the rule. This results in an increased overall tax burden on the fund recipient. The value of the fund must be high enough initially to meet the increased tax burden resulting from fund growth during the early years.

None of the other methods of calculation would yield appropriate results. In this example, the value determined by using net wages and high grade municipals would be too high once again, even though the municipal yield is lower than the after-tax yield on taxable instruments, while the fund based upon gross earnings and pre-tax yields would be too low.

If the initial fund of $386,683 determined by using municipals were properly invested (in this instance in taxable securities), the fund would pay out as shown in Table 8, resulting in an end of period windfall of $773,600. If the growth rate of 5% were assumed to be representative of the expected rate of increase in the cost of living, that ending fund balance still would have a present day purchasing power of $140,246, a very sizable sum indeed. On the other hand, the smaller figure of $321,487 associated with gross income and pre-tax yields would generate a shortfall, shown in Table 9. The fund would play out toward the end of the thirty-third year, having been unable to meet both the withdrawals and the tax demands that had been placed upon it.

- Table 7 -

Tax Rate:	20.0%	Pre-Tax Yield:	10.0%
		After-Tax Yield:	8.0%
First Year's Gross Cash Flow:	$20,000	Tax-Free	
Net Cash Flow:	$16,000	Municipal Yield:	7.0%
Growth Rate:	5.0%		
Number of Periods:	35		

Fund Value Calculated by Using Net Wages and After-Tax Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	334,361	33,436	6,687	16,000	345,110
2	345,110	34,511	6,902	16,800	355,919
3	355,919	35,592	7,118	17,640	366,752
4	366,752	36,675	7,335	18,522	377,570
5	377,570	37,757	7,551	19,448	388,328
6	388,328	38,833	7,767	20,421	398,974
7	398,974	39,897	7,979	21,442	409,450
8	409,450	40,945	8,189	22,514	419,692
9	419,692	41,969	8,394	23,639	429,628
10	429,628	42,963	8,593	24,821	439,177
11	439,177	43,918	8,784	26,062	448,249
12	448,249	44,825	8,965	27,365	456,744
13	456,744	45,674	9,135	28,734	464,550
14	464,550	46,455	9,291	30,170	471,543
15	471,543	47,154	9,431	31,679	477,588
16	477,588	47,579	9,552	33,263	482,532
17	482,532	48,253	9,651	34,926	486,208
18	486,208	48,621	9,724	36,672	488,433
19	488,433	48,843	9,769	38,506	489,002
20	489,002	48,900	9,780	40,431	487,690
21	487,690	48,769	9,754	42,453	484,253
22	484,253	48,425	9,685	44,573	478,418
23	478,418	47,842	9,568	46,804	469,887
24	469,887	46,989	9,398	49,144	458,334
25	458,334	45,833	9,167	51,602	443,399
26	443,399	44,340	8,868	54,182	424,689
27	424,689	42,469	8,494	56,891	401,773
28	401,773	40,177	8,035	59,735	374,180
29	374,180	37,418	7,484	62,722	341,392
30	341,392	34,139	6,828	65,858	302,845
31	302,845	30,285	6,057	69,151	257,922
32	257,922	25,792	5,158	72,609	205,947
33	205,947	20,595	4,119	76,239	146,184
34	146,184	14,618	2,924	80,051	77,827
35	77,827	7,783	1,557	84,054	(0)

- Table 8 -

Fund Value Calculated by Using Net Wages and Tax-Free Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	386,683	38,668	7,734	16,000	401,618
2	401,618	40,162	8,032	16,800	416,947
3	416,947	41,695	8,339	17,640	432,663
4	432,663	43,266	8,653	18,522	448,754
5	448,754	44,875	8,975	19,448	465,206
6	465,206	46,421	9,304	20,421	482,002
7	482,002	48,200	9,640	21,442	499,121
8	499,121	49,912	9,982	22,514	516,537
9	516,537	51,654	10,331	23,639	534,220
10	534,220	53,422	10,684	24,821	552,137
11	552,137	55,214	11,043	26,062	570,245
12	570,245	57,025	11,405	27,365	588,500
13	588,500	58,850	11,770	28,734	606,846
14	606,846	60,685	12,137	30,170	625,223
15	625,223	62,522	12,504	31,679	643,562
16	643,562	64,356	12,871	33,263	661,784
17	661,784	66,178	13,236	34,926	679,801
18	679,801	67,980	13,596	36,672	697,513
19	697,513	69,751	13,950	38,506	714,808
20	714,808	71,481	14,296	40,431	731,561
21	731,561	73,156	14,631	42,453	747,633
22	747,633	74,763	14,953	44,575	762,869
23	762,869	76,287	15,257	46,804	777,094
24	777,094	77,709	15,542	49,144	790,117
25	790,117	79,012	15,802	51,602	801,725
26	801,725	80,173	16,035	54,182	811,681
27	811,681	81,168	16,234	56,891	819,725
28	819,725	81,973	16,395	59,735	825,568
29	825,568	82,557	16,511	62,722	828,891
30	828,891	82,889	16,578	65,858	829,344
31	829,344	82,934	16,587	69,151	826,541
32	826,541	82,654	16,531	72,609	820,055
33	820,055	82,006	16,401	76,239	809,421
34	809,421	80,942	16,188	80,051	794,123
35	794,123	79,412	15,882	84,054	773,600

Present Purchasing Power of Residual Balance: $140,246

- Table 9 -

Fund Value Calculated by Using Gross Wages and Pre-Tax Yields
Invested in Taxable Instruments

Period:	Beginning Balance:	Fund Earnings:	Taxes:	After Tax Withdrawal:	Ending Balance:
1	321,487	32,149	6,430	16,000	331,206
2	331,206	33,121	6,624	16,800	340,902
3	340,902	34,090	6,818	17,640	350,535
4	350,535	35,053	7,011	18,522	360,055
5	360,055	36,006	7,201	19,448	369,412
6	369,412	36,941	7,388	20,421	378,544
7	378,544	37,854	7,571	21,442	387,386
8	387,386	38,739	7,748	22,514	395,863
9	395,863	39,586	7,917	23,639	403,893
10	403,893	40,389	8,078	24,821	411,383
11	411,383	41,138	8,228	26,062	418,232
12	418,232	41,823	8,365	27,365	424,325
13	424,325	42,432	8,486	28,734	429,537
14	429,537	42,954	8,591	30,170	433,730
15	433,730	43,373	8,675	31,679	436,749
16	436,749	43,675	8,735	33,263	438,426
17	438,426	43,843	8,769	34,926	438,575
18	438,575	43,857	8,771	36,672	436,988
19	436,988	43,699	8,740	38,506	433,441
20	433,441	43,344	8,669	40,431	427,686
21	427,686	42,769	8,554	42,453	419,448
22	419,448	41,945	8,389	44,575	408,428
23	408,428	40,843	8,169	46,804	394,298
24	394,298	39,430	7,886	49,144	376,698
25	376,698	37,670	7,534	51,602	355,232
26	355,232	35,523	7,105	54,182	329,469
27	329,469	32,947	6,589	56,891	298,935
28	298,935	29,894	5,979	59,735	263,115
29	263,115	26,311	5,262	62,722	221,442
30	221,442	22,144	4,429	65,858	173,299
31	173,299	17,330	3,466	69,151	118,012
32	118,012	11,801	2,360	72,609	54,844
33	54,844	5,484	1,097	76,239	(17,007)
34	0	0	0	0	0
35	0	0	0	0	0

The upshot of these demonstrations is this: the use of gross income and pre-tax yields creates inappropriate results. After-tax yields and net income should be used in every case when determining present values of lost future income. Caution must be exercised, however, when choosing the appropriate after-tax rate to use. In some instances, the after-tax yield on taxable securities will be appropriate, while in others the non-taxable yield on high grade municipals would be preferred. The litmus lies with determining which of the two after-tax yields produces the lower present value. That value will always be correct. This brings about the first qualification of the method propounded in *Culver v. Slater Boat Co.* (hereinafter *Culver II*).[117] In that opinion, the court advocated the use of an appropriate after-tax yield[118] but did not suggest which particular after-tax yield should be used.

FURTHER COMMENTS ON *Culver II*, and Other Extensions

Some further complications can result when real-world tax rates are taken into account. In the example shown in Table 7, for instance, taxes on both fund and wage earnings were assumed to be 20%. In actuality, because the fund earnings differ from wage earnings in almost every year, they would be taxed at different average and marginal rates. In the preceding example, for instance, the early years' fund earnings would be subjected to higher tax rates than wage earnings would have been. Besides that, fund earnings which also differ from one another year by year, would be taxed at different rates as well.

This is a complication that a computer can handle with relative ease, although its exposition goes beyond the scope of this paper.[119] What is important to consider with respect to *Culver II* is this: in *Culver II*, the net cash flow for each year is to be discounted at a particular after-tax rate.[120] In fact, however, each year does not stand alone to bear its taxes separately or apart from other years. Rather, the whole fund, which may be substantial, is taxed in the aggregate, thereby bearing higher marginal and average tax burdens than would have applied to any one year taken singly. If that fact is not considered, then the relative tax burden on the fund will be understated, often resulting in a smaller than appropriate fund value.

REAL WORLD EXAMPLES

With these caveats in mind, using examples that correspond more closely to conditions prevailing at the time of this writing may finally

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117. 722 F.2d 114 (5th Cir. 1983) (en banc) (*Culver II*), cert. denied, 467 U.S. 1252, 104 S. Ct. 3537 (1984); see also Jones & Laughlin Steel Corp. v. Pfeifer, 462 U.S. 523, 103 S. Ct. 2541 (1983) (cited by the *Culver II* Court in formulating its new rule).

118. *Culver*, 722 F.2d at 122-23.

119. See Brady, Brookshire & Cobb, supra note 11, for a more in-depth discussion and model for calculating fund earnings which differ year-to-year with variable tax rates.

120. *Culver*, 722 F.2d at 122-23.

illustrate the degree of error introduced by relying upon gross earnings and pre-tax yields and lend further support to the general tax methodology advocated in *Culver II*.[121] In the first example, net earnings resulting from $20,000 in first year annual gross earnings are presumed to be replaced for various periods of up to thirty-five years. The average yield on a portfolio of taxable United States Treasury securities is taken to be approximately 8.5%, while the yield on tax-free high grade municipals is about 7.1%. A tax structure corresponding to that of 1990 in real terms is presumed for the period, along with the minimum standard deduction and two exemptions. The below market discount (the rate by which interest rates are expected to exceed inflation) is taken to be 3%, the upper limit of the range proposed in *Culver II*.[122]

Differences between the present values determined by using net income and after-tax yields, or high-grade municipals on net earnings, compared to those obtained by using gross earnings and pre-tax yields on taxable securities are shown in Figure 2. In this case, calculations based upon gross earnings would consistently overstate any award of less than twenty-seven years. After that point the award would be understated. The percentages by which the awards would be in error range to approximately 10%.

High grade municipal yields would never be preferred since their values would always be higher than those developed by using after-tax yields. This makes sense since income levels and tax rates based upon only $20,000 in gross earnings would be too low throughout to benefit from the tax-free properties of high-grade municipals, given their lower rates of return.

Normally, non-taxable securities are used to project the large earnings of large funds, which are taxed at higher rates. Since they are demanded for this purpose, their prices are bid up (and their yields bid down) until the differential in earnings between them and taxable securities is enough to offset the marginal tax burden of the large investor. Thus, their yield differential, which reflects high tax rates on large funds, would be inappropriately large for a fund of this size, and the resulting low yields on tax-free instruments would be too low to make their use worthwhile here.

Present values corresponding to the same set of variables, but to a first year gross income of $50,000 per year are shown for various years in Figure 3. As can be seen there, the present values associated with the use of after-tax yields provide consistently lower figures than either gross earnings without taxes considered or high-grade municipals on net wages, until about the twenty-seventh year. Errors created by using gross

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121. Id.
122. Id.

earnings can result in overestimates of approximately 15% in this instance. In this case, high-grade municipals become preferred for funds which must last for more than twenty-five years.

Finally, when replacing net earnings from a first year gross income of $75,000, the error generated by using gross earnings and pre-tax yields could be nearly 20%, as shown in Figure 4. High-grade municipals become preferred for funds lasting for more than twenty years (the fund and fund earnings are large enough then to make them worthwhile), and correct fund values never become as large as the calculated values that would result from using gross earnings and pre-tax rates. The absolute amount by which such calculations could be in error would range from nearly 22% at a maximum for funds of short duration to about 3% as a minimum for funds that would last much longer. A windfall would accrue to the fund recipient in every case for every year.

It is interesting to note that the larger the recipient's income, the larger the errors that result from using gross income. Not only is the percentage of error greater, but that larger percentage applies to the larger absolute size of any award. In essence, the richer the recipient, the greater the windfall. The reason for this is that the size of the

figure 2
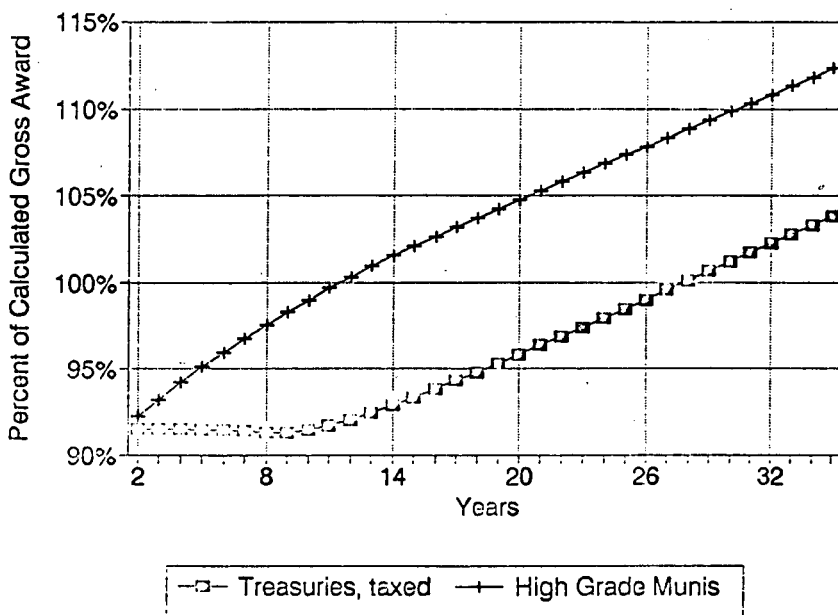## Net vs Gross Present Values by Period
$20,000 Gross Income

Legend: —□— Treasuries, taxed   —+— High Grade Munis

figure 3
Net vs Gross Present Values by Period
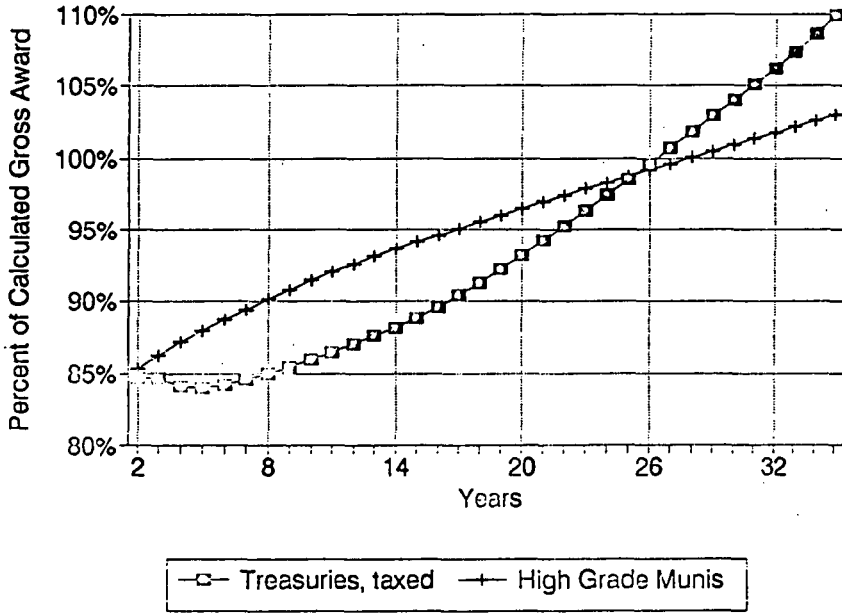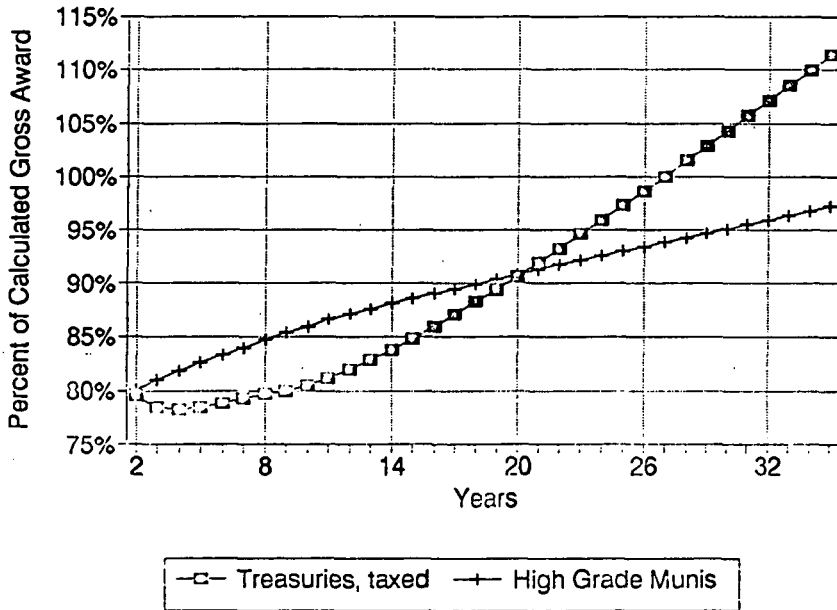## $50,000 Gross Income

figure 4
Net vs Gross Present Values by Period
$75,000 Gross Income

error is a function of tax rates. The higher the tax rate, the more important a matter taxes should be, and the larger is the gain obtained by not taking them properly into account.

SUMMARY AND CONCLUSIONS

American jurisprudence, developed mainly since World War II, has been divided on the issue of whether to use gross or net income in calculating damages for lost earnings suffered by plaintiffs in personal injury or wrongful death suits. The traditional, majority view is that gross income should be used. The three most common reasons advanced by various courts of this view are that calculating future tax liability is too conjectural, that tax liability is an extraneous issue between the government and the plaintiff, and that to introduce the issue would unnecessarily complicate the trial. The minority view, of using net after-tax income, has found judicial and scholarly support as well. The main reason given for this approach is that the injured party would have paid taxes on the income he would have received had he continued to work. Thus, not to deduct for taxes actually would place the victim of the wrong in a position more favorable than if the wrong had not occurred. Other courts have repudiated the majority's contention that estimating future tax liability is too speculative, stating that if future income, life expectancy, and the future value of the dollar can be calculated, so can future tax liability.

The Louisiana courts of appeal that have dealt with the issue have exhibited similar inconsistency and vacillation. The courts of appeal for the first, third, and more recently the fifth circuits, have generally calculated lost earnings based on gross income. With the exception of the first circuit, the other two circuits have sometimes departed from the rule that gross income should be applied, because of the need for a flexible approach on the issue. The second circuit, in contrast to the foregoing, generally has utilized net, after-tax income, but has also recently used gross income. The fourth circuit recently overruled its prior decisions which had applied net income at times, and now subscribes to only the gross income standard.

As is evident from the foregoing discussion, there is a definite lack of consistency and predictability in Louisiana jurisprudence regarding tax liability for lost earnings in personal injury and wrongful death actions. A number of the cases cite a need for flexibility so that the court can have the option of fitting the tax liability to the unique facts of the case at issue. Despite the apparent fairness of such an approach, however, those courts which opt for calculating damages based on gross income are ignoring economic realities. In fact, awarding damages based

on gross income in any situation is not only inappropriate, but usually provides an injustice to the defendant and a windfall to the plaintiff.

If any one of the three primary reasons advanced in support of gross wages were compelling, their influence might still override the usefulness, accuracy, and equity associated with the use of net earnings. But they are not compelling. Overall tax rates have remained fairly constant over time and are capable of estimation. Techniques used to estimate tax effects are broadly available and commonly used, and the ready availability of computers has made those techniques even more accurate. Finally, tax burdens imposed upon wages compared to those imposed upon fund earnings are not equivalent, nor are they synchronized in time. They do not offset one another. By not taking taxes into account, a consistent bias is produced which is often substantial, is capable of elimination, and should be removed. Net earnings provide consistently more accurate results than do gross.

In general, the tax treatment proposed in *Culver II* has much to recommend it. The procedure set forth in that opinion was proposed to establish consistency and simplicity, and it does. With minor modifications to that method, to take into account differential tax rates on earnings and to properly choose the after-tax discount rates whether after-tax United States Treasury rates or tax-free municipal rates, that procedure will tend to produce more consistent and accurate results than have been obtained recently. The adoption of the *Culver II* methodology, or another quite like it, would establish a consistent and equitable standard.