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Tax Aspects of Jury Valuation of Future Earnings

John J. Kennett*

WHETHER OR NOT a jury should be instructed, in a personal injury case, that its verdict is exempt from federal income taxation, has been much discussed recently.¹ A most practical element in this problem is the difference between "gross pay" and "take-home pay" in computing the present value of future earnings, when estimating damages.²

The real question presented by the topic concerns impairment, or deprivation, of *future* earning capacity. Some of the early English cases which I shall mention considered earnings lost between the time of injury and the time of trial, in addition to the impairment of *future* earning capacity. Unfortunately, such decisions, in some instances, fail to make clear the apparent (more than real) distinction between the two situations.

I shall attempt to be practical, to point out how a devastating seed (from the standpoint of the plaintiff) may be planted in the minds of the jurors, even before the first witness is sworn. It can very well be planted by defense counsel's questions on voir dire examination of jurors concerning the fact that plaintiff's recovery, under Federal laws, is not subject to the income tax. The seed may be planted during the defense counsel's opening statement. At any time during the trial the seed may be planted; or if already planted, it may be nurtured by a statement of defense counsel in making an objection.

The point is that today almost everybody is sensitive to taxes. Most of the jurors are chagrined over the fact that their own weekly, bi-weekly, or monthly paychecks are considerably de-

* Member of the firm of Kennett, McCutcheon & Soderland of Seattle, Washington; former Chief Dep. Prosecuting Atty. of King County, Wash.; Special Pros. Atty. Snohomish County, Wash.; President, Western Region of NACCA; Advisory Editor of NCS (Negligence & Compensation Service); etc.

[*Editor's Note:* This is the substance of an address delivered before a national audience of attorneys in San Francisco, Calif. in February 1957.]

¹ See, for example, Knachel, *Jury Instructions on Tax Exemptions in Personal Injury Cases*, 6 Clev. Mar. L. R. 71 (1957), citing a number of other articles on this subject (defense attorney's view).

² For tables and methods of computation, see Oleck, *Damages to Persons and Property*, 294, 966.24-966.62 (1957 revision).

pleted before they get them, because of the deductions on behalf of Uncle Sam—(a) the withholding for income tax, (b) the withholding for Social Security, and (c) in some cases, the withholding for State government for workman's compensation, medical aid, etc.

Therefore, it should be clear that if by any means whatsoever, the jurors are given to understand that any amount they award to a plaintiff is (a) free of Federal income tax, (b) free of any deduction for Social Security, or (c) free of other deductions for government purposes such as the jurors have to pay—they will indeed humanly and instinctively (because jealousy is a part of human nature) be *conditioned* to award to the plaintiff something *less* than the present value of his impaired future *gross* earnings. In short, jurors are human beings.

Under F. E. L. A., the Safety Appliance Act, the Boiler Inspection Act, the Jones Act, State statutes dealing with wrongful death, and the statutory laws of the several States with respect to personal injuries resulting in *impaired future earning capacity*, the plaintiff is entitled, in the case of wrongful death, to recover the *pecuniary* loss resulting to decedent's statutory beneficiaries; and, in the case of personal injury, the plaintiff is entitled to be compensated adequately and fully for his pecuniary loss. Of course, under the decisions, there are elements such as (1) impaired ability to engage in recreational activities, (2) disfiguring and humiliating scars, (3) pain and suffering, (4) loss of society, companionship, consortium, care; and in the case of children as beneficiaries, the loss of guidance, instruction, etc. These last mentioned elements, all of which, under our decisions, necessarily have a pecuniary value, are not subjects to be covered in this discussion. The amounts to be awarded for their impairment, or deprivation, are, however, closely connected, from the standpoint of pecuniary measurement, with the subject which I am discussing, i.e., the impairment or loss of future earning capacity.

We all know that the principal guides available to the jury for measuring *such* losses are to a great extent measured by the decedent's or plaintiff's earnings prior to his death or injury. We also all know that a decedent's or plaintiff's earnings prior to his death or injury were, as between him and the United States government, subject to an income tax, a portion of which was regularly withheld from his paycheck. We all know that there were other regular deductions from his paycheck. Hence, defense

counsel argues that the loss to the decedent's beneficiaries, or to the plaintiff in case of disabling injuries, must be measured by his "take-home" pay, rather than by his gross earnings.

At first blush, such an argument seems quite plausible. It is an argument calculated to find immediate acceptance by jurors who instinctively resent these deductions from their paychecks. Therefore, the mere mention, in the presence of the jury, of the fact that its award is tax free, or the suggestion that decedent's or plaintiff's "take-home" pay rather than gross earnings should be the yardstick by which impaired future earning capacity should be measured, strikes a responsive chord in the mind of most jurors.

As I have said, such an argument is plausible,—but, on analysis, as will be presently demonstrated, it is totally unrealistic, and opens the field for the wildest conjecture and speculation concerning the future. *Implicit in this defense argument, is the proposition that the defendant should be given the benefit of the taxes and other deductions which would have gone to the United States government or to the state.* It means that the *wrongdoer*, who is responsible for the death or injury, claims the benefit of those amounts which decedent or plaintiff would have paid for taxes, and the benefit of social security deductions.

The fallacy of such an argument must be immediately apparent. Yet, every day in some court in this country, some lawyer unprepared on this subject permits this ill-founded and fallacious thought to be planted in the minds of the laymen who sit as jurors to determine the case.

The legal means for avoiding such an improper result have been spelled out by all the decisions except those of the Supreme Court of Missouri, where there are two diametrically opposed decisions.³

Even in the absence of the decisions which I shall hereafter mention, any plaintiff's lawyer should be able to advance the following arguments against the right of the defense to restrict, (a) by an instruction of the court, or (b) by argument or remarks in the presence of the jury, the computation of the present worth of impaired or lost future earning capacity, to take-home pay as distinguished from gross pay:

³ *Dempsey v. Thompson*, 363 Mo. 339, 251 S. W. 2d 42 (1952); *Hilton v. Thompson*, 360 Mo. 177, 227 S. W. 2d 675 (1950). As to pleading present value of future earnings, see, *Jacobsen v. Poland*, 80 N. W. 2d 891 (Nebr. 1957).

1. A plaintiff under the doctrine of *res judicata* is required to recover all of his damages in one lawsuit; therefore, if tax rates were reduced after he recovered his judgment, he could not return to court and ask for additional damages to compensate for the change of the tax law.

2. The rate of taxation which might be imposed on future earnings is variable and unpredictable.

3. The tax law relative to permissible exemptions and deductions are subject to constant change.

4. The marital status and the number of dependents affect an individual's tax liability, and these factors cannot be assumed to remain changeless throughout an injured plaintiff's life expectancy.

5. The payment of income taxes is a matter between the individual and his government, and not a concern of the wrongdoer by which the wrongdoer can profit.

6. Wrongdoers who harm plaintiffs in the upper income tax brackets could virtually evade liability by reason of the fact that any award to such an injured plaintiff would represent income already preempted by the Bureau of Internal Revenue.

In short, such a contention by the defense has implicit in it the wildest possible conjecture and speculation, because of the variables which no one can predict with anything bordering on reasonable certainty. The adoption of such a contention would therefore grant to the defendant the means of reducing an award by speculation and conjecture; whereas, a plaintiff must, under the decisions of most states, prove his case with respect to future losses by a *reasonable certainty*, or *reasonable probability*.

It has been distinctly held that it is reversible error to advise the jury, either by an instruction or by argument, that a personal injury award is not subject to federal income tax.⁴ Of this, the oft-cited *Hall* case said:

"It does not necessarily follow that the argument is proper because it correctly states the law. For if the defendant's argument is proper on the basis that it tells the jury what the law is then what objection can there be for plaintiff's counsel to state that the expense of trial is not provided for in the instruction concerning damages, that the cost of medical witnesses is not paid by the defendant, that the expense of taking depositions, as well as court reporting at the

⁴ *Hall v. Chicago and N. W. Ry. Co.*, 5 Ill. 2d 135, 125 N. E. 2d 77, 50 A. L. R. 2d 661 (1955).

trial, must be borne by the individual litigants, that the fees of plaintiff's attorney are not recognized as an element, that the defendant can deduct any award it pays from its income and excess profits tax return and that the amounts of awards are allowed as expenses in providing for increasing railroad fares? This could be developed ad infinitum, and all this is the law.

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

It is proper for the trial court to receive the testimony of an actuary concerning present value based upon the plaintiff's gross income, and it is not error for the trial court to reject defendant's offer of proof of the plaintiff's average net earnings after deductions.⁵

It is improper to get the matter of taxation before a jury either by oral argument or written instruction, because it introduces an extraneous subject, giving rise to conjecture and speculation.⁶

In *Stokes v. United States*,⁷ the court said:

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

The early decisions on these matters came from England, Scotland, and Canada.⁸

In an English case of 1949, we find the following:⁹

"The amount of tax he might have to pay might differ from year to year; but with all these things the defendants certainly have nothing to do, and are equally certainly not

⁵ *Hall v. Chicago and N. W. Ry. Co.*, *Ibid.*, n. 4. *Stokes v. United States*, 144 F. 2d 81 (CCA. 2, 1944); *Majestic v. Louisville & Nashville Ry. Co.*, 147 F. 2d 621 (CCA. 6, 1945).

⁶ *Hall v. Chicago and N. W. Ry. Co.*, *Ibid.*, n. 5.

⁷ Above, n. 5.

⁸ See anno., 9 A. L. R. 2d 320.

⁹ *Ibid.*, n. 8.

entitled to say that, as wrongdoers, they should receive an abatement of the damages they ought to pay by deducting tax, solely for their benefit.”

In a Canadian case, the court said:¹⁰

“The plaintiff by contract is entitled to receive a certain wage. If, by reason of having received these wages he is compelled to pay a certain amount for income tax, that is a matter between him and the Crown. Regardless of the amount of the income tax liability the plaintiff became entitled under his contract with his employer to receive a fixed amount for wages. After carefully considering the matter, I am of the opinion that in awarding compensation, the Court is only concerned, as a guide to the amount awarded, with the amount which the plaintiff would have earned pursuant to his contract with his employer. Whether or not these earnings would or would not be subject to income tax, is entirely outside the scope of the Court’s consideration.”

No deduction for income tax can be made from an award under the Longshoremen’s and Harbor Workers’ Compensation Act, on the present value of an injured employee’s lost future wages.¹¹

Income tax liability cannot be taken into consideration as a ground for diminishing the amount of damages for the impairment of earning capacity.¹²

It is reversible error for *defense counsel to remark* in the presence of the jury that an award to the plaintiff is not subject to federal income tax.¹³

It is prejudicial and reversible error, under F. E. L. A., for *the court to instruct the jury* that plaintiff’s damages are not subject to federal income taxes.¹⁴

Inquiries at the trial into the incidence of taxation in damage suits for personal injuries are not the proper subject for instruction or argument of counsel.¹⁵

Future tax liability is subject to too many variables to be the matter of consideration in an award for future impairment in earning capacity.¹⁶

¹⁰ *Ibid.*, n. 8.

¹¹ *Runnells v. Douglas*, 124 F. Supp. 657 (Alaska, 1954).

¹² *O’Donnell v. Great Northern R. Co.*, 109 F. Supp. 590 (D. C. Calif., 1951).

¹³ *Hall v. Chicago and N. W. Ry. Co.*, above, n. 5.

¹⁴ *Wagner v. Illinois C. R. Co.*, 7 Ill. App. 2d 745, 129 N. E. 2d 771 (1955).

¹⁵ *Highshew v. Kushto*, 134 N. E. 2d 555 (Ind., 1956).

¹⁶ *Combs v. Chicago, etc.*, 135 F. Supp. 750 (D. C. Iowa, 1955).

The trial court, in an action under F. E. L. A., did not commit error in refusing defendant's requested instruction to the effect that any amount received by the plaintiff was exempt from federal income taxation and that the jury should consider that fact in arriving at the amount of their verdict.¹⁷

The trial court did not commit error in rejecting evidence of plaintiff's present income tax liability on the issue of damages in a personal injury action, for the reason that no possible estimate of future tax liability on any given income could be estimated.¹⁸

The same rule applies in a death action arising out of collision between an automobile and a train at a grade crossing.¹⁹

In conclusion, I want to offer this very practical suggestion. In a case which I concluded early this February, and in which I received a \$71,000 verdict, I had as opposition two of the ablest defense counsel in the State of Washington. In pre-trial discovery depositions, they had required the production of plaintiff's income tax returns. I surmised that they intended to argue that any award for plaintiff's impairment of future earning capacity should be based on his take-home pay.

Accordingly, I requested the judge to hold a conference in chambers, with the court reporter present, before any prospective jurors were called into the jury box. This was granted. I advised the judge that I suspected that defense counsel would interrogate prospective jurors concerning their knowledge of the difference between take-home pay as distinguished from gross earnings. The judge immediately responded that he saw nothing wrong with that if they did.

Fortunately, I was prepared to present to him the cases which I have mentioned in this discussion. He was very surprised to find that the law was as I have here stated it. When he became convinced that my position was correct, and when defense counsel were unable to give him any authority to the contrary, he sustained my position and emphatically forbade counsel to inject that issue into the case.

I tell you of this experience because you too may wish to prevent the first seed being planted. If you neglect to do so,

¹⁷ *Maus v. N. Y., Chicago, etc.*, 165 Ohio St. 281, 135 N. E. 2d 253 (1956).

¹⁸ *Texas & N. O. R. Co. v. Pool*, 263 S. W. 2d 582 (Tex., 1953).

¹⁹ *Missouri-Kansas-Texas R. Co. v. McFerrin*, 279 S. W. 2d 410 (Tex., 1955); *Buchner & Sons v. Allen*, 289 S. W. 2d 387 (Tex., 1956).

certainly you should object the first time the matter is mentioned before the jury, and ask that the jury be excused while you argue your contention. However, it may be too late, because you might have a tax-sensitive juror who grasped defense counsel's point simply from hearing the question asked or the statement made. It is mighty hard to unring a bell. It is my suggestion that you don't put yourself in a position where you have to try to do that.