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INCOME TAX CONSEQUENCES: IS THE EFFECT OF INCOME TAXES A PROPER INQUIRY FOR THE COURT OR JURY IN PERSONAL INJURY OR WRONGFUL DEATH ACTIONS?

Kristin A. Nilsson

I. INTRODUCTION

FEDERAL INCOME TAXES are an unavoidable aspect of modern life. With few exceptions, the Federal Income Tax Code requires those who receive income to file a return. Various provisions of the Code specify what should and should not be included in the taxable income of the recipient. Most sources of income are taxable unless specifically excluded by a particular Code provision.

Section 104 of the Code contains one specific exclusion. This section excludes "any damages received . . . on

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1. I.R.C. § 6012 (1987). Section 6012(a) states the general rule that "[r]eturns with respect to income taxes . . . shall be made by the following: (1)(A) [e]very individual having for the taxable year gross income which equals or exceeds the exemption amount. . . ." Id. Following the general rule, a list of exceptions exempts certain individuals from making such returns provided the requisite qualifications are satisfied. Id.

2. The Federal Income Tax Code contains numerous provisions relating to the computation of taxable income. Id. §§ 61-291. Sections 61 through 67 set out the basic definitions, beginning with gross income. Id. §§ 61-67; see infra note 3 for the definition of "gross income." Sections 71 through 89 continue by specifying those items that are specifically included in gross income. Id. §§ 71-89. Items that are specifically excluded from gross income are listed in sections 101 through 135. Id. §§ 101-135; see infra notes 4-7 and accompanying text for a discussion of the section 104 exclusion regarding compensation for injuries or sickness. Provisions relating to deductions and additional exclusions follow. Id. §§ 141-291.

3. Id. § 61. Section 61(a) provides that "gross income means all income from whatever source derived. . . ."

4. Id. § 104. Section 104(a) provides:
account of personal injuries” from the gross income of the recipient. This exclusion “extends to personal injury damages allocable to lost wages.” The result of this exclusion is that the injured party often receives damage awards from personal injury suits and wrongful death actions free of any adverse tax consequences.

This provision is the subject of much debate in the courts. Two primary questions concerning the effect of

(a) In General — Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include —

(1) . . .
(2) the amount of any damages received (whether by suit or agreement and whether as lump sum or as periodic payments) on account of personal injuries or sickness . . . .

Id.

“Id. For a more detailed analysis of damages awards and their taxability, see Jaeger, Owens & Field, Taxability of Damages, 18 Tax Adviser 432 (1987).


“Annotation, Damages — Consideration of Income Taxes, 16 A.L.R.4th 589, 592 (1982). In addition to exemption from federal income taxes, damage awards in a personal injury or wrongful death action are often similarly exempted from state income taxes. Id. at 592-93. However, punitive damages are an exception to the general rule that “any” personal injury damages are excludable. Initially, Revenue Ruling 75-45, 1975-1 C.B. 47 provided that personal injury damages, including both compensatory and punitive damages, were excludable due to the “any” damages language of section 104(a)(2). I.R.C. § 104 (1987). The Tax Court followed this rationale in Roemer v. Commissioner, 716 F.2d 693, 700 (9th Cir. 1983), the first case to apply Revenue Ruling 75-45. See Note, supra note 6, at 305-06. In 1984, the Internal Revenue Service, reasoning that punitive damages are not compensatory but are awarded based on the defendant’s “degree of fault,” reversed Revenue Ruling 75-45. Rev. Rul. 84-108, 1984-2 C.B. 32, 34. Revenue Ruling 84-108 provided that punitive damages are taxable in all circumstances. As a result, the nature of damages controls the taxability of those damages. Roemer, in conjunction with Revenue Ruling 84-108, indicates that the “nature” of damages is determined by reference to state law.

“Uncertainty as to the courts’ tax treatment of damage awards has resulted in problems for taxpayers who are seeking damages. Jaeger, Owens & Field, supra note 5, at 433-34. In particular, because the tax consequences of certain damages remain in dispute, it is difficult to determine the actual amount the taxpayer will receive after taxes. Id. at 440. In addition, this vagueness produces doubt as to the amount the taxpayer should ask for and how he should apportion that request. Id.
income taxes arise. The first inquiry is whether the income tax allocable to lost wages or lost support should be deducted from the total amount awarded. The second is whether it is proper to instruct the jury that personal injury and wrongful death awards which are based on lost wages are not subject to taxation.

In many cases, the answer to both questions is determined by the applicable state law. In other cases, the outcome depends upon the particular federal statute involved. In either case, it is a subject of great concern for many industries, including the airline industry. The larger the potential award, the greater the concern.

This comment analyzes whether the effect of income taxes is a proper inquiry for the court or for the jury in personal injury or wrongful death actions. Part I sets up a general introduction to this analysis, while Part II of this comment contains a general overview of the arguments both for and against the consideration of taxes when calculating damage awards. Part III addresses consideration of tax effects on an award for loss of income. Part IV focuses on the propriety of instructing the jury regarding the taxability of an award. Finally, Part V reviews two recent aircrash cases in which the effect of income taxes was considered on appeal, demonstrating the criti-
cal influence that state law can have on the amount of damages awarded.\textsuperscript{15}

II. JUDICIAL CONSIDERATION OF THE EFFECT OF INCOME TAXES — ARGUMENTS PRO AND CON

Whether the individual courts decide to ignore or consider the tax consequences of a personal injury or wrongful death damage award, the justifications given by the courts over the years are fairly consistent. The split in authority as to whether the courts should consider income taxes does not result from the different arguments that are advanced. The opposing views are simply the consequence of different courts placing more emphasis upon different considerations and, thereby, following one rationale over another. Most of the arguments advanced on both sides are generally made in reference to jury trials. However, many apply to courts sitting without a jury as well.

The majority of courts ignores the tax implications of a damage award.\textsuperscript{16} These courts advance a variety of reasons in support of this proposition. The most common justification is the speculative or conjectural nature of future taxes. This rationale is based on the number of variables that might effect a plaintiff’s tax liability.\textsuperscript{17} Arguably, income tax rates are so subject to change that a court or jury cannot estimate them with sufficient accuracy to justify their admission into evidence. Proponents of the “too speculative” rationale also argue that considera-

\textsuperscript{15} See infra notes 141-163 and accompanying text for a comparison of two recent air crash cases involving the tax considerations of a damages award.

\textsuperscript{16} Note, supra note 6, at 311. The majority of jurisdictions holds that taxability of income is not a proper consideration. Id. Both instructions as to taxability and the evidence itself are improper considerations. Id. (quoting Potts, Income Tax Issues in Personal Injury Litigation, 46 Mont. L. Rev. 59, 65 (1985)).

\textsuperscript{17} Bradford, Measuring Tort Damages for Loss of Earnings Without Deducting Income Taxes: A Wisconsin Rule Which Lost Its Rationale, 70 Marq. L. Rev. 210, 226 (1987). The Second Circuit of the United States Court of Appeals, as early as 1944, refused to deduct income taxes from an award for lost earnings. Stokes v. United States, 144 F.2d 82, 87 (2d Cir. 1944). The court based its refusal on the idea that such a deduction was “too conjectural.” Id.
tion of income tax is an extraneous subject having insufficient relevance to the compensatory determination before the court. Inquiries into taxation at trial open up matters that are not directly pertinent to the issues involved. Income taxes are a private matter between the plaintiff and the government and of no legitimate concern to the tortfeasor. Interjecting income tax questions tends to raise more problems than it solves.

Another common argument relates to the complex nature of taxes. Some courts hold that a plaintiff's potential tax liability is beyond jury expertise and too complex for them to handle while focusing on the factual issues of the case. The Court of Appeals for the Second Circuit

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18 See Yukon Equip., Inc. v. Gordon, 660 P.2d 428, 434 (Alaska 1983). In *Yukon*, the court followed the rationale previously set forth in Alaska Supreme Court decisions and found that the risk of making tax considerations an inappropriate collateral issue at trial outweighed the benefit to the administration of justice. *Id.*

19 Highshew v. Kushto, 235 Ind. 505, 507-08, 134 N.E.2d 555, 556, *petition dismissed*, 235 Ind. 509, 135 N.E.2d 251 (1956) (personal injury action in which the court held that introducing taxation issues into the jury instruction was too complex and would open up matters that were not pertinent); see *Hall* v. Chicago & N.W. Ry., 5 III. 2d 135, 151, 125 N.E.2d 77, 86 (1955). The Supreme Court of Illinois stated in *Hall* that the parties' financial "status" which effectively determines the taxability of an award is immaterial. *Hall*, 5 III. 2d at 151, 125 N.E.2d at 86. What the plaintiff does with the damages award is of no concern to the defendant or the court. *Id.*

20 Lumber Terminals, Inc. v. Nowakowski, 36 Md. App. 82, 373 A.2d 282, 291-92 (Md. Ct. Spec. App. 1977). In holding that damages for lost income are calculated using gross income, the court in *Lumber Terminals* acknowledged the "conjectural or speculative" argument. *Id.* at 82, 373 A.2d at 291. While the court placed its reliance on the "extraneous issue" argument, the court expressly stated that such reliance was not to the exclusion of other relevant factors. *Id.* at 82, 373 A.2d at 291; *see also* Atlantic Coast Line R.R. v. Brown, 93 Ga. App. 805, 92 S.E.2d 874, 876 (1956) (stating that it is no concern to the jury what taxes, fees, or costs are paid by the plaintiff out of his recovery).

21 Gorham v. Farmington Motor Inn, Inc., 159 Conn. 576, 271 A.2d 94, 97 (1970) (a personal injury action following the "majority rule" that taxes are not a consideration in determining the amount of damages).

22 McWeeney v. New York, New Haven & Hartford R.R., 282 F.2d 34, 37 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960). *McWeeney*, brought under the Federal Employers' Liability Act (FELA), 45 U.S.C. §§ 51-60 (1982), held that although a refusal to instruct the jury to calculate lost income damages using "net income" was not error, such an instruction might be proper in the case of a plaintiff with higher earning power. *McWeeney*, 282 F.2d at 38, 39. The court also stated that imposing the duty upon the jury to reduce damages for income taxes might result in impairment of their ability in other areas. *Id.* at 37.
states that three elements influence the determination of lost earning power: future normal earning power; life expectancy; and, the present value discount factor. Adding various other factors, such as income taxes, inflation, and attorney's fees, burdens the jury with "a task that [they] cannot reasonably be expected to perform." In considering income tax effects, the court risks making the tax question a collateral issue at trial, which may overshadow the basic issue of liability. This result burdens more than benefits the administration of justice.

Another explanation supporting the majority view is that Congress intended to bestow a "benefit" when it enacted section 104 of the Federal Income Tax Code. The recipient of a personal injury award benefits by virtue of the Congressional decision not to tax that award. Although Congress has not articulated its reasoning behind enactment of the section, several courts have inferred that the exclusion was intended to benefit the victim, rather than the tortfeasor. Through enactment of section 104, Congress specifically provided an exclusion for personal injury damages and has yet to limit or repeal that exclusion.

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23 McWeeney, 282 F.2d at 35.
24 Id. at 37.
25 Yukon, 660 P.2d at 434 (products liability action following the McWeeney reasoning in holding that failure to give an instruction regarding taxation is not reversible error).
26 Id.
27 See Note, Tort Law — Upon Request, Jurors in a Personal Injury Case Must Be Instructed That the Damages Awarded Are Not Subject to Federal and State Income Taxes, 13 U. Balt. L. Rev. 210, 211 (1983); Hall, 5 Ill. 2d at 152, 125 N.E.2d at 86.
29 Id. at 501; Bradford, supra note 17, at 213; see Hall, 5 Ill. 2d at 135, 125 N.E.2d at 86 (the court stated that "[i]f 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"); Lumber Terminals, 36 Md. App. at 82, 373 A.2d at 292 (court held the award should be based on plaintiff's gross earnings and should not be reduced because of income tax savings resulting from the exemption). The tortfeasor benefits rather than the victim if the section 104 exemption reduces the judgment against him. Bradford, supra note 17, at 212.
30 Bradford, supra note 17, at 212.
Still another rationale opposing the consideration of income taxes by the jury is founded on the idea that the jury is instructed to determine the award in order to "compensate" the victim. Compensatory damages, theoretically, do not include any surmised loss due to income taxes. A strong dissent by Justice Blackmun in *Norfolk & Western Ry. v. Liepelt* asserts that a tax liability instruction does not affect the victim's compensation, the determination of liability or the calculation of damages. It is "purely cautionary in nature." However, since courts cannot presume that an instruction given to the jury is not followed, the majority views an instruction to compensate the victim as sufficient. The court must assume that the jury will follow an instruction to compensate the victim since it is simply not feasible for an instruction to guard against every possible mistake which the jury might make.

A final view in support of the majority position concerns what courts have labeled "offsetting factors." Any overcompensation that might occur when the court ignores tax consequences is offset when the court also ignores inflation and the plaintiff's attorney fees. A third, less commonly mentioned, offsetting factor is the fact that juries do not ordinarily award the plaintiff the "full amount" of their calculations.

The Second Restatement of Torts (Restatement) sup-

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31 Note, supra note 6, at 312.
32 444 U.S. at 498 (Blackmun, J., dissenting); see supra notes 67-70 and accompanying text for further discussion of the case.
34 *Hall*, 5 Ill. 2d at 135, 125 N.E.2d at 85. In *Hall*, the court stated that if the jury is correctly instructed on the measure of damages and told what factors to consider, the court cannot assume that the jury considered factors other than those provided to them. *Id.* In *Michaud v. Steckino*, 390 A.2d 524 (Me. 1978), the court stated that it must presume the jurors reached their decision following the rules of law given to them. *Id.* at 536. The court continued by stating that any other presumption would "assume misconduct on the part of the jury, an assumption in which we are not justified to indulge." *Id.*
35 Note, supra note 6, at 312. As Justice Blackmun states, "It does nothing more than call a basically irrelevant factor to the jury's attention, and then directs the jury to forget that matter." *Liepelt*, 444 U.S. at 502.
36 Bradford, supra note 17, at 229; see *McWeeney*, 282 F.2d at 38.
37 *McWeeney*, 282 F.2d at 38 n.10. The "full amount" is considered the earning
ports the majority view for personal injury suits. The draft states that an award of tort damages is "not augmented or diminished [just] because . . . the award is . . . not subject to taxation." No reduction occurs regardless of the fact that the award "is to compensate for the loss of future benefits which would have been subject to taxation." The comments to the Restatement encompass most of the arguments propounded above. Under the Restatement view, "[w]hether an award of tort damages is itself subject to taxation does not and should not have any effect on the amount of the award."

A minority of courts reject the previously discussed rationales. Instead, these courts hold that tax implications in a damage award are too significant to justify their exclusion. They reject the "speculative nature" argument because other variables that are considered in setting a damage award are also speculative. In particular, with

power multiplied by the plaintiff's life expectancy, discounted to present value.

Id.

RESTATEMENT (SECOND) OF TORTS § 914A (Tent. Draft No. 19, 1973) [hereinafter RESTATEMENT]. Section 914A reads as follows:

§ 914A EFFECT OF TAXATION.

(1) The amount of an award of tort damages is not augmented or diminished because of the fact that the award is or is not subject to taxation.

(2) The amount of an award of tort damages is ordinarily not diminished because of the fact that although the award is not itself taxed, all or a part of it is to compensate for the loss of future benefits which would have been subject to taxation.

It is important to note that no position is taken with respect to: (1) income tax considerations of damages for benefits lost prior to the judgment; or (2) income tax considerations for benefits subject to peculiarly high income tax rates. Id.

The Restatement notes that the Internal Revenue Code excludes personal injury awards from taxable income. Id. comment a; see I.R.C. § 104 (1987). Such a provision in the tax code was made for the benefit of the injured party. RESTATEMENT § 914A comment a. The arguments that this matter is too complicated for the jury and the existence of "countervailing factors" are also addressed. Id. The draft further recognizes that these arguments do not necessarily apply to a loss of past earnings. Id.

See, e.g., Burlington N., Inc. v. Boxberger, 529 F.2d 284, 292-93 (9th Cir. 1975) (remanding case to permit evidence regarding impact of income taxes and non-taxable status of lost-earnings portion of damage award); Floyd v. Fruit In-
respect to determining an amount which compensates for lost income, the possibility of future employment and life expectancy are equally, if not more, unpredictable.\textsuperscript{44} In fact, given the current federal tax provisions and the amount of national debt, the "existence of the income tax in the future is a virtual certainty."\textsuperscript{45} Additionally, problems due to speculation and complexity may be significantly reduced through the use of expert witness testimony.\textsuperscript{46}

The dominant argument advocating the consideration of income taxes is that the jury will erroneously assume the judgment is taxed to the plaintiff and, therefore, will inflate the damage award to compensate for the presumed income tax effect.\textsuperscript{47} Advocates of the minority position argue that when the majority rule was first established, the American public was not as "tax conscious" as they are today.\textsuperscript{48} Informing the jury that an award is not taxable is viewed as a simple and uncomplicated way to prevent such erroneous inflation.

Another reason advanced which supports consideration of the tax consequences of a plaintiff's lost income is that the defendant should not be made to compensate a plaintiff for a loss the plaintiff did not suffer.\textsuperscript{49} Had the plaintiff actually earned the income, he would have paid income

\begin{footnotes}
\item[44] Burlington, 529 F.2d at 293; Bradford, \textit{supra} note 17, at 226.
\item[45] Bradford, \textit{supra} note 17, at 227.
\item[46] See Burlington, 529 F.2d at 293. The court in \textit{Burlington} recognized that "today's sophisticated jurors surely have had some personal experience in determining their own tax liability . . . [and] our juries and judges, with the aid of such competent expert testimony as may be received, are equal to the task and the responsibility." \textit{Id.}
\item[47] Liepelt, 444 U.S. at 497-98; Note, \textit{supra} note 6, at 313. A jury member who is unfamiliar with the federal income tax provisions is likely to assume that the plaintiff is required to pay a portion of the award to the government as taxes. Annotation, \textit{supra} note 7, at 593.
\item[48] Liepelt, 444 U.S. at 491; Note, \textit{supra} note 6, at 314.
\item[49] See McWeeney, 282 F.2d at 40 (Lumbard, J., dissenting) (dissent stated that plaintiff should receive only the amount necessary to make him whole); see \textit{infra} notes 51-60 and accompanying text for further discussion of the \textit{McWeeney} reasoning and decision.
\end{footnotes}
taxes on that income.50 This particular argument applies with equal force to lost support. In wrongful death actions, taxes paid by the decedent would reduce the amount available for the support of his family. The ultimate issue is whether the defendant should be required to compensate the plaintiff or the decedent's family for income the plaintiff or decedent would have never received.

III. Income Tax Consequences in Determining Lost Income

A more specific issue is whether damage awards in personal injury or wrongful death actions should be determined using the plaintiff's or decedent's "net" or "gross" income. Defendants argue that a damage award is properly calculated by estimating and deducting the amount that would have been paid in income taxes. Plaintiffs, on the other hand, contend that the correct amount is determined without deducting income taxes on the income lost. Because of the differing viewpoints, decisions from federal courts and from state courts warrant separate analysis.

A. Federal Decisions

The position taken by federal courts with respect to the income tax issue has changed dramatically over the years. The initial view, clearly enunciated in McWeeney v. New York, New Haven & Hartford R.R.,51 maintained that it was improper to deduct income taxes from a loss of earnings

50 Annotation, supra note 7, at 593. Especially with respect to a damage award attributable to a recovery period or long-term impairment, the award is compensating what would have qualified as "taxable" income had it been earned. Id.
51 282 F.2d at 34 (the McWeeney court considered whether income taxes are an essential factor in calculating lost income and whether to instruct the jury that any damages awarded are not taxable income); see infra notes 102-140 and accompanying text for a discussion of the propriety of instructing the jury as to the taxability of an award. The court in McWeeney was not considering the relevancy of income taxes on damages awards for the first time. The court even references an earlier decision, Stokes v. United States, 144 F.2d 82 (2d Cir. 1944), and expressly adheres to the decision in Stokes where federal law is concerned or applicable state law is silent. McWeeney, 282 F.2d at 39.
award. McWeeney, a FELA action, upheld the trial court's refusal to instruct the jury to consider only the plaintiff's net income in determining future loss of earnings. The court determined that the jury should consider three elements when it calculated damages: future normal earning power, life expectancy, and the present value discount factor. Regardless of the speculation and complications inherent in those three factors, these difficulties did not require the jury to consider other elements. The court held that additional elements would impose an unrealistic and unreasonable task upon the jury. The court also recognized the existence of counterbalancing factors, such as inflation and attorney fees, which offset the possibility of an excessive jury verdict. However, the court expressly confined its holding to cases where the plaintiff brought under federal law or in which state law was silent.

This rule set out in McWeeney was not absolute, allowing flexibility for cases involving particular circumstances.

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52 McWeeney, 282 F.2d at 39. The court expressly followed Stokes, 144 F.2d at 87, which held that a refusal to consider (deduct) income taxes in estimating lost earnings was not error. McWeeney, 282 F.2d at 39.

53 McWeeney, 282 F.2d at 35. However, the court pointed out that when an injured plaintiff is only partially disabled, it must consider post accident earning power as a fourth factor. Id. at 35 n.3.

54 Id. at 36.

55 Id. at 36-37. The court stated that giving an instruction would "[impose] on the jury a task that the jury cannot reasonably be expected to perform . . . [and] would be likely to impair the quality of [the jury's] performance . . . ." Id. at 37.

56 Id. at 37-38.

57 Id. at 39. Although the court in McWeeney was following the holding set out in Stokes, the court explicitly limited its adherence to Stokes to cases where "the question is one of federal law or the applicable state law is silent . . . ." Id.; see Petition of Marina Mercante Nicaraquense, S.A., 364 F.2d 118, 125 (2d Cir. 1966) (holding that where New Jersey Wrongful Death Act was silent with respect to consideration of income tax in computing death awards, judge erred in deducting taxes from decedent's projected gross income); cert. denied, 385 U.S. 1005 (1967).

58 McWeeney, 282 F.2d at 38-39. The court noted that "[t]here may be cases where failure to make some adjustment for . . . income taxes would produce an improper result . . . ." Id. at 38. The court further recognized the need to draw a line to determine when the "high income" of the plaintiff justified consideration of income taxes, but left it to the discretion of the trial judges to draw that line. Id. at 39; see Cox v. Northwest Airlines, Inc., 379 F.2d 893 (7th Cir. 1967), cert. denied, 389 U.S. 1044 (1968). In Cox, the decedent, killed in an airplane crash, had
Despite the McWeeney court's refusal to instruct that lost income is calculated on net income, the court recognized cases in which failure to make such an instruction would produce an incorrect result.\(^5\) An instruction regarding taxes was proper, for instance, if the plaintiff had "great earning power."\(^6\)

Eventually, Burlington Northern, Inc. v. Boxberger\(^6\) recognized the inherent inequity of a damage award that ignores income tax consequences, thus allowing the plaintiff to take home his "gross pay." In Burlington, the survivors of a deceased railroad employee brought suit under FELA.\(^6\) The Ninth Circuit applied the basic principle that the "primary aim in measuring damages has been compensation . . . [to] place the injured person as nearly as possible in the condition he would have occupied had the wrong not occurred . . . ."\(^6\) After addressing objections to the consideration of taxes, the court concluded that "as a matter of fairness and logic, the just approach would require a rule providing for the admissibility of evidence of, and corresponding deduction to account for, future income taxes in all cases."\(^6\) However, recognizing a projected range of lost earnings between $15,655 to $20,608 per annum. \(\text{Id. at 896.}\) Effectively relying on the rationale set out in McWeeney, the court stated that under those circumstances the "impact of income tax has a significant and substantial effect in the computation and may not be ignored." \(\text{Id.}\)

\(^5\) McWeeney, 282 F.2d at 38. The court recited the situation in which a plaintiff had potential earnings of $100,000 annually, half of which would be consumed by income taxes. \(\text{Id.}\) The court stated that in such a situation, an award based on gross earnings would be "plainly excessive." \(\text{Id.}\) The court, however, expressly left the line between high incomes which required consideration of income taxes and lower or middle incomes, which did not, to be drawn at the discretion of the trial judges. \(\text{Id.}\)

\(^6\) \(\text{Id. at 38-39; see LeRoy v. Sabena Belgian World Airlines, 344 F.2d 266, 276 (2d Cir.) (stating that McWeeney "left open the possibility that adjustment for income taxes would be proper if the income were so high that the award would otherwise be excessive . . . ."), cert. denied, 382 U.S. 878 (1965); Montellier v. United States, 315 F.2d 180, 186 (2d Cir. 1963) (holding that Montellier's potential earnings were not so clearly above the "middle reach of the income scale" that it was erroneous not to make such a deduction).}\)

\(^5\) 529 F.2d 284 (9th Cir. 1975).

\(^6\) \(\text{Id. at 286.}\)

\(^6\) \(\text{Id. at 291 (quoting C. McCormack, Law of Damages 560 (1935)).}\)

\(^6\) \(\text{Id. at 294.}\)
the potential conflict with other circuits, the court refused to adopt such a broad rule.\textsuperscript{65} Since the lost income calculated in \textit{Burlington} was beyond “the lower or middle reaches of the income scale” and income taxes thus had the required “significant and substantial effect,” the court simply held that the case fell within the \textit{McWeeney} exception.\textsuperscript{66} Therefore, although the court recognized the need to adjust damage awards for income taxes, it did not expressly hold that such adjustment was proper in all cases.

The rule applicable in federal actions was finally established in \textit{Norfolk & Western Ry. v. Liepelt}.\textsuperscript{67} In \textit{Liepelt}, the Supreme Court held that a determination of lost support under FELA is undeniably influenced by the federal income tax the decedent would have been required to pay.\textsuperscript{68} Recognizing that damage award issues in a FELA action are federal in character, the court stated that the federal character of FELA damages remains even when the action is brought in state court.\textsuperscript{69} Focusing on the ability of the bar to present tax considerations to the jury in an understandable manner and on the “tax consciousness” of the American public, the court found that the decedent’s income tax was a relevant consideration in calculating his lost future earnings.\textsuperscript{70}

The Supreme Court adopted this position three years

\textsuperscript{65} \textit{Id.} The court stated that adopting so broad a rule would place it in conflict with a number of circuits which have adopted the \textit{McWeeney} approach. \textit{Id.}

\textsuperscript{66} \textit{Id.} at 295.

\textsuperscript{67} 444 U.S. 490, reh’g denied, 445 U.S. 972 (1980). For a further discussion of \textit{Liepelt}, see infra notes 107-15 and accompanying text. \textit{See also} Vasina \textit{v. Grumman Corp.}, 644 F.2d 112, 118 (2d Cir. 1981). In \textit{Vasina}, a wrongful death action following the crash of a Navy airplane, the court refused to follow the reasoning of \textit{Liepelt} and held that current New York law supported the lower court’s refusal to permit evidence or jury instruction regarding taxability of a lost income award and that such refusal was not error. \textit{Id.}

\textsuperscript{68} \textit{Liepelt}, 444 U.S. at 493. After-tax dollars provide the only realistic measure of the amount of wages actually lost. \textit{Id.}

\textsuperscript{69} \textit{Id.} Since both \textit{Burlington} and \textit{Liepelt} involve FELA actions, arguably, the reasoning behind the court’s decision is equally applicable to any personal injury suit. \textit{See} Elligett, \textit{supra} note 9, at 646.

\textsuperscript{70} \textit{Liepelt}, 444 U.S. at 494-98.
later in Jones & Laughlin Steel Corp. v. Pfeifer. The Court in Pfeifer held that a damage award in a personal injury action under federal maritime law should reflect after-tax earnings. The Court concluded that it cannot determine an appropriate compensatory award without first considering the income it purports to replace. Thus, a "lost stream of income" is calculated by approximating a series of after-tax payments.

In addition to actions brought under FELA, another common federal statutory cause of action is found in the Federal Tort Claims Act (FTCA). Subject to certain restrictions, the FTCA requires a federal court to determine damages in accordance with the applicable state law. However, in applying state law, the court must subtract income tax when it determines an FTCA award for lost support. This calculation is necessary due to the com-

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71 462 U.S. 523 (1983). In Pfeifer, an employee was injured while working as a loading helper on a Pennsylvania coal barge. Id. at 525. The respondent brought suit under the Longshore and Harbor Workers' Compensation Act, 33 U.S.C. §§ 901-948a (Supp. IV 1986). Pfeifer, 462 U.S. at 526. Actions brought under this act are governed by federal maritime law. Id. at 547.

72 Id. at 534.

73 Id. at 533.

74 Id. at 536.


76 The government of the United States is generally liable to the claimant "in accordance with the law of the place where the act or omission occurred." 28 U.S.C. § 3146(b) (1982). Thus, the United States is liable "to the same extent as a private individual under like circumstances," but is not liable "for interest prior to judgment or for punitive damages." 28 U.S.C. § 2674 (1982). See Barrett v. United States, 660 F. Supp. 1291, 1318 (S.D.N.Y. 1987) (stating that "the FTCA requires a federal court to follow state law in determining damages . . . ").

77 Because section 2674 provides for "actual or compensatory damages," courts have found this requires a deduction for federal income taxes, at least when the earnings are substantial. Shaw v. United States, 741 F.2d 1202, 1206 (9th Cir. 1984) (income tax withheld from damage award in FTCA claim brought on behalf of baby born with severe brain damage due to negligence of army hospital medical staff); Flannery v. United States, 718 F.2d 108, 111 (4th Cir. 1983) (taxes on future income not included in damages awarded to comatose plaintiff injured in collision with vehicle driven by federal employee), cert. denied, 467 U.S. 1226 (1984). Failure to deduct income tax compensates the plaintiff for more than "actual" loss and is therefore deemed punitive, and punitive damages cannot be awarded when the defendant is the United States. Flannery, 718 F.2d at 111.
pensatory nature of the FTCA. Income taxes are thus considered despite applicable state law to the contrary.

Therefore, a relevant consideration for parties bringing diversity suits in federal court is which law the court will apply. The allowance or preclusion of income tax consideration with respect to lost income by the particular state can significantly affect a party's choice of forum. Generally, the proper measure of damages in cases arising under federal law is considered a federal issue and determined under appropriate federal law. However, damages arising in a diversity case may be subject to applicable state law.

B. State Decisions

Although the position taken in cases brought under federal law is fairly well established, a federal court adheres to state law if it can determine what that state law is.

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78 Barrett, 660 F. Supp. at 1318.
79 Id.; see also O'Connor v. United States, 269 F.2d 578, 584-85 (2d Cir. 1959). O'Connor held that income taxes should be deducted from the decedent's estimated future earnings under the FTCA. Id. at 584. The court also noted that Oklahoma law implied that "take home" pay was the proper basis for an award of lost earnings. Id. at 585.
80 Annotation, supra note 7, at 594.
81 Id.; see Turcotte v. Ford Motor Co., 494 F.2d 173, 184-85 (1st Cir. 1974) (court allowed deduction for decedent's state and federal income taxes from wrongful death award).
82 Annotation, supra note 7, at 594; see also Turcotte, 494 F.2d at 177 (Rhode Island applies state law to conflict of law cases only after weighing factors such as predictability of results, simplification of judicial tasks, advancement of the forum's interest and application of the better rule of law).
83 Liepelt, 444 U.S. at 493 (stating that the measure of damages in a FELA action is federal in character). The federal nature of damages in a FELA action remains even when the action is brought in state court. Norfolk S. Ry. v. Rayburn, 213 Va. 812, 195 S.E.2d 860, 864 (1973) (holding that in a FELA personal injury suit, the trial court did not err in refusing to give an instruction advising the jury that any award was not subject to income taxes).
84 Liepelt, 444 U.S. at 493-94; Hobbs, Damages Recoverable for Wrongful Death in Alabama Under the Federal Tort Claims Act, 48 Ala. Law. 16, 17 (1987) (established method is calculating lost earnings on an after-tax basis); see also Note, supra note 6, at 312-13 (although courts recognize the holding in Liepelt, they consider it controlling only if a federal action is involved).
85 Elligett, supra note 9, at 647-48. If state law differs from federal common law, state law, if determinable, is applied. Id.; see also Croce v. Bromley Corp., 623 F.2d
States continue to disagree as to which method best compensates the plaintiff without unduly burdening the defendant. Most state authority holds that it is improper to deduct potential taxes from the lost future income calculation. Gross pay, and not take-home pay, is the proper basis upon which to calculate loss of future earnings. Courts which embrace the majority view often limit their decision to the facts of the situation presented to them. One limitation in particular is to the type of income involved; for example, using gross income with respect to

1084, 1096-97 (5th Cir. 1980) (Louisiana's wrongful death statute did not include a deduction for federal income taxes; the court upheld a calculation based on gross income because the statute was a creation of the state), cert. denied, 450 U.S. 981 (1981).


Annotation, supra note 7, at 606. Several courts have "ruled that it is improper to take income taxes into consideration" but limited such ruling by referring to the particular type of income involved in the case, the amount of such income, or the time it should have been earned. Id.; see, e.g., Beaulieu, 434 P.2d at 673 (holding that an award for future earnings is not reduced by income taxes, but that reduction is proper for portion of award constituting past loss of income).

Beaulieu, 434 P.2d at 673 (distinguishing between past and future income). Relevant factors under "type" of income involved include the nature of the income, its amount, and when it would have been earned. Annotation, supra note 7, at 606.
future or current earnings and net income with respect to past wages.\textsuperscript{90}

In addition to the disparity between state and federal actions, some courts also differentiate between personal injury and wrongful death actions.\textsuperscript{91} A wrongful death action is a statutorily created cause of action. The objective of wrongful death statutes is to compensate the survivors for the value of benefits they would have received from the decedent.\textsuperscript{92} Income taxes reduce both the amount available for the support of the survivors and the amount of earnings the decedent could have accumulated during his lifetime.\textsuperscript{93} Therefore, theoretically, reducing an award by the amount of applicable income taxes is not depriving the survivor of anything he would have received had the income actually been earned. The same reasoning can apply to personal injury awards for lost wages. Reducing an award for income tax does not deprive the plaintiff of any amount he would have received had he actually earned the income.

Another distinction sometimes drawn in tax effect arguments is between past loss of income and future loss of income.\textsuperscript{94} Arguments of uncertainty and speculation do not apply to the portion of the award lost before the time of the trial.\textsuperscript{95} Those taxes are easily calculated using applicable income tax rates. However, distinguishing between past and future lost income places an additional burden

\textsuperscript{90} See infra notes 94-95 and accompanying text for a brief discussion regarding the distinction between income lost prior to trial and income lost post trial.

\textsuperscript{91} Annotation, supra note 7, at 594. Compare Mitchell v. Emblade, 80 Ariz. 398, 405, 298 P.2d 1034, 1038 (incident of income taxes has \textit{no} part in determining correct amount for personal injury damages), modified on other grounds, 81 Ariz. 121, 301 P.2d 1032 (1956), \textit{with} Lux v. McDonnell Douglas Corp., 803 F.2d 304, 310 (7th Cir. 1986) (amount of income tax attributable to decedent’s lost earnings is relevant to plaintiff’s pecuniary damages) (both cases applying Arizona law).

\textsuperscript{92} Bradford, supra note 17, at 231.

\textsuperscript{93} Id.

\textsuperscript{94} Beaulieu, 434 P.2d at 673. The Supreme Court of Alaska expressly requires the deduction of income taxes in determining wages lost from date of decedent’s death to time of trial (past lost earnings). \textit{Id.}

\textsuperscript{95} See Annotation, supra note 7, at 607.
on the jury by requiring even more calculations on their part.

A fewer number of states embrace the idea that a deduction for income taxes is a proper element in the calculation of lost income. As for the speculative nature of taxes, an award based on net income simply requires "guessing" the income after taxes instead of before. Some state courts explicitly require that taxes on lost earnings be taken into account in determining damages. Additionally, some courts in the minority position also make reference to or limit their holdings to particular types of income.

C. Conclusion

The most logical, and apparently Congressionally supported answer is the "majority" view. Under this view, income taxes are not deducted in determining the amount of lost income or lost support in a personal injury or wrongful death action. The Federal Income Tax Code is

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1 See, e.g., Ruff v. Weintraub, 105 N.J. 233, 519 A.2d 1384, 1386-88 (1987) (personal injury action in which the court held that plaintiff's damages are calculated on the basis of net income after taxes, and awards for future lost wages are accordingly reduced by an amount representing future tax liability); Tenore v. Nu Car Carriers, Inc., 67 N.J. 466, 341 A.2d 613, 628-29 (1975) (wrongful death action in which court held that under New Jersey wrongful death statute, plaintiff's recovery is calculated on basis of testimony or extrinsic evidence that proves deceased's net income after taxes).


3 Thornton & Schwartz, Calculating Lost Earnings In Wrongful Death Cases: The Pennsylvania Experience, 58 Pa. B.A.Q. 37, 39 (1987). For an example of a statutory enactment, see Fla. Stat. Ann. §§ 768.18(5), 768.21 (6)(a) (West 1984) (providing that damages for future lost wages in the wrongful death context are based on "net accumulations"; net accumulations are defined as being "probable gross income after taxes").

4 Annotation, supra note 7, at 611; see Adams v. Deur, 173 N.W.2d 100, 105-06 (Iowa 1969) (holding that in a wrongful death action taxes may be considered in calculating plaintiff's damages for past and future earnings, but taxes are irrelevant, and therefore not considered, in calculating damages for future family services.).

5 See I.R.C. § 104(a)(2) (1987) which provides that damage awards for personal injury or sickness are not included in gross income and thus are not taxable; see supra notes 4-7 and accompanying text for further discussion of the section 104 exclusion.
uncontroverted evidence that Congress intended to bestow a benefit upon the injured party. The benefit results from section 104, which excludes from gross income any damages awarded because of personal injuries, whether awarded through a law suit or by settlement agreement.\textsuperscript{101} There is no evidence that Congress intended the courts to void this benefit through jury consideration, and subsequent deduction, of income taxes. If income taxes are not deducted from awards for lost income, no “unjustified windfall” results to the plaintiff. Moreover, the result of allowing such a deduction is that the defendant tortfeasor profits from a statute enacted to benefit the injured plaintiff. Additionally, any requirement imposed upon the jury to apply different rules to different types of income only creates added confusion and adds additional burdens to an already difficult task.

IV. Propriety of Instructing the Jury

The court must also decide whether taxability of an award should be openly addressed at trial; that is, whether or not the court should instruct the jury as to the taxability of a personal injury or wrongful death damage award. The average juror may or may not know of the “tax exempt status” of such damage awards.\textsuperscript{102} Some courts argue that if the jury does not know of the nontaxability of the award, they will mistakenly inflate their verdict to compensate the plaintiff for his presumed tax liability. Courts have generally responded to this issue in one of three ways: (1) accepting the notion that the jury is ignorant of tax laws and, therefore, is entitled to such an instruction;\textsuperscript{103} (2) rejecting the idea of an instruction

\textsuperscript{101} I.R.C. § 104(a)(2) (1987).

\textsuperscript{102} See supra notes 1-7 and accompanying text for a discussion of the tax exempt status of personal injury and wrongful death awards.

\textsuperscript{103} Annotation, supra note 7, at 593; see infra notes 124-29 and accompanying text for a discussion of the view that a tax instruction is proper and necessary to protect against erroneously inflated jury verdicts.
altogether;\textsuperscript{104} and finally, (3) allowing the trial judge the discretion to decide as he sees fit.\textsuperscript{105} A fourth category exists in which the court has simply followed the holding of the court below without stating the rationale behind its decision.\textsuperscript{106}

A. Federal Position

The initial consideration is whether the claim is one based on state or federal law. The 1980 Supreme Court decision of Norfolk & Western Ry. v. Liepelt\textsuperscript{107} addressed the position taken by the courts regarding claims brought under federal law. Liepelt was a wrongful death action brought under FELA.\textsuperscript{108} The court noted the prevailing practice of refusing to allow evidence regarding the effect of income taxes, but explicitly overruled it.\textsuperscript{109}

The Supreme Court began its analysis by stating that, as a matter of law, damages in a FELA action are federal in character and governed by federal law.\textsuperscript{110} The measure of damages in a wrongful death action brought under FELA is the monetary loss suffered by beneficiaries caused by the decedent’s death.\textsuperscript{111} Realistically, such a loss is calculated by taking the decedent’s after-tax income into ac-

\textsuperscript{104} Annotation, \textit{supra} note 7, at 593; see \textit{infra} notes 118-123 for a discussion of the majority position which rejects a taxability instruction.

\textsuperscript{105} Annotation, \textit{supra} note 7, at 593; see \textit{infra} notes 130-132 and accompanying text for a discussion of the discretionary view.

\textsuperscript{106} Annotation, \textit{supra} note 7, at 593; see \textit{infra} notes 136-137 and accompanying text for court decisions which silently follow the ruling of the court below.


\textsuperscript{108} \textit{Id.} The case involved a 1973 collision caused by an employer’s negligence which resulted in fatal injuries to an employed fireman. \textit{Id.} at 491.

\textsuperscript{109} \textit{Id.} at 490-91. The court noted the prevailing practice developed when federal taxes were relatively insignificant and observed a growing trend toward a different practice. \textit{Id.} at 491.

\textsuperscript{110} \textit{Id.} at 493. The rationale that damages in a FELA action are governed by federal law is based, in part, on the purpose behind the enactment of FELA, which is to create a uniform rule of law regarding railroads’ liability for injuries to their employees. \textit{Id.} at 493 n.5.

\textsuperscript{111} \textit{Id.} at 493 (quoting Michigan Cent. R.R. v. Vreeland, 227 U.S. 59, 70 (1913), the Court stated that the proper measure of damages is “the damages . . . [that] flow from the deprivation of the pecuniary benefits which the beneficiaries might have reasonably received. . . .”).
count. The Court rejected arguments supporting the exclusion of the decedent's tax liability. Those arguments claimed tax consequences were too speculative, too complex, and opened the door to other equally relevant evidence. The Court concluded by acknowledging the "tax consciousness" of the public and noting that a brief and easily understood instruction is not harmful. Additionally, it may help to prevent overcompensation by preventing the jury from falsely inflating the award.

B. States' Position

Despite the United States Supreme Court's support for the introduction of income tax evidence and a "taxability" instruction to the jury, most state courts do not follow this decision on matters involving state law. Once again, majority and minority positions exist on the subject of the propriety of a jury "taxability" instruction. A majority

112 Id.

113 Id. at 494-96. The Court refers to "other equally relevant evidence" as including the consequences of discounting to present value and attorney fees. Id. at 495. This portion of the respondent's argument is rejected simply because the court does not agree with it. Id. The "too speculative argument" is rejected due to the fact that the other factors used to calculate a damage award, such as future employment and interest rates, are matters of estimate and prediction. Id. at 494. The "too complex" argument is rejected in light of the legal profession's ability to present expert testimony in a form that is understandable by the jury. Id.

114 Id. at 498. The Court held that reversible error was committed when the lower court refused to give an instruction informing the jury that a judgment under FELA was not taxable. Id.

115 Id. (quoting Burlington N., Inc. v. Boxberger, 529 F.2d 284, 297 (9th Cir. 1975)).

116 Liepelt is considered by several courts as controlling only in an action under federal law. See Croce v. Bromley Corp., 623 F.2d 1084, 1096-97 (5th Cir. 1980) (holding Liepelt was not controlling because the wrongful death action arose under a state statute, and federal concerns were lacking), cert. denied, 450 U.S. 981 (1981); Klawonn v. Mitchell, 105 Ill. 2d 450, 475 N.E.2d 857, 860-61 (1985) (holding that Liepelt was not directly controlling because the case involved state, rather than federal, law); Tennis v. General Motors Corp., 625 S.W.2d 218, 226-28 (Mo. Ct. App. 1981) (finding that the trial court did not err in refusing to give a taxability instruction to the jury because the case was a state action in state court and lacked any federal concern); Otis Elevator Co. v. Reid, 101 Nev. 515, 706 P.2d 1378, 1382 (1985) (the Supreme Court of Nevada stated that in a claim arising under state law, it was not bound to follow the United States Supreme Court decision in Liepelt which was expressly predicated on federal law).

117 See Annotation, supra note 7, at 595-600.
of the states hold, as a general rule, that such an instruction is improper.118 Although not a wide-spread practice,

118 Combs v. Chicago, St. Paul, Minneapolis & Omaha Ry., 135 F. Supp. 750, 757 (N.D. Iowa 1955) (holding that the issue of income tax liability should not be injected into an instruction to the jury because it "would probably give rise to more problems than it would solve"); Mitchell v. Emblade, 80 Ariz. 398, 298 P.2d 1034, 1037-38 (finding that few courts had passed on the issue of an instruction regarding the taxability of damages, the court agreed with the three states constituting a majority that the question of income tax has no part in the instruction on damages), modified on other grounds, 81 Ariz. 121, 301 P.2d 1032 (1956); Henninger v. Southern Pac. Co., 250 Cal. App. 2d 872, 59 Cal. Rptr. 76, 81 (1967) (noting the majority of courts which considered the issue of income tax instructions concluded they should not be given to the jury, the court followed the majority); Davis v. Fortino & Jackson Chevrolet Co., 32 Colo. App. 222, 510 P.2d 1376, 1378 (1973) (holding that an instruction on the taxability of damages was not prescribed by the Colorado Jury Instructions, and would have been improper); Gorham v. Farmington Motor Inn, Inc., 159 Conn. 576, 271 A.2d 94, 96 (1970) (holding that "[t]he great weight of authority in the United States is committed to the rule that, in an action to recover damages for personal injuries, an instruction ... [involving the taxability of damages] is improper and, when requested, should be refused."); Kawamoto v. Yasutake, 49 Haw. 42, 51, 410 P.2d 976, 981 (1966) (the court held that it was "in agreement with those jurisdictions which hold that the incidence of taxation is not a proper fact for a jury's consideration" since it introduces a wholly collateral issue into the determination of damages); Hall v. Chicago & N.W. Ry., 5 Ill. 2d 135, 151, 125 N.E.2d 77, 86 (1955) (holding that it is improper for a jury to consider the incident of taxation because it introduces an extraneous subject); Highshew v. Kushto, 235 Ind. 505, 507-08, 134 N.E.2d 555, 556, petition dismissed, 235 Ind. 509, 135 N.E.2d 251 (1956) (finding inquiries into the incidents of taxation in personal injury damage suits are not a proper subject for instructions to the jury because they bring up new issues not pertinent to the issues involved); Spencer v. Martin K. Eby Constr., 186 Kan. 345, 350 P.2d 18, 24 (1960) (following the majority rule that instructing the jury that damages awarded for personal injury are exempt from state or federal income taxes would be improper); Louisville & Nashville R.R. v. Mattingly, 318 S.W.2d 844, 848 (Ky. 1958) (deciding to follow the majority view because a taxability instruction is "misleading in its effect on the minds of the jury"); Michaud v. Steckino, 390 A.2d 524, 535 (Me. 1978) (holding that whether a plaintiff must pay taxes on an award concerns only the government and the plaintiff, not the jury); Briggs v. Chicago Great W. Ry., 248 Minn. 418, 432, 80 N.W.2d 625, 636 (1957) (holding that the incidence of federal income taxation is not a proper factor for inclusion in jury instructions in a personal injury suit); Senter v. Ferguson, 486 S.W.2d 644, 647 (Mo. Ct. App. 1972) (finding that an instruction regarding the taxability of damages constituted prejudicial error and might have influenced the amount of the verdict); Bracy v. Great N. Ry., 136 Mont. 65, 543 P.2d 848, 853 (1959) (holding that the lower court did not err in refusing to instruct that the award is not subject to state or federal income taxes), cert. denied, 361 U.S. 949 (1960); Ott v. Frank, 202 Neb. 820, 277 N.W.2d 251, 253 (1979) (decedent's potential tax liability was a proper evidentiary matter, but was not a proper subject for special instruction); Scallon v. Hooper, 58 N.C. App. 551, 293 S.E.2d 843, 845 (1982) (adopting the majority view that a taxability instruction is reversible error); South v. National R.R. Pas-
some courts go so far as to distinguish between personal injury and wrongful death actions.\textsuperscript{119}

The Supreme Court of Indiana expressed concerns as to how comprehensive such an instruction, if given, needs to be.\textsuperscript{120} In \textit{Highshew v. Kushto}, it held that "incidents of taxation" are not a proper subject for jury considera-

senger Corp., 290 N.W.2d 819, 828 (N.D. 1980) (in light of Congressional intent to give tax benefit to injured party, the court found it was not error not to instruct the jury that the award is not subject to income tax in a personal injury action); Maus v. New York, Chicago & St. Louis R.R. Co., 165 Ohio St. 281, 135 N.E.2d 253, 256 (1955) (defendant's request for taxability instruction in personal injury suit was correctly refused "since the effect would be to give the jury license to disregard the charge on the measure of damages already given"); Chicago, Rock Island & Pac. R.R. v. Kinsey, 372 P.2d 863, 868 (Okla. 1962) (holding, in line with the majority view, that it was not error to refuse to give taxability instruction); Plourd v. Southern Pac. Transp. Co., 266 Or. 666, 513 P.2d 1140, 1148 (1973) (in a personal injury action, the court held it was not error to refuse to instruct the jury regarding tax consequences considering the additional confusion a tax liability instruction would create); Gradel v. Inouye, 491 Pa. 534, 421 A.2d 674, 680 (1980) (holding that the relationship between income taxes and the damage award should not be mentioned either in argument or in jury instructions); Stallcup v. Taylor, 62 Tenn. App. 407, 463 S.W.2d 416, 422 (1970) (holding that an instruction regarding the tax exemption of personal injury awards is not proper); Missouri-Kansas-Texas R.R. of Tex. v. McFerrin, 279 S.W.2d 410, 418-19 (Tex. Civ. App. 1955) (instructing the jury that a wrongful death award is exempt from income tax presumes the jury will consider issues not before it; the court cannot indulge in such assumptions of jury misconduct), \textit{rev'd on other grounds}, 291 S.W.2d 931 (Tex. 1956); Boeke v. International Paint Co., 27 Wash. App. 611, 620 P.2d 103, 106-07 (1980) (holding that no taxability instruction is necessary where the plaintiff's income was not extremely high); Crum v. Ward, 146 W. Va. 421, 122 S.E.2d 18, 30-31 (1961) (concluding that consideration of taxes in a personal injury suit might be confusing and create problems for either the plaintiff or the defendant); Hardware Mut. Cas. Co. v. Harry Crow & Son, Inc., 6 Wis. 2d 396, 94 N.W.2d 577, 581-83 (1959) (holding that plaintiff's tax liability on a personal injury award is a matter left to the legislature); Barnette v. Doyle, 622 P.2d 1349, 1365-67 (Wyo. 1981) (holding that state court awards under state law are not controlled by United States Supreme Court decision requiring instruction on income taxes for claims brought under federal law).

\textsuperscript{119} Annotation, \textit{supra} note 7, at 595 n.10. "While most jurisdictions do not make any apparent distinction between personal injury and wrongful death actions in regard to this rule, there have been some exceptions, and it is conceivable that others might choose to apply a different rule for each type of action." \textit{Id.; see supra} note 91 for an illustration of one jurisdiction that differentiates between treatment of personal injury awards and lost income awards.

\textsuperscript{120} Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555, \textit{petition dismissed}, 235 Ind. 509, 135 N.E.2d 251 (1956). In \textit{Highshew}, a personal injury case, the court held that an instruction to the jury advising them that any award to the plaintiff is not subject to income tax was not proper. \textit{Id.} at 505, 134 N.E.2d at 556.
According to the court, inquiry into the tax area requires detailed and complex instructions as to both tax and non-tax liabilities. The court stated it cannot give instructions, dealing with all possible tax implications, with any degree of certainty without "a tax expert at its side."

Some jurisdictions hold that a tax instruction is not only proper, but necessary to set the appropriate amount of damages. In jurisdictions which hold that income tax effects should not reduce an award, three justifications in particular support an instruction to that effect. First, it is the only way to protect against erroneously inflated jury

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121 Id. at 505, 134 N.E.2d at 556.
122 Id. at 505, 134 N.E.2d at 556.
123 Id. at 505, 134 N.E.2d at 556. The court further stated that "[i]n our judgment such matters are not a proper subject for instruction or argument of counsel." Id. at 505, 134 N.E.2d at 556.
124 Floyd v. Fruit Indus., Inc., 144 Conn. 659, 136 A.2d 918, 925-26 (1957) (wrongful death action holding that an assessment of reasonable compensation for loss includes offsetting decedent's income by probable incomes taxes); State Highway Dep't v. Buzzuto, 264 A.2d 347, 357 (Del. 1970) (holding the trial judge erred in refusing a requested instruction in a wrongful death action that the award is not subject to state or federal income taxes); Francis v. Government Employees Ins. Co., 376 So. 2d 609, 612 (La. Ct. App. 1979) (holding that an instruction informing the jury that "any amount [awarded] . . . is not subject to income tax" was authorized and was not erroneous); Dempsey v. Thompson, 363 Mo. 339, 251 S.W.2d 42, 45-46 (1952) (prospectively ruling that to avoid any juror misconceptions regarding the taxability of a personal injury award, an instruction that such an award is not subject to federal or state income taxes is desirable); Anderson v. Burlington N., Inc., 218 Mont. 456, 709 P.2d 641, 646-47 (1985) (prospective only) (holding that trial court should give a nontaxability instruction in the future to avoid the possibility of overcompensation based on erroneous tax assumptions by the jury), cert. denied, 476 U.S. 1174 (1986); Bussell v. DeWalt Prods. Corp., 105 N.J. 223, 519 A.2d 1379, 1381-82 (1987) (applying the Tenore rule to personal injury actions, the court held that a taxability instruction was appropriate for personal injury damage awards); Tenore v. Nu Car Carriers, Inc., 67 N.J. 466, 341 A.2d 613, 628-29 (1975) (holding that in a wrongful death action, the court should instruct the jury that the damage award is not subject to income taxation); Lanzano v. New York, 71 N.Y.2d 208, 519 N.E.2d 331, 332, 524 N.Y.S.2d 420, 422 (1988) (holding that, as a matter of policy, where the award is excluded from taxation, the court should instruct the jury that the award is not taxable and that the jury is not to add or to subtract from the award because of income taxes); Towli v. Ford Motor Co., 30 A.D.2d 319, 292 N.Y.S.2d 8, 9 (N.Y. App. Div. 1968) (holding that when a jury questioned the court as to whether an award to the plaintiff is taxable, the court should have answered the jury's question directly).
verdicts. Moreover, such an instruction is easily understood. Finally, it requires no calculation. Judge Ely wrote, “To put the matter simply, giving the instruction can do no harm, and it can certainly help by preventing the jury from inflating the award and thus overcompensating the plaintiff on the basis of an erroneous assumption that the judgment will be taxable.” The reasoning set out above in Liepelt for FELA cases is just as persuasive when dealing with other personal injury cases. In 1981, the Court of Special Appeals of Maryland, while noting that Liepelt expressed a minority view, held the courts must provide a “taxability” instruction. The court found that such an instruction was a “simple and non-prejudicial way to deal with [a jury’s] tax consciousness.”

The third alternative embraced by the courts leaves the decision within the discretion of the trial judge. Some courts which embrace this view hold that taxability instructions are appropriate “only as curative devices designed to eliminate any prejudice resulting from the jury’s exposure to tax-related issues at trial.” The lower court uses its discretion to determine whether tax-related issues were discussed during trial and whether such discussions were significant enough to warrant a tax-

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126 Id. at 41.
127 Burlington N., Inc. v. Boxberger, 529 F.2d 284, 297 (9th Cir. 1975).
129 Id. at 325, 428 A.2d at 87.
130 Poirier v. Shireman, 129 So. 2d 439, 444-45 (Fla. Dist. Ct. App. 1961) (court held that “on this question and on these facts,” a nontaxability instruction was not error); Griffin v. General Motors Corp., 380 Mass. 362, 403 N.E.2d 402 (1980) (holding that tax instruction is appropriate only in special circumstances such as when tax-related issues were discussed during the trial); Otis Elevator Co. v. Reid, 101 Nev. 515, 706 P.2d 1378, 1382 (1985) (holding that in the absence of any indication that the subject of income tax was presented to the jury, refusal to give instruction was not error; if subject has been presented to jury, judge must, in his best judgment and discretion, determine whether an instruction is warranted); see also Annotation, supra note 7, at 601.
131 Otis Elevator Co., 101 Nev. at 515, 706 P.2d at 1382.
ability instruction.\textsuperscript{132}

In conjunction with the discretionary view is the view expressed by the Indiana Court of Appeals.\textsuperscript{133} Recognizing the rule of law set out by the Supreme Court of Indiana, the court held that an instruction regarding the tax consequences of a damage award was not proper.\textsuperscript{134} Despite the lower court's "taxability" instruction, however, the appellate court found the instruction harmless under the particular circumstances of the case.\textsuperscript{135}

Although most courts follow one of the three rationales discussed above, a few remaining jurisdictions follow the ruling of the trial court without explanation. The reviewing courts hold that the decision in the trial court was not reversible error, without stating what factors influenced their decision.\textsuperscript{136} These courts address the issue, but they fail to clarify the reasoning behind their position.\textsuperscript{137} In these cases not stating a general rule, the courts uphold

\textsuperscript{132} Id. at 515, 706 P.2d at 1382. A taxability instruction is not given as "a matter of right," but is only appropriate in special circumstances. \textit{Id.} at 515, 706 P.2d at 1382.


\textsuperscript{134} \textit{Id.} at 332, 348 N.E.2d at 99.

\textsuperscript{135} \textit{Id.} at 332, 348 N.E.2d at 100. The court stated that the "instruction given . . . merely served to caution the jury to base its award on the evidence, and not on speculations about tax consequences," and concluded that the instruction resulted in no prejudice to the plaintiffs. \textit{Id.} at 332, 348 N.E.2d at 100. A similar result was reached in Montana. Anderson v. Burlington N., Inc., 218 Mont. 456, 709 P.2d 641 (1985), \textit{cert. denied}, 476 U.S. 1174 (1986). The Supreme Court of Montana, in dicta, stated that in the future a nontaxability instruction for a FELA case is warranted in light of \textit{Liepelt}. \textit{Id.} at 456, 709 P.2d at 646-47; see \textit{supra} notes 107-115 and accompanying text for a discussion of \textit{Liepelt}. However, despite the failure of the trial court to give a nontaxability instruction in this case, the court ruled that such failure was harmless because the jury awarded less than the amount of damages projected by the economist. \textit{Id.} at 456, 709 P.2d at 646. The court's rationale was that the jury clearly did not award additional damages based upon perceived tax obligations. \textit{Id.} at 456, 709 P.2d at 646.


\textsuperscript{137} Note, \textit{supra} note 6, at 316.
decisions of trial courts not to give taxability instructions as well as decisions which gave such instructions.

C. Conclusion

Given the tax consciousness of the American public, an instruction to the jury stating that personal injury and wrongful death awards are not taxable is the better view. This view does not necessarily advocate detailed and complex instructions as to both tax and non-tax liabilities.\textsuperscript{138} The court must give the jury a simple and easily understood instruction.\textsuperscript{139} An instruction informing the jury of the non-taxability of the award is an appropriate and effective method to deter erroneous inflation of the award.\textsuperscript{140} Even in jurisdictions which have concluded that the effect of income taxes is an appropriate consideration, a simple instruction informing the jury of that factor and how to apply it would aid in the jury's calculations. Obviously, if tax effects are considered, the evidence presented to the jury will include projections of future income tax liability and facts as to past income tax liability. The jury needs instructions concerning the handling of that information.

V. Air Crash Cases

With potential damage awards ranging from tens of thousands to the millions, an extremely important consideration for parties in a personal injury action or for parties suing under a wrongful death statute is the applicable state law with respect to the calculation of damage awards.\textsuperscript{141} Considering the current split of authority as to

\textsuperscript{138} Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555, 556, \textit{petition dismissed}, 235 Ind. 509, 135 N.E.2d 251 (1956) (found that detailed and complex tax related instructions contain a substantial amount of uncertainty).


\textsuperscript{140} \textit{Id.} at 40.

\textsuperscript{141} Annotation, \textit{supra} note 7, at 594. "It has been held that allowing or precluding the deduction of taxes from a lost income award would have so important an
whether income taxes are a relevant consideration, it is imperative that courts apply the proper state law.

In particular, two recent federal circuit cases exemplify the intense debate, and consequent results, that continues over the correct application of state law in calculating loss of income damages. In line with the majority view is the 1987 decision from the Second Circuit of the United States Court of Appeals, Woodling v. Garrett Corp. However, the Seventh Circuit issued an equally strong opinion supporting the deduction of income taxes from future lost earnings in Lux v. McDonnell Douglas Corp.

Woodling v. Garrett Corp. was a wrongful death action brought after the death of an airplane passenger. On appeal, Woodling contended that the district court erred in allowing the deduction of future taxes from the decedent's estimated future income. Following the well-established principle set out in Erie R.R. v. Tompkins, the court found that New York state law providing for "fair and just compensation" controlled the measure of damages. As a result, the Second Circuit concluded that in

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142 In addition to the two cases which are discussed, several other recent cases considering tax implications involved the airline industry. The United States Court of Appeals, in In re Air Crash Disaster Near Chicago, Ill. on May 25, 1979, 701 F.2d 1189 (7th Cir. 1983), found Illinois' measure of damages was the same as the measure under FELA, thereby authorizing the district court to admit evidence of income tax liability. Id. at 1195. Applying New York law, Vasina v. Grumman Corp., 644 F.2d 112 (2d Cir. 1981), held that the lower court did not err in refusing to admit evidence on the effect of income taxes in determining a wrongful death damages award. Id. at 118.

143 813 F.2d 543 (2d Cir. 1987).
144 803 F.2d 304 (7th Cir. 1986).
145 Woodling, 813 F.2d at 546. In Woodling, the action was brought against the owner and operator of the aircraft which crashed and against the manufacturer and repairer of an engine part alleged to have caused the crash. Id.
146 Id. at 557.
147 304 U.S. 64 (1938). In Erie, the Supreme Court first established the principle that a federal court sitting in a diversity action must apply the substantive law of the applicable state. Id. Additionally, Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487 (1941), extends the Erie doctrine to the field of conflict of laws. Id. at 496. The Court in Klaxon held that in a diversity action, a federal court must apply the choice of law rules prevailing in the state in which it sits. Id.
148 Woodling, 813 F.2d at 557. The court noted that "an action for wrongful
come taxes are not a proper consideration in determining lost income or support.\textsuperscript{149}

Although the court in \textit{Woodling} had definite New York precedent to follow in reaching its decision, this was not the case in the Seventh Circuit decision of \textit{Lux v. McDonnell Douglas Corp.}\textsuperscript{150} Again, the issue was whether evidence of the decedent's income taxes was admissible in a wrongful death action to reduce the amount awarded as compensation for lost support.\textsuperscript{151} Recognizing that a federal court sitting in diversity must apply the applicable state law, the court turned to the question of what damages Arizona law allowed.\textsuperscript{152} The Arizona wrongful death statute provides for damages as the jury "deems fair and just."\textsuperscript{153} Arizona courts had not decided whether a lost income award was properly determined on the decedent's gross or net income.\textsuperscript{154}

dead is one created by state law and that state law controls the correct measure of damages for such a claim." \textit{Id.} The district court had concluded that, although the passenger and his survivors were residents of Connecticut, New York law would govern in determining wrongful death damages because New York was the site of the accident and tortious conduct resulting in the accident, the principle place of business of the primary defendant, and the forum chosen by the plaintiff. Morgan Guaranty Trust Co. v. Garrett, 625 F. Supp. 752 (S.D.N.Y. 1986), \textit{aff'd in part, vacated and remanded in part sub nom., Woodling v. Garrett Corp.}, 813 F.2d 543 (2d Cir. 1987). Although the difference in law between the states of New York and Connecticut is not as divergent as a "majority" versus "minority" type conflict, the state laws did differ. Morgan Guaranty Trust Co., 625 F. Supp. at 760. Connecticut law allows for "just damages" which includes a claim for the "decedent's lost enjoyment of life." \textit{Id.} at 761. New York law, on the other hand, calls for "fair and just compensation," which means recovery for pecuniary loss only. \textit{Id.}

\textsuperscript{149} \textit{Woodling}, 813 F.2d at 557. The court followed the rule established in \textit{Vasina v. Grumman Corp.}, 644 F.2d 112 (2d Cir. 1981), which held that New York law does not allow the jury to consider the effect of income taxes on lost income. \textit{Woodling}, 813 F.2d at 557.

\textsuperscript{150} 803 F.2d at 304.

\textsuperscript{151} \textit{Id.} at 309-12. The case was a wrongful death action brought by the widow under an Arizona wrongful death statute for damages resulting from the death of the pilot. \textit{Id.} at 306.

\textsuperscript{152} \textit{Id.} at 309-10.

\textsuperscript{153} \textit{ARIZ. REV. STAT. ANN.} § 12-613 (1982). The statute provides that "[i]n an action for wrongful death, the jury shall give such damages as it deems fair and just with reference to the injury resulting from the death to the surviving parties who may be entitled to recover . . . ." \textit{Id.}

\textsuperscript{154} \textit{Lux}, 803 F.2d at 310. The court specifically stated, "[w]hether the measure
The Arizona Supreme Court had previously held in personal injury suits that income taxes are not an appropriate consideration for the jury and that the proper amount for calculating lost future earnings is gross, as opposed to net, income.\textsuperscript{155} The Seventh Circuit expressly refused to apply the same rationale in a wrongful death case, concluding that the Arizona Supreme Court would apply a different rule under the circumstances.\textsuperscript{156} Looking to the Restatement,\textsuperscript{157} the circuit court concluded that the decedent's income taxes are a relevant factor in the determination of damages in a wrongful death action and should have been admitted.\textsuperscript{158}

With the district court judgment for lost support in \textit{Woodling} amounting to $750,000 and a damage award in excess of $3,000,000 in \textit{Lux}, the tremendous potential impact of income taxes on a judge or jury verdict is readily apparent.\textsuperscript{159} Whether a court determines that federal law of the plaintiff's pecuniary damages for lost support in wrongful death actions is the decedent's gross income or the surviving parties' net pecuniary loss . . . has not been decided by any Arizona court." \textit{Id.}\textsuperscript{156} Mitchell v. Emblade, 80 Ariz. 398, 405, 298 P.2d 1034, 1038 (stating that the "case [should] be tried on the issues and presented to the jury with the correct measure of damages, of which the incident of income tax has no part."); \textit{modified on other grounds}, 81 Ariz. 121, 301 P.2d 1032 (1956); Seely v. McEvers, 115 Ariz. 171, 174, 564 P.2d 394, 397 (Ariz. Ct. App. 1977) (stating that the proper basis for calculating loss of future earnings is "gross pay and not net or 'take home' pay").

\textsuperscript{157} The court noted that the Arizona Supreme Court continuously asserted that "in the absence of controlling statute or precedent, it [would] follow the Restatement of the Law whenever it is applicable." \textit{Id.} at 311. In this case, the court turned to the Restatement (Second) of Torts. \textit{Id.; see Bank of Am. v. J & S Auto Repairs, 143 Ariz. 416, 418, 694 P.2d 246, 248 (1985) (Restatement followed in Arizona in the absence of contrary authority). According to the Seventh Circuit, the Restatement's position with respect to income taxes in wrongful death actions is clear. \textit{Lux}, 803 F.2d at 311. The loss to the plaintiff is measured by the "contributions that the deceased would have made to [the injured party] if he had lived." \textit{Id.} (quoting the \textit{RESTATEMENT (SECOND) OF TORTS} § 914A comment b (Tent. Draft No. 19, 1973)). Therefore, the Restatement supports reducing lost earnings by potential taxes to determine the amount the decedent would have contributed to the plaintiff had he lived. \textit{Id.}

\textsuperscript{156} \textit{Lux}, 803 F.2d at 311.

\textsuperscript{157} For example: Using the basic 28% tax bracket for a married individual filing

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or state law is applicable, the potential advantages and disadvantages of one forum over another cannot be unduly stressed.

A statutory body of law particularly relevant to the airline industry is the Warsaw Convention. Federal courts have concluded that the calculation of damages under the Warsaw Convention need not consider the effect of income taxes. The fluctuating and speculative tendencies of national or local taxes introduces an unnecessary complexity in the determination of a damage award under the Warsaw Convention. An international procedure such as that stipulated by the Warsaw Convention requires only a fair and reasonable result.

VI. Conclusion

The principle problem with respect to income taxes is not whether a court should consider the tax implications of a lost income award or how to instruct the jury as to jointly after 1987, a lost wages award of $750,000 is subject to $206,132.50 in federal income tax.

See, e.g., Shu-Tao Lin v. McDonnell Douglas Corp., 742 F.2d 45, 49-51 (2d Cir. 1984) (wrongful death diversity action resulting from the crash of a commercial airliner; held that when state law claims are tried in federal court, state law governs the method of calculating damages and no adjustment for tax liability is permitted); DeLucca v. United States, 670 F.2d 843, 844 (9th Cir. 1982) (FTCA action; damages governed by state law but limited by the Act to compensatory damages); Rudelson v. United States, 602 F.2d 1326, 1331 (9th Cir. 1979) (FTCA action following midair collision; taxes were appropriately deducted); Kennett v. Delta Air Lines, Inc., 560 F.2d 456, 461-62 (1st Cir. 1977) (wrongful death action following airplane crash; when no evidence before jury on income tax, court has no duty to instruct jury to speculate concerning income tax effects); Feldman v. Allegheny Airlines, Inc., 524 F.2d 384, 387 (2d Cir. 1975) (wrongful death diversity action following airline crash; under Connecticut law, judgment reduced by income taxes payable on future earnings); Downs v. United States, 522 F.2d 990, 1005 (6th Cir. 1975) (Florida Wrongful Death Act required deduction of taxes).


Butler, 774 F.2d at 431.

Id.
that question. The difficulties arise because of the lack of a uniform rule, regardless of which direction that rule takes. Inconsistencies are apparent between federal and state law as well as among the several states.

The rationales on either side of the arguments, both pro and con, are valid. Differences arise when one court gives a particular rationale or combination of rationales more weight than another court. The resulting variety of treatment of the tax issue has led to forum shopping and considerable emphasis on the application of the appropriate state law. Although this comment advances the proposition that the proper method of determining lost income awards is to use gross income figures in conjunction with a "taxability" instruction, all of the arguments deserve due consideration. Regardless of which rationale the courts agree upon, agreement is what the courts ultimately need to accomplish.

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164 See supra notes 16-50 and accompanying text for the arguments both pro and con regarding the consideration of income taxes in calculating a lost wages award.

165 See supra notes 51-101 and accompanying text for a discussion of whether "gross" income or "net" income is the proper base for the determination of damages.