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Instructions on Taxes in Personal Injury Suits

*Lloyd J. Fingerhut**

THE INTERNAL REVENUE CODE enacted in 1954 has continued the 1939 Code provision of law that damages received, whether by suit or agreement, for personal injuries or sickness, are exempt from the Federal income taxation, by providing that such awards are specific exclusions from gross income.[1] In light of this, many defense attorneys engaged in suits of such nature are asking the courts to instruct the jury of such provision, or in their closing arguments are mentioning the same. The introduction of the provision in closing arguments has been the cause of many appeals and subsequent reversals due to prejudicial error.

There are three basic arguments used in support of bringing such information to the attention of the jury. The following is a brief sketch of each:

1. The weight of authority is that on the issue of earning capacity evidence of gross earnings before taxes is proper.[2] "If, then, the jury made its award on basis of the testimony of plaintiff's gross earnings, then plaintiff made a profit from his injuries, because the award made by the jury is tax exempt. Had he not been injured and earned this amount he would have paid several thousand dollars income tax." [3]

2. The jury may think that such awards are taxable and compensate for same ". . . Present economic conditions are such that most citizens, most jurors, are not only conscious of, but acutely sensitive to, the impact of income taxes. Few persons, other than those who have had special occasion to learn otherwise, have any knowledge of the exemption involved in this case. It is reasonable to assume the average juror would believe the award involved in this case to be subject to taxation. It seems clear, therefore, that in order to avoid any harm such misconception could bring about, it would be competent and desirable to instruct the jury that an award of damages for personal injuries is not subject to Federal tax . . . Surely plaintiff has no right to receive any enhanced award due to a possible and we think, probable misconception on the part of a jury that

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* The writer is a second-year student at Cleveland-Marshall Law School. He is a graduate of Ohio State University, where he majored in accounting.

1 Section 104(a) (2) I. R. C. (1939) and Section 22(b) (5) I. R. C. (1954).

2 9 A. L. R. 2d 320.

3 Texas and N. O. R. Co. v. Pool, 263 S. W. 2d 582 (Tex. Civ. App. 1953).

the amount allowed by it will be reduced by taxes. Such instruction would at once and for all purposes take the subject of income taxes out of the case." The preceding quotation is from Justice Hollingsworth's opinion in stating the Supreme Court of Missouri's favorable answer to such a plea, in the case of *Dempsey v. Thompson,* decided July 14, 1952.[4]

3. In such an instruction, the court is merely stating a law to the jury. ". . . It is difficult to perceive how the law is distorted by advising the jury of a simple and concise provision of a statute. Such procedure is not uncommon in the trial of cases; statutes and ordinances are frequently set forth, where applicable, for the enlightenment of the jury . . ."[5] The case containing this dictum was reversed in a higher court of the same state,[6] which opinion serves as a good rebuttal, as we shall later see.

Let us now see how the courts have rebutted such arguments.

As to the first of such reasons as set forth in (1) above, i.e. gross income vs. net income, there is a great deal of judicial opinion to counteract the reasoning used. We find in England, Justice Tucker, speaking for the King's Bench, saying with reference to a physician recovering subject damages: ". . . It seems to me, apart from the practice which has prevailed for so many years (in not allowing such instructions) that *restitutio in integrum* requires the plaintiff to be put in the position in which he would have been vis-a-vis his patients, that is, to receive his fees in full, and that questions of his ultimate liability to the Inland Revenue are matters which do not concern the defendant. . . . A man's income is his own and he can do with it what he likes. Income tax is a charge on the person and not on property or gains; it is to be charged in respect of all property, profit or gains. . . . To give the defendant as wrongdoers, benefit of the tax law, the State would certainly lose, and the measure of the State's loss would be the measure of the defendant's gain."[7]

Such theory is also used in this country, as pointed out by the opinion of Judge Bland. In speaking of alimony in *Phillips v. Phillips*[8] he states " . . . Courts may not readjust a tax burden in a way not intended by Congress. . . ." The Sixth Circuit

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[4] Dempsey v. Thompson, 251 S. W. 2d 42 (Mo. App., 1952).
[5] Hall v. Chicago and N. W. Ry. Co., 349 Ill. App. 175, 110 N. E. 2d 654 (1953).
[6] Ibid.
[7] Billingham v. Hughes, 1 K. B. 643, 9 A. L. R. 2d 311 (1949).
[8] Phillips v. Phillips, 219 S. W. 2d 249 (K. C., Mo. App., 1949).

Court of Appeals, in February of 1945, followed this same line of reasoning, although in relation to bringing to the jury's attention amounts to be recovered under Workmen's Compensation, by saying that "damages wrought by a wrongdoer are measured by the whole loss. The party injured is entitled to recover for all the loss inflicted and the wrongdoer may not take advantage of the contracts or other relations that may exist between injured persons and third persons. The ethics of this rule are that the wrongdoer should not have the benefit of a fund or contract directly or indirectly or by circumvention, to which he in no wise has contributed."[9] The same rebuttal to the original theory was differently expressed by the Supreme Court of Illinois, by stating that ". . . If the jury were to mitigate the damages of the plaintiff by reason of income tax exemption accorded him, then the very intent of Congress to give such injured party a tax benefit would be nullified."[10]

The courts have also looked at such a contention in the light of the practicability of such reasoning. "... We can neither speculate nor conjecture as to how plaintiff's financial status might be affected in the future by business booms or depressions."[11]

A problem would arise in the mathematical separation of the loss of earnings award from the overall damage award which also contains medical expenses and compensation for pain and suffering, as well as cause the discussion of all manifestations of tax deductions. An Ohio Court of Appeals' opinion best brings this out by stating ". . . The result of several such inquiries would so complicate the trial of a personal injury action, into an intricate discussion of tax and non-tax liabilities, and so confuse the ordinary jury with technical tax questions, as to defeat the purpose of a trial."[12]

As to the second argument, as discussed in (2) above—the thoughts of the jury—we can look to the Court of Civil Appeals of Texas, which answers it by saying ". . . It assumes that the jury will not confine itself to the evidence nor the court's charge, but will consider and take into account matters not mentioned therein. This is to assume that there will be misconduct on the part of the jury, an assumption in which we cannot indulge."[13]

[9] Majestic v. Louisville and N. R. Co., 147 F. 2d 641 (C. C. A. 6, 1945).

[10] Hall v. Chicago and N. W. Ry. Co., supra, n. 5.

[11] Cole v. Chicago, St. P., M. & O. Ry. Co., 59 F. Supp. 443, 445 (D. C., Minn., 1945).

[12] John R. Mans v. New York, Chicago & St. Louis Railroad Co., 128 N. E. 2d 166 (Ohio App., 1955).

[13] Missouri-Kansas-Texas R. R. Co. of Texas v. McFerrin, 279 S. W. 2d 410 (Tex. Civ. App., 1955).

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Such reasoning is further emphasized by the reversal by the Illinois Supreme Court in *Hall v. Chicago & Northwestern Railway Co.*, in which the court says that ". . . It may be conceded that the possibility of harm exists if the jury is left uninformed on this matter; on the other hand, it is conceivable that the plaintiff could be prejudiced if they were told of this law. In either case, however, the possibility is speculative and conjectural, and such being the case, it is better to instruct the jury on the proper measure of damages and then rely on the presumption that they will properly fulfill their duty by following said instructions." [14]

As to our third argument, brought out in (3) above—i.e. it is a mere statement of the law—we can again look at the *Hall* case,[15] which easily shows the fallacy by stating that if such were true then why would it be objectionable for plaintiff's counsel to state that the expense of trial is not provided for in instructions concerning damages; and the same for the cost of medical witnesses, plaintiff's attorney, expense of depositions, court reporting, and that the defendant (in this case a corporation), can deduct any award it pays from its income and excess profits tax; and that amounts of rewards are allowed as expenses for increasing railroad fares. This could be developed *ad infinitum*, and all this is the law.

In summary it can be said that the majority of courts do not allow such instructions to the jury.[16] And as stated so well by Judge Graven on November 28, 1955 in the case of *Combs v. Chicago, St. Paul, Minneapolis and Omaha Railway Co.*, ". . . In a final analysis, it would seem that the matter of the giving of an instruction such as that requested . . . should be determined from the viewpoint of judicial administration. A greater number of the courts are apparently of the view that the giving of such an instruction would not in general be in the interest of better judicial administration in that injection of the question of income tax liability into jury cases would probably give rise to more problems than it would solve. . . ." [17]

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[14] Hall v. Chicago and N. W. Ry. Co., supra, n. 5.

[15] Ibid.

[16] Ibid. Mans v. N. Y. C. & St. L. R. Co., supra, n. 12; Combs v. Chicago, St. P., M. & O. R. Co., 135 F. Supp. 750 (D. C. Iowa, 1955); Texas & N. O. R. Co. v. Pool, supra, n. 3; Aikens v. State of Wisconsin, 195 U. S. 194, 206 (1904); Missouri-Kansas-Texas Railroad Co. of Texas v. McFerrin, supra, n. 13; Stokes v. United States, 144 F. 2d 82 (C. C. A. 2, 1944).

[17] Combs v. Chicago, St. Paul, Minneapolis and Omaha Railway Co., supra, n. 16.