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Should Tax Exemption of Tort Recoveries be Considered by the Jury?

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RECENT CASES

SHOULD TAX EXEMPTION OF TORT RECOVERIES BE CONSIDERED BY THE JURY?—Plaintiff, a railway employee, brought an action under the Federal Employers' Liability Act for injuries suffered when he slipped and fell on loose gravel while walking to operate a derail switch. From a judgment for the plaintiff, the railroad appealed on questions of law. The Ohio Court of Appeals held that the trial court did not err in refusing to instruct the jury that any amount received by the employee for personal injuries was exempt from federal income taxation, and that the jury had to take that fact in consideration in arriving at their verdict. *Maus v. New York, C. & St. L. RR.*, 128 N.E. 2d 166 (Ohio App. 1955).

The requested instruction was:

... I charge you as a matter of law that by virtue of the Internal Revenue Act of 1954, any amount received by the plaintiff as compensation for personal injuries is exempt from Federal Income Taxation, and you must take this fact in consideration in arriving at the amount of your verdict in this case.\(^3\)

The court's basis for refusing the instruction was that it was not pertinent to the case. Their language was that if the charge is "a correct statement of the law, pertinent to one or more issues and applicable to evidence adduced in the case", a mandatory duty would devolve on the court to give it to the jury. That was not the case here, and the Ohio court held that the instruction was therefore properly refused.

The court further pointed out that the requested charge would serve to confuse the jury:

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 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.\(^5\)

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4 *Id.* at 167.
Thus it will be seen that the court was reluctant to inject the question of income tax consequences into a tort case.

Although the above language is persuasive at first blush, it should be noted at the outset that the Ohio court has in reality used a line of reasoning applicable to a related, but plainly distinguishable line of cases.\(^6\)

In *Stokes v. United States*, Judge Frank refused to deduct income taxes in computing libellants' loss of earning power, saying that "such deductions are too conjectural".\(^7\) He rationalized that tax rates, exemptions and deductions, and dependency status vary too much to consider them in determining the present value of loss of future income. In *O'Donnell v. Great Northern Ry. Co.*,\(^8\) estimated future income tax was not deductible in determining present value of future earnings, in fixing damages for personal injuries. So, in *Chicago & N.W. Ry. Co. v. Curl*,\(^9\) the refusal to permit proof of plaintiff's average net earnings, after taxes, was not prejudicial error. In *Billingham v. Hughes*, a noted English case, the same line of reasoning was advanced; Justice Birkett stated, "when assessing the damages of an injured taxpayer, the court has no concern with the incidence of taxation".\(^10\) (Emphasis supplied) Upon careful analysis, it will be observed that these cases all deal with the question of *whether the injured person's net income, after deduction of income taxes, rather than his gross income*, will be used as the basis for determining the monetary amount of damages due him for loss of his future earning power. As evidenced by the cited cases, the almost universal holding is that the *gross income* must be used, since the probable future deductions are entirely speculative.\(^11\) This is undoubtedly settled law, but it is not necessarily controlling on the problem in the case at hand.

Here, we are faced with the defendant's requested instruction to charge the jury that *nothing should be included in its verdict to compensate for a supposed income tax on the amount of the verdict*. This had nothing to do with whether the damages are computed on the

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\(^7\) Stokes v. United States, *supra* note 6 at 87.

\(^8\) *Supra* note 6.

\(^9\) 178 F. 2d 487 (8th Cir. 1949).

\(^10\) *Supra* note 6 at 649, 9 A.L.R. 2d at 319.

\(^11\) In addition to the fact that possible future deductions are too conjectural, an additional basis for this rule is that the courts cannot "inquire into what happens to the money after it has become the income of the recipient." (Tucker, L. J. in Billingham v. Hughes, *supra* note 6 at 647, 9 A.L.R. 2d at 316).
basis of the plaintiff's net earnings, after taxes, or on his gross earnings. A hypothetical illustration of the difference in the questions may clarify this somewhat. Suppose the plaintiff, injured in an accident, has a work-span of ten years, and his average annual income, before taxes, has been $10,000. He has been paying $3,000 per year federal income tax. The Stokes line of cases would require that the damage figure for loss of future earning power be $100,000 rather than $70,000. No evidence as to net income (after taxes), and no instruction allowing the jury to consider his net income would be proper. The instruction at hand, as analyzed here by the writer, is a cautioning one. It reminds the jury that, after arriving at a damage figure computed on the basis of plaintiff's gross income—in our hypothetical case $100,000—nothing should be added to the $100,000 figure under a misapprehension on the jury's part that the sum is taxable to the plaintiff. In other words, they should not try to "net" the plaintiff $100,000 by awarding him a judgment of $150,000.  

Since this precise question is relatively new, few courts of last resort have squarely passed on the matter. The cases appear to be almost evenly divided on whether a cautionary instruction to prevent the addition of a sum to the judgment (to offset plaintiff's supposed income tax liability) should be allowed. A Missouri case, Hilton v. Thompson supports the Maus holding. (As will be pointed out subsequently, a later Missouri case expressly overruled this decision, therefore this case is used only to indicate the reasoning by which the court arrived at its decision in the instant case). The court said:

"The instruction was properly refused. The jury was properly instructed on the factors to be considered in fixing the amount of respondent's damages and it would not have been proper to inject into the case an extraneous issue regarding the tax exempt status of the damages which might be awarded."

It should be noted that the Missouri court agreed with the Ohio court that the instructions are "extraneous" (the Ohio court said "not pertinent"). Likewise, in Pfister v. City of Cleveland, an argument before the jury by defendant's counsel wherein he stated "... and any verdict you award him will be tax free" was held improper, but not prejudicial.

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12 For a judicial evaluation of this erroneous "tacking-on" of a sum to compensate for income taxes, see Hall v. Chicago & N.W. Ry. Co., 349 Ill. App. 175, 110 N.E. 2d 654, 658 (1953). 13 360 Mo. 177, 227 S.W. 2d 675 (1950). 14 Id. at 681. 15 96 Ohio App. 185, 113 N.E. 2d 366 (1953). 16 Id. at 367. 17 The court ruled that the plaintiff, by not objecting, waived his right to have the jury correctly informed.—Also it is not clear on what basis the court held
However, as before mentioned, *Hilton v. Thompson*\(^ {18} \) has been expressly overruled by a later Missouri Case, *Dempsey v. Thompson*.\(^ {19} \) The latter case said:

We are now convinced and hold that an instruction substantially in the form above outlined above should have been given in this case, and that the case of *Hilton v. Thompson*, 360 Mo. 177, 227 S.W.2d 675, insofar as it is in conflict with the ruling here made, should no longer be followed.\(^ {20} \)

In justifying the decision, the court reasoned as follows:

... it is based on the theory that such an instruction should be given in order to avoid the imminent possibility of juries being led astray due to their likely ignorance of the fact that awards such as is here involved are not subject to income taxes.\(^ {21} \)

The Illinois court indorsed this view in a recent case decided in that jurisdiction.\(^ {22} \) The court remarked:

... Defendant does not maintain that plaintiff should receive anything less than he is rightly entitled to under the law, but it does contend that the jury, after awarding plaintiff an amount of money based on his gross earnings, pain and suffering and medical expenses, should not add anything to this amount for income tax because there is no tax (emphasis supplied) ...

... Since counsel's remark about income tax ... was a correct statement of the law, we perceive no reason why it should be held to be improper, illegal, or prejudicial.\(^ {23} \)

In conclusion it appears that conflicting policy considerations will govern whether or not the *Maus* ruling will be adopted, or whether the *Dempsey* and *Hall* decisions will be chosen. On the one hand we have the argument that the instruction is not pertinent, and will confuse the jury; on the other, the argument that the jury, through mistake, the argument improper. The court intimated that counsel had made an incorrect statement of the law when he informed the jury that the judgment was tax free. They said "technically it would seem" that compensation for loss of wages is not exempt from income taxation under 22(4)(5)—now sec. 104(A)(3)(2) in the 1954 Code. They considered this cured by a general verdict, however. Therefore the value of this case is somewhat doubtful.

\(^ {18} \) Supra note 13.
\(^ {19} \) 363 Mo. 399, 251 S.W. 2d 42 (1952).
\(^ {20} \) *Id.* at ......., 251 S.W. 2d at 45. The court made this ruling prospective only, due to the hardship in this case and the fact that the requested instruction was cautionary only, and within the discretion of the trial judge.
\(^ {21} \) *Id.* at ......., 251 S.W. 2d at 46.
\(^ {22} \) *Hall v. Chicago & N.W. Ry., supra* note 12. Also see *Margevich v. Chicago & N.W. Ry. Co.*, 1 Ill. App. 2d 162, 116 N.E. 2d 914 (1953) where the *Hall* and *Dempsey* cases were approved, but the instruction was struck down nevertheless for addition of another confusing clause.
\(^ {23} \) *Hall v. Chicago & N.W. Ry., supra* note 12 at ......., 110 N.E. 2d at 659, 660. Although this case concerned argument by counsel, the court stated that the same principles governed submission of an instruction on this matter.
will unjustly increase the judgment to compensate for income tax supposedly assessable against the plaintiff. In careful analysis, the better result would appear to be to allow the instruction. After all, a carefully worded instruction will only inform the jury what the law is. Why should it be withheld? Why should they be allowed to speculate on whether or not the plaintiff is liable for income tax on the judgment? As was stated in the Dempsey case:

... 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.\(^\text{24}\)

By applying this rule, the subject of income taxes would be at once and for all purposes removed from the case.\(^\text{25}\)

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Addendum: Since this comment was written, there have been several new decisions which indicate that the trend or judicial opinion is contrary to my conclusion that the instruction should be permitted as within the discretion of the trial court. In Combs v. Chicago, St. P., M. & O. R. Co., 135 F. Supp. 750 (N.D. Iowa, 1955), the court said, "... [T]he giving of such an instruction ... would probably give rise to more problems than it would solve ...", and held that the trial court properly refused such an instruction.

The Hall Case, supra note 12, was reversed on appeal in Hall v. Chicago and North Western Ry. Co., 5 Ill. 2d 135, 125 N.E. 2d 77 (1955), where the Supreme Court, in reversing, upheld the action of the trial court in granting a new trial for the improper injection of tax consequences in argument to the jury. Apparently the language and reasoning of the Appellate Court was not as persuasive to the Supreme Court of Illinois as it was to me.

In Wagner v. Ill. Central Rd. Co., 7 Ill. App. 2d 445, 129 N.E. 2d 771 (1955) the Court went even further and held it to be reversible error to give such an instruction. The Court said at 129 N.E. 2d 772, "... [I]ntroducing the tax question into a suit for personal injuries is prejudicial error if that question possibly entered into the calculation of the jury's award. ..." E.C.R.

\(^{24}\) Dempsey v. Thompson, supra note 19.

\(^{25}\) Even if the conclusion of this paper as to the admissibility of the instruction is adopted, the result reached by the Ohio Court of Appeals might be proper. Since the instruction is cautionary only, and normally within the discretion of the trial judge, the consideration on appeal would be whether or not the refusal, although admittedly in error, was prejudicial. Dempsey v. Thompson supra note 19 at 251 S.W. 2d 45. The treatment in this paper has been limited to whether the granting of this instruction is proper as within the discretionary power of the court. No cases have been found reversing because of refusal to give such an instruction. This is probably because of the difficulty of establishing the prejudicial nature of the error.