

1-1-1957

Taxation – Jury Charge – Tax Benefit Rule

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Recommended Citation

Jack Ankus, *Taxation – Jury Charge – Tax Benefit Rule*, 11 U. Miami L. Rev. 304 (1957)
Available at: <https://repository.law.miami.edu/umlr/vol11/iss2/15>

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CASES NOTED

TAXATION—JURY CHARGE—TAX BENEFIT RULE

Defendant in a personal injury suit requested the trial court to charge that any award made to the plaintiff would not be subject to federal income taxes.¹ *Held*, the court's refusal to give this charge was not error since federal income taxes were not a proper subject for the jury's consideration. *Maus v. New York, Chicago & St. Louis Rd. Co.*, 165 Ohio St. 281, 135 N.E.2d 253 (1956).

Proper charges concerning federal income taxation present a modern² twofold problem.³ The weight of authority sustains the proposition that, due to the myriad uncertainties involved, no deduction ought to be made for future income tax liability when computing damages for the plaintiff's loss of future earning capacity.⁴ In addition, the majority of courts hold that juries should not be instructed that the damage award itself is not taxable income to the plaintiff.⁵ This latter inhibition is premised on the contention that *no* matters relating to federal income taxation can be presented to the jury.⁶ A prescient Missouri court, in *Dempsey v. Thomp-*

1. INT. REV. CODE OF 1954 § 104 (a), which provides: ". . . gross income does not include . . . the amount of any damages received (whether by suit or agreement) on account of personal injury . . ."

2. Compare the number of individual income tax returns filed in 1938, 6,150,776; U. S. BUREAU OF CENSUS, DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF UNITED STATES, 254 (1943) with the number filed in 1952, 56,317,000; *Id.* 371 (1952). See 8 ARK. L. REV. 174 (1954).

3. *Combs v. Chicago St. P., M. & O. Ry.*, 135 F. Supp. 750 (N.D. Iowa 1955); *Mitchell v. Emblade*, 80 Ariz. 398, 298 P.2d 1034 (1956); *Allendorf v. Elgin, Joliet and Eastern Ry.*, 8 Ill. 2d 164, 133 N.E.2d 288 (1956); *Wagner v. Illinois Cent. R.R.*, 7 Ill. App. 2d 445, 129 N.E.2d 771 (1955); *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 125 N.E.2d 77 (1955), *reversing* 349 Ill. App. 175, 110 N.E.2d 654 (1953); *Dempsey v. Thompson*, 363 Mo. 339, 251 S.W.2d 42 (1952); *Phister v. Cleveland*, 96 Ohio App. 185, 113 N.E.2d 336 (1953); *John F. Buckner & Sons v. Allen*, 289 S.W.2d 394 (Tex. Civ. App. 1956).

4. *Chicago & N.W. Ry. Co. v. Curl*, 178 F.2d 497 (8th Cir. 1949); *Stokes v. U.S.*, 144 F.2d 82 (2d Cir. 1944); *Combs v. Chicago, St. P., M. & O. Ry.*, 135 F. Supp. 750 (N.D. Iowa 1955); *Runnels v. Douglas*, 124 F. Supp. 657 (D.C. Alaska 1954); *O'Donnell v. Great N.R.*, 109 F. Supp. 590 (N.D. Cal. 1951); *Atlantic Coast Line R.R. v. Brown*, 93 Ca. App. 805, 92 S.E.2d 874, 875 (1956) (dictum); *Wawryszyn v. Illinois Cent. R.R.*, 10 Ill. App. 2d 394, 135 N.E.2d 154 (1956); *Smith v. Penn. R.R.*, 88 Ohio App. 243, 99 N.E.2d 501 (1950); *Missouri-Kan.-Tex. R.R. v. McFerrin*, 279 S.W. 2d 410 (Texas 1955); *Billingham v. Hughes* [1949] 1 K.B. 643, 9 A.L.R.2d 311. *Cf. Cole v. Chicago, St. P., M. & O. Ry.*, 59 F. Supp. 443 (D.C. Minn. 1945).

5. *Combs v. Chicago St. P., M. & O. Ry.*, 135 F. Supp. 750 (N.D. Iowa 1955); *Wagner v. Illinois Cent. R.R.*, 7 Ill. App. 2d 445, 129 N.E.2d 771 (1955); *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 125 N.E.2d 77 (1955); *John F. Buckner & Sons v. Allen*, 289 S.W.2d 394 (Tex. Civ. App. 1956); *Missouri-Kan.-Tex. R.R. v. McFerrin*, 279 S.W.2d 410 (Tex. Civ. App. 1955), *rev'd on other grounds* 291 S.W.2d 931 (Tex. Civ. App. 1956).

6. *Combs v. Chicago St. P., M. & O. Ry.*, *supra* note 5; *Wagner v. Illinois Cent. R.*, *supra* note 5; *Hall v. Chicago & N.W. Ry.*, *supra* note 5; *John F. Buckner & Sons v. Allen*, *supra* note 5. These courts manifestly are of the opinion that the

son,⁷ recognizing the "tax consciousness" of the jury, reached a conclusion partially contrary to established authority.⁸ It agreed that the determination of plaintiff's damage for loss of future earnings should be based upon his gross income. However, the court ruled that the defendant was entitled to have the jury instructed that any amount that was awarded to the plaintiff would not be subject to federal income taxes.⁹ It was decided that the plaintiff had no right to receive an enhanced award due to a *probable* misconception on the part of a tax conscious jury that the judgment would be considerably reduced by federal income taxation.¹⁰

The instant case adopts in its entirety the reasoning of the majority. However, the jury must take into account the fact that plaintiff's award, for loss of future earnings, must be reduced to its value as a lump sum payable at present.¹¹ Dictum of the concurring Justice, in effect, agrees with the "tax conscious" rule in the *Dempsey* case.¹²

By refusing to inform the jury of the "tax benefit" rule,¹³ the defendant may be inordinately prejudiced; and the plaintiff, ipso facto, may receive more than that to which he is entitled. The avowed purpose of compensatory damages is to make the plaintiff whole.¹⁴ The court's refusal to give the requested "tax benefit" charge will result in a compound violation of this postulate. To the extent that an additional benefit is conferred upon the plaintiff this refusal does not, per se, render the ruling of the majority erroneous. However, when by the application of the "no charge" rule a penalty may be haphazardly imposed upon the defendant, in addition to the plaintiff's being more than wholly compensated, the position of the majority becomes untenable. A penalty is haphazardly imposed upon the defendant whenever he is unable to take as a tax deductible item the amount of the plaintiff's recovery, because the plaintiff's claim was not incident to the defendant's business, but

two matters under discussion are inextricably wound together; therefore any attempt to separate them, i.e., give the requested "tax benefit" charge, would be prejudicial to the plaintiff.

7. 363 Mo. 339, 251 S.W.2d 42 (1952), *overruling*, *Hilton v. Thompson*, 360 Mo. 177, 227 S.W.2d 675 (1950) (in which defendant requested "the jury to exclude any amount for taxes because the plaintiff would not have to pay any.") *But see* *Margevich v. Chicago & N.W. Ry.*, 1 Ill. App. 2d 162, 116 N.E.2d 914 (1953).

8. See notes 3 and 4 *supra*.

9. *Dempsey v. Thompson*, 363 Mo. 339, 347, 251 S.W.2d 42,45 (1952). (This ruling was held, for extraneous reasons, to be prospective only.) See *Southern Pac. v. Guthrie*, 186 F.2d 926 (9th Cir. 1951); *Texas & N.O.Ry. v. Pool*, 263 S.W.2d 582 (Tex. Civ. App. 1953).

10. *Id.* at 346, 251 S.W.2d at 45.

11. *Maus v. New York, Chi. & St. L. R.R.*, 165 Ohio St. 281, 285, 135 N.E.2d 253, 256 (1956).

12. *Id.* at 286, 135 N.E.2d at 256.

13. INT. REV. CODE OF 1954 § 104 (a).

14. *Sidelinker v. York Shore Water Co.*, 117 Me. 578, 105 Atl. 122 (1918). See *Oleck, Damages to Persons and Property* §§ 80-84 (1955).

arose out of a purely personal venture.¹⁵ The decisions in virtually all of the cases¹⁶ dealing with the two issues under discussion were based upon the doctrine of *Billingham v. Hughes*.¹⁷ The reasoning of the English Justices in that case, *i.e.*, the uncertainties involved require the elimination of *all* tax issues, is therefore the foundation upon which the American cases stand. That foundation has been completely destroyed by a recent House of Lords decision, *British Transport Commission v. Gourley*,¹⁸ which specifically overruled the *Billingham* case, Lord Jowett stating:

To ignore the tax element at the present day would be to act in a manner which is out of touch with reality.¹⁹

It is submitted that the rationale of the *Dempsey* case demands re-evaluation for the following reasons: (1) the complete overthrow of *Billingham v. Hughes* by the tax conscious Lord Justices; (2) the untenability of the American position in view of the penalty imposed;²⁰ (3) the unjustifiable imposition of the plaintiff's gross damages upon the defendant;²¹ (4) the patent inconsistency of the majority which allows the jury to consider the depreciation of the purchasing value of the dollar,²² while excluding from their consideration the uncertainties of federal income taxation.

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15. Assume that a plaintiff earns \$10,000 a year, subject to a tax rate of 25%. He would net \$7,500. A payment of \$7,500, therefore, would fully compensate him for total disability for one year. If a defendant operating his business at a taxable profit caused the plaintiff's injury and was required to pay him \$10,000, plaintiff would be additionally compensated \$2,500 because of the "tax benefit" rule. The business entity, however, would suffer no penalty. The \$10,000 being a deductible expense item, the net cost to the defendant (assuming the tax rate to be 25%) would be \$7,500, the amount required to make the plaintiff whole. Under these circumstances the majority's position is concededly tenable.

If an individual were sued in his personal capacity, *i.e.*, the cause of action was not incident to his business, our hypothetical plaintiff would again profit to the extent of \$2,500. However, the defendant whose trial expenses would not constitute a deductible tax item, would be penalized to the extent of \$2,500. Under these circumstances, the position of the majority becomes untenable due to the imposition of the penalty. See INT. REV. CODE OF 1954 § 162; 2 P.H. Corp. 1956 Fed. Tax Serv. Vol. 11, ¶ 11,044, 11,046.

16. See notes 3 and 4 *supra*.

17. [1949] 1 K.B. 643. The cases involved (notes 3 and 4 *supra*) were either decided directly on the authority of *Billingham*, or upon the authority of *Hall v. Chicago & N.W. Ry.*, (note 3 *supra*) which relied directly upon the authority of the *Billingham* case.

18. *British Transport Comm'n v. Gourley*, [1956] 2 W.L.R. 41. For a discussion of the *Gourley* case from an accounting standpoint see 19 Mod. L. Rev. 365 (1956).

19. *British Transport Comm'n v. Gourley*, at 48.

20. See note 15 *supra*.

21. 72 L.Q. REV. 153 (1956).

22. *Anderson v. Mullaney*, 191 F.2d 123 (9th Cir. 1951); *Southern Pac. v. Zehnle*, 163 F.2d 453 (9th Cir. 1947); *Southern Pac. v. Guthrie*, 180 F.2d 295, 303 (9th Cir. 1949) (dictum). Note, *Fluctuating Dollars and Tort Damage Verdicts*, 48 COL. L. REV. 264 (1948); *Changes in Cost of Living or in Purchasing Power of Money as Affecting Damages for Personal Injuries or Death*, 12 A.L.R.2d 611.