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MEASURING TORT DAMAGES FOR LOSS OF EARNINGS WITHOUT DEDUCTING INCOME TAXES: A WISCONSIN RULE WHICH LOST ITS RATIONALE

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Nearly thirty years ago, the Wisconsin Supreme Court ruled that damages awarded for lost earnings in personal injury actions are not to be reduced by taxes which would have been payable on such earnings had the injury not occurred. The court reasoned that Congress intended to confer a benefit on injured plaintiffs by exempting personal injury awards from taxation and this benefit would be nullified if the plaintiff's loss was measured by after-tax earnings.¹

In 1980, the United States Supreme Court rejected the reasoning behind the Wisconsin rule and opined that neither the statute which exempts personal injury awards from taxation nor its legislative history indicates that Congress intended to confer a benefit on plaintiffs or change the measure of damages awardable for loss of earnings.²

As a result of the Supreme Court's interpretation of federal tax law, the Wisconsin rule prohibiting the use of after-tax figures in measuring loss of earnings is a rule which has lost its rationale and should be reconsidered. This article examines the rationale for the Wisconsin rule which requires that gross earnings be used to measure damages awarded to tort victims who sustain a loss of earning capacity. Concluding that the rationale is based on a now unfounded interpretation of federal tax law, the article next considers, but rejects, the exclusion of tax evidence on other evidentiary grounds be-

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1. *Hardware Mut. Casualty Co. v. Harry Crow & Son*, 6 Wis. 2d 396, 94 N.W.2d 577 (1959).

2. *Norfolk & W. Ry. v. Liepelt*, 444 U.S. 490, 496 n.10 (1980).

cause such a rule would be inconsistent with other Wisconsin case law. Finally, a proposal is presented recommending that the Wisconsin Supreme Court determine that tort damages awarded to restore losses of past and future earnings should be measured by the victim's earnings net of income taxes.³

I. EXEMPTION OF PERSONAL INJURY AND WRONGFUL DEATH AWARDS FROM TAXATION

A. Internal Revenue Code Section 104

Section 104(a)(2) of the Internal Revenue Code of 1986 provides that damages received on account of personal injuries are excluded from gross income.⁴ The term "damages" includes all amounts received which are based on tort or tort-type rights.⁵ Such damages, therefore, include recoveries of past and prospective loss of earnings and earning capacity even though these earnings would have been taxable if received in the ordinary course of the plaintiff's employment.⁶ Wrongful death recoveries are also excluded from gross in-

3. This article does not discuss the related issue of whether the jury should be given instructions regarding the impact of taxation on the measurement of the award and the tax consequences of the plaintiff's receipt of the award.

In Wisconsin, whether tax instructions are given is within the discretion of the trial judge. *Behringer v. State Farm Mut. Auto. Ins. Co.*, 6 Wis. 2d 595, 603, 95 N.W.2d 249, 254 (1959). In *Behringer*, the court said that if an instruction is given it should state that the jury is neither to add any amount to its award nor deduct any amount from it for federal or state income taxes. *Id.* at 603-04, 95 N.W.2d at 254. See Wis. Jury Instructions-Civil 1735 (1981).

However, if the proposal recommended in this article is accepted, the jury would have to be instructed that the damages awarded to the plaintiff for loss of earnings must be measured by earnings net of estimated income taxes that would have been paid on such earnings if they had been received in the normal course of employment. The jury also should be instructed that the damages the plaintiff receives will not be subject to taxation. The latter instruction will be necessary to prevent the jury from inflating its award by the amount of tax it might otherwise believe would be payable on the award. *Liepelt*, 444 U.S. at 497-98 (quoting *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 297 (9th Cir. 1975)).

In actions involving a federal claim, the jury must be instructed that damage awards are not taxable. *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 486 (1981); *Liepelt*, 444 U.S. at 498.

4. I.R.C. § 104(a)(2) (1986), provides that gross income does not include "the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness." *Id.*

5. Treas. Reg. § 1.104-1(c) (as amended in 1970).

6. I.R.C. § 61 (1986).

come.⁷ For Wisconsin state income taxes, the same exclusions apply.⁸

B. The Historical Impact of Section 104 on the Measurement of Personal Injury Damages

Congress first included the exclusion for personal injury damages in the Internal Revenue Code of 1918.⁹ The exemption was enacted to remove doubt as to whether damages awarded in personal injury actions were gross income within the meaning of the sixteenth amendment.¹⁰ However, since that time, it has been established that Congress can constitutionally tax any gain which would include recoveries of past and future losses of earnings.¹¹ Nevertheless, Congress has never repealed or limited the scope of the exemption for per-

7. Rev. Rul. 54-19, 1954-1 C.B. 179. *But cf.* Rev. Rul. 84-108, 1984-2 C.B. 32 (holding that recoveries under wrongful death acts that provide exclusively for payment of punitive damages are taxable).

The latter revenue ruling would not apply to damages awarded for wrongful death under WIS. STAT. ANN. § 895.04(4) (West 1983 & Supp. 1986) because the statute prohibits awards of punitive damages in wrongful death actions. *Wangen v. Ford Motor Co.*, 97 Wis. 2d 260, 314-15, 294 N.W.2d 437, 464-65 (1980). Only compensatory damages are recoverable under the Wisconsin wrongful death statute. *Nichols v. United States Fidelity & Guar. Co.*, 13 Wis. 2d 491, 497, 109 N.W.2d 131, 135 (1961).

8. WIS. STAT. § 71.02(2)(i) (1985-86).

9. Revenue Act of 1918, § 213(b)(6), 40 Stat. 1066. The statute excluded "damages received whether by suit or agreement on account of such injuries or sickness." For the current statute see I.R.C. § 104(a)(2)(1986).

10. H.R. REP. NO. 767, 65th Cong., 2d Sess. 9-10 (1918), states:

Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages on account of such injuries or sickness, are required to be included in gross income. The proposed bill provides that such amounts shall not be included in gross income.

Id.

The doubt existed because the Commissioner had promulgated regulations taxing damages received for personal injuries in lawsuits or settlements reasoning that they were like insurance proceeds. *Treas. Reg. 33 (rev.) art. 4 § 25 (1918)*. A few weeks later, in response to an inquiry from the Treasury Department, the Attorney General opined that insurance proceeds were "'capital' as distinguished from 'income' receipts." 31 *Op. Atty. Gen.* 304, 308 (1918). The Commissioner then reversed his earlier position and held that insurance proceeds were not taxable as income and that personal injury damages also were excluded from gross income. 20 *Treas. Dec. Int. Rev.* 457 (1918); *Nordstrom, Income Taxes and Personal Injury Awards*, 19 *OHIO ST. L.J.* 212, 222-23 (1958).

11. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955).

sonal injury damages which replace lost earnings.¹² From these facts, several courts inferred that Congress intended to confer a benefit on victims of personal injuries by exempting damages they receive from taxation. To preserve this perceived benefit and prevent defendants from using it to their advantage, these courts held that personal injury awards for loss of earnings must be measured by the plaintiff's gross (before tax) earnings.¹³

II. THE WISCONSIN RULE AND ITS RATIONALE

In 1959, Wisconsin joined the jurisdictions using gross income to estimate personal injury awards for lost earnings. In *Hardware Mutual Casualty Co. v. Harry Crow & Son*,¹⁴ the Wisconsin Supreme Court held that awards for loss of earnings are not to be reduced by the amount of tax the plaintiff would have paid if he had received his earnings in the ordinary course of his employment.¹⁵ The court adopted the following quotation (without further explanation) as the rationale for the Wisconsin rule:

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

12. Damages attributable to, but not in excess of, medical expenses that the taxpayer deducted in prior taxable years must be included in gross income. I.R.C. § 104 (1986); see also I.R.C. § 213 (1986).

13. *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 151-52, 125 N.E.2d 77, 86 (1955); *Briggs v. Chicago Great W. Ry.*, 248 Minn. 418, ___, 80 N.W.2d 625, 635-36 (1957); *Louissaint v. Hudson Waterways Corp.*, 111 Misc. 2d 122, ___, 443 N.Y.S.2d 678, 682 (Sup. Ct. 1981); *Hardware Mut. Casualty Co. v. Harry Crow & Son*, 6 Wis. 2d 396, 407-08, 94 N.W.2d 577, 582-83 (1959); cf. *Haynes v. United States*, 353 U.S. 81, 84-85 n.3 (1957) (applying its holding to health insurance benefits); *Epmeier v. United States*, 199 F.2d 508, 511 (7th Cir. 1952) (applying its holding to health insurance benefits).

14. 6 Wis. 2d 396, 94 N.W.2d 577 (1959).

15. *Id.* at 407-08, 94 N.W.2d at 582-83.

law to give an injured party a tax benefit would be nullified."¹⁶

On its face, the rationale provides two separate reasons for the Wisconsin rule: (1) the immateriality of the tax consequences the plaintiff sustains by reason of the receipt of damages and (2) the need to preserve the benefit Congress intended to confer on plaintiffs by enacting the exemption for personal injury awards. On closer scrutiny, the first reason (immateriality) is a conclusion drawn when the tax exemption of damages is considered to be a benefit Congress has conferred upon a tort victim which falls within the scope of the collateral source rule. The continuing validity of both reasons therefore depends upon a resolution of a federal tax law issue. The issue contemplated is whether Congress enacted the exclusion for personal injury damages in order to confer a benefit on injured parties, thereby requiring that gross earnings be used to measure the amount of damages the defendant must pay, rather than after-tax earnings which would be the appropriate measure if the general theory of damages is followed.¹⁷

A. *Taxation and the General Theory of Damages*

The relationship of taxes to damages is readily apparent when the general theory of damages is considered. In Wisconsin, damages are ordinarily awarded to compensate a plaintiff

16. *Id.* at 407, 94 N.W.2d at 582-83 (quoting *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 151-52, 125 N.E.2d 77, 86 (1955)).

17. *Hardware Mut.* is the only Wisconsin case that specifically addresses the relationship of the exclusion for damages and the measurement of tort damages. There are no cases in Wisconsin addressing the issue of whether the *Hardware Mut.* rule applies to the measurement of wrongful death recoveries for pecuniary loss. However, the *Hardware Mut.* rule is probably applicable since the amount of support and property accumulations which the plaintiff may recover in a wrongful death action is derived from the deceased's estimated loss of earnings. *Maloney v. Wisconsin Power, Light & Heat Co.*, 180 Wis. 546, 548-49, 193 N.W. 399, 399-400 (1923); *Belstner v. Town of Sumner*, 157 Wis. 556, 559-60, 147 N.W. 1072, 1073 (1914); *Castello v. Landwehr*, 28 Wis. 522, 532 (1871); see also Wis. Jury Instructions-Civil 1860 (1981).

WIS. STAT. ANN. § 895.04(4) (West Supp. 1986), provides: "(4) Judgment for damages for pecuniary injury from wrongful death may be awarded to any person entitled to bring a wrongful death action. Additional damages not to exceed \$50,000 for loss of society and companionship may be awarded to the spouse, children or parents of the deceased."

for losses sustained as a result of a defendant's tort.¹⁸ To quantify the plaintiff's loss, it is necessary to consider the purpose to be achieved by the award of damages. Professor McCormick states in his treatise on damages: "In a case of tort . . . the general purpose of compensation is to give a sum of money to the person wronged which, as nearly as possible, will restore him to the position he would be in if the wrong had not been committed."¹⁹

In other words, the damages awarded to a plaintiff who sustains a loss of earnings should place the plaintiff in approximately the same economic position he would have been in if he had received his earnings in the normal course of his employment.

Since earnings received in the normal course of employment are subject to taxation, the true and realistic measure of the amount of economic loss the plaintiff suffers when the stream of earnings is terminated or diminished is necessarily the plaintiff's after-tax earnings. An award of damages that approximates the plaintiff's gross earnings would place the plaintiff in a better economic position than he would have been in if he had been able to continue his regular employment. Therefore, taxes the plaintiff would have paid if the plaintiff had not been injured by the defendant are highly relevant to the measure of damages to be awarded to the plaintiff. Such taxes must be taken into account to determine what amount will restore the plaintiff to the same economic position the plaintiff would have been in if the defendant's wrong had not been committed.²⁰

In contrast, the tax treatment of the damages the plaintiff receives is irrelevant to the amount of damages awarded to the plaintiff unless a tax is imposed on damage receipts as a result of the defendant's tortious conduct. Since no tax is imposed, taxation of damage awards need not be considered unless the tax exemption accorded to personal injury damages is considered to be a benefit that Congress has conferred upon the

18. *Fee v. Heritage Mut. Ins. Co.*, 17 Wis. 2d 364, 365, 117 N.W.2d 269, 270 (1962) (quoting BLACK'S LAW DICTIONARY 466 (4th ed. 1968)), *rev'd on other grounds*, 99 Wis.2d 136, 299 N.W.2d 226 (1980).

19. C. MCCORMICK, HANDBOOK OF THE LAW OF DAMAGES § 137, at 560-61 (1935).

20. *Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523, 536-37 (1983).

plaintiff which falls within the scope of the collateral source rule.

B. Collateral Source Rule

In *Hardware Mutual*, the Wisconsin Supreme Court did not mention the collateral source rule by name. However, the language used by the court in support of its holding bears a striking similarity to the language found in the leading Wisconsin case on the collateral source rule. Thus, the holding in *Hardware Mutual* may be a conclusion drawn from application of the collateral source rule. In *Campbell v. Sutliff*,²¹ the leading case on the collateral source rule, the defendant contended that insurance payments the plaintiff received pursuant to an accident insurance policy reduced the loss the plaintiff sustained and should, therefore, decrease the plaintiff's recovery. In response, the court stated that "such insurance . . . ought not to inure to the benefit of the defendant. The only parties interested in such a contract of insurance are the plaintiff and the insurer."²² Similarly in *Hardware Mutual*, the court held that "whether the plaintiff has to pay a tax on the award is a matter that concerns only the plaintiff and the government. The tort-feasor has no interest in such question."²³ The similarity of these statements indicates that the court may have been relying on the collateral source rule when it held that the defendant's liability is not to be reduced by reason of the plaintiff's tax savings. However, as the following analysis demonstrates, for the tax exemption of injury damages to fall within the scope of the collateral source rule, the exemption must be considered a benefit Congress has conferred upon the plaintiff by mandating that gross earnings be used to measure a plaintiff's loss of past and prospective earnings.

The collateral source rule provides that a tortfeasor's liability for losses caused by wrongful conduct is not reduced by compensatory payments or benefits the victim receives from third parties.²⁴ Wisconsin has extended the collateral source

21. 193 Wis. 370, 214 N.W. 374 (1927).

22. *Id.* at 375, 214 N.W. at 377 (citing *Gatzweiler v. Milwaukee Elec. Ry. & Light Co.*, 136 Wis. 34, 39, 116 N.W. 633, 634 (1908)).

23. *Hardware Mut.*, 6 Wis. 2d at 407, 94 N.W.2d at 582-83 (quoting *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 152, 125 N.E.2d 77, 86 (1955)).

24. *Payne v. Bilco Co.*, 54 Wis. 2d 424, 433, 195 N.W.2d 641, 647 (1972).

rule to cover not only insurance payments received by tort victims, but also gratuitous and contractual wage payments²⁵ as well as medical services provided without charge to the victim by third parties, including governmental entities.²⁶ Although these payments and benefits reduce the loss the tort victim actually sustains as a result of the tortfeasor's conduct, they do not reduce the amount the plaintiff may recover from the defendant. The defendant's liability is the same whether or not the plaintiff's losses are compensated or diminished by benefits conferred by collateral sources.

For example, in Wisconsin the plaintiff is entitled to recover the reasonable value of medical costs reasonably required as a result of injuries inflicted by the defendant. The measure of the plaintiff's recovery is reasonable value, not what is actually charged. The same measurement is used even if medical services are provided to the plaintiff free of charge. Thus, the plaintiff recovers the reasonable value of the medical services he receives even though the plaintiff will not bear the cost of those services. The collateral source rule affords the plaintiff this recovery.²⁷

The collateral source rule is inconsistent with the compensatory theory of damages because it permits the plaintiff to recover damages from the defendant even though the plaintiff's loss has already been restored by benefits bestowed upon the plaintiff by third parties. Nevertheless, overcompensation of the plaintiff resulting from application of the collateral source rule is considered necessary, or perhaps is tolerated, for two reasons. The additional damages awarded to the plaintiff have a penal effect on the tortfeasor because they burden the defendant with the loss the plaintiff would have sustained if he had received no collateral benefits. Also, the additional damages prevent the tortfeasor from gaining the advantage of benefits from third parties in the form of reduced liability for

25. *Ashley v. American Auto. Ins. Co.*, 19 Wis. 2d 17, 119 N.W.2d 359 (1963); *Prunty v. Vandenberg*, 257 Wis. 469, 44 N.W.2d 246 (1950); *Cunnie v. Superior Iron Works Co.*, 175 Wis. 172, 184 N.W. 767 (1921).

26. *Thoreson v. Milwaukee & Suburban Transp. Corp.*, 56 Wis. 2d 231, 243-45, 201 N.W.2d 745, 751-52 (1972); *McLaughlin v. Chicago, M., St. P. & P.R.R.*, 31 Wis. 2d 378, 395-96, 143 N.W.2d 32, 40-41 (1966).

27. *Thoreson*, 56 Wis. 2d at 243, 201 N.W.2d at 752.

damages.²⁸ To accomplish these goals, the collateral source rule requires that benefits which reduce or diminish the amount of loss the plaintiff sustains as a result of the defendant's tort be disregarded in determining the harm the defendant has caused.

If damages awarded to restore a loss of earnings are measured by the plaintiff's after-tax earnings, then the collateral source rule is inapplicable to the plaintiff's damages. The collateral source rule is applicable only to benefits conferred upon the plaintiff which restore or diminish loss the plaintiff would have otherwise sustained as a result of the defendant's wrongful conduct. The exemption of damages from taxation is not a benefit that restores income the plaintiff has lost as a result of the defendant's tort. It also is not a benefit (like gratuitous medical services) that diminishes a cost the plaintiff otherwise would not have incurred absent the tortfeasor's wrongful act. The opposite is true of income taxes on earnings. They would have been incurred if the defendant's tort had never been committed. The tax exemption is therefore distinguishable from benefits and payments that fall within the scope of the collateral source rule. The tax exemption of damages simply ensures that when the plaintiff's loss is restored by the defendant's payment of damages, the plaintiff's recovery is not diminished by the imposition of taxes on the award.

The only way the tax exemption of damages can fall within the scope of the collateral source rule is if the tax exemption is a benefit which, when taken into account in measuring the defendant's liability, would reduce the amount of damages the defendant would have to pay to the plaintiff. However, for the tax exemption to confer such a benefit, the defendant must be required to pay damages for loss of earnings measured by the plaintiff's gross earnings. If gross earnings are the required measure of the plaintiff's loss of earnings, then permitting the defendant to reduce liability by the tax benefit the exemption confers upon the plaintiff would shift the advantage of the tax exemption from the plaintiff to the defendant. The reduction also would diminish the amount

28. *Id.*; see also Note, *Unreason in the Law of Damages: The Collateral Source Rule*, 77 HARV. L. REV. 741 (1964).

of loss which burdens the defendant. The collateral source rule would therefore prohibit the reduction.

However, the tax exemption of damages can only confer a benefit upon the plaintiff which falls within the scope of the collateral source rule if the damages to be awarded to the plaintiff are measured by the plaintiff's gross earnings. Thus, if Congress enacted the tax exemption for personal injury damages in order to confer a benefit on plaintiffs in the form of increased awards of damages, then it must also be assumed that Congress enacted the tax exemption to mandate that damage awards replacing loss of earnings must be measured by gross earnings. If this were the correct interpretation of the purpose of the tax exemption statute, then the tax exemption extracts a "tax" from the defendant in the form of increased liability and awards the revenue raised by the exemption to the plaintiff. If Congress did not enact the exemption for damages to confer the benefit of additional damages on the plaintiff, then the court is free to measure the plaintiff's loss of earnings by the after-tax earnings. The only "benefit" the plaintiff loses when he is awarded damages which approximates his loss of past and prospective after-tax earnings is the windfall that results when the defendant is required to pay damages which place the plaintiff in a better position than he would have been in if he had never been injured. If the tax-exemption of personal injury recoveries creates a benefit, it is a benefit that the plaintiff realizes only by virtue of the defendant's payment of damages.

C. Congressional Intent

The second reason adopted for the Wisconsin rule is that reducing the amount of damages awarded to the plaintiff by the plaintiff's tax savings would nullify Congress' intent to confer a tax benefit on injured parties. This tax benefit approximates the amount of taxes the plaintiff would have paid on his earnings if he had received them in the normal course of his employment.²⁹

This reasoning is an interpretation of federal tax law. Specifically, if the purpose of the income tax exemption of per-

29. *Hardware Mut.*, 6 Wis. 2d at 407, 94 N.W.2d at 582-83.

sonal injury damages is interpreted as mandating that gross earnings be used to measure recoveries for loss of earnings, then the plaintiff will receive a tax benefit that approximates the amount of tax he would have paid if his stream of earnings had not been terminated or diminished by the defendant's tort.

The amount of tax benefit the plaintiff derives from the tax exemption of damages necessarily depends upon how the damages are measured. Only damages measured by gross earnings will yield a tax benefit which approximates the amount of tax that would have been paid if no loss of earnings had been sustained. Therefore, assuming that Congress intended to confer a tax benefit on a plaintiff that approximates the amount of tax the plaintiff would have paid on gross earnings, Congress also must have intended to mandate that gross earnings be used to measure damages awarded to a plaintiff who sustains a loss of earnings as a result of injuries inflicted.

III. THE WISCONSIN RULE HAS LOST ITS RATIONALE

In 1980, the United States Supreme Court ended the controversy regarding whether federal tax law requires gross earnings to be used in measuring damages based on lost earnings. In *Norfolk & Western Railway Co. v. Liepelt*,³⁰ the Supreme Court rejected the contention that the exclusion for personal injury damages was enacted to confer a benefit on tort victims thereby requiring that gross earnings be used to measure damages awarded to restore losses of past and future earnings. The Court held that after-tax earnings must be used in calculating damages awarded for wrongful death in Federal Employers Liability Act (FELA) cases.³¹

Three years later, relying on the *Liepelt* decision, the Court in *Jones & Laughlin Steel Corp. v. Pfeifer*,³² held that after-tax earnings must be used to measure loss of earnings in negligence actions brought under the Longshoremen's and Harbor Workers' Compensation Act.³³

30. 444 U.S. 490 (1980).

31. *Id.* at 493-94. The text of the FELA is found at 45 U.S.C. §§ 51-60 (1982).

32. 462 U.S. 523 (1983). In *Pfeifer*, the Court also held that an after-tax interest rate must be used in discounting the award to its present value. *Id.* at 536-38.

33. 33 U.S.C.A. § 905 (West 1986).

In *Liepelt*, the Supreme Court's ruling that Congress has not required that gross earnings be used to measure damages based on loss of earnings is only a footnote in response to the dissenting opinion.³⁴ However, it is an important footnote for courts which previously felt compelled to award damages measured by gross earnings in order to preserve tax benefits they thought Congress intended to confer on plaintiffs. The *Liepelt* decision now permits courts to consider, without the restraint previously believed to be imposed by federal tax law, whether independent state law grounds justify continuing the practice of awarding loss of earnings damages measured by gross earnings. Indeed, jurisdictions like Wisconsin whose decisions have been based solely on a now unfounded interpretation of federal tax law should consider this matter anew.

A. *The Dissenting Opinion*

Although it may seem odd to consider a dissenting opinion before the majority opinion, the dissenting opinion in *Liepelt* is instructive because it develops the interpretation of the federal tax exclusion for personal injury damages that the majority opinion summarily rejects. The dissenting opinion suggests that damages for loss of earnings must be measured by gross earnings, reasoning that Congress has bestowed a benefit on tort victims by choosing not to tax damage awards.³⁵ The dissent reaches this conclusion by focusing on the tax exemption rather than on the purpose the damage award is to accomplish. In doing so, the dissent's reasoning necessarily becomes somewhat circular: loss of earnings must be measured by gross earnings because the tax exemption of damages is intended to confer a benefit on tort victims, and in order for the tax exemption to result in a benefit for the tort victim, gross earnings must be used to measure the tort victim's loss.

The dissent acknowledges that Congress has not articulated its reasons for enacting the exclusion for damages; however, the dissent reasons that since it is unlikely that Congress enacted the exemption to benefit tortfeasors, Congress must have had some other purpose in mind. The dissent finds two

34. *Liepelt*, 444 U.S.at 496 n.10.

35. *Id.* at 500-02 (Blackmun, J., dissenting).

probable reasons which favor the tort victim's position that loss of earnings must be measured by gross earnings.³⁶

First, the dissent supposes that Congress might have enacted the exemption because taxing damages awarded for lost earnings would involve the same complexity which many courts note as a reason for not taking taxes into account in measuring damage awards. The dissent assumes that if Congress were to tax damages, it would have to enact a special statute that would impose a tax on the award approximating the amount of tax that would have been paid on the victim's income if it had been earned over a period of time.³⁷ Thus, the dissent concludes, if Congress decided it was not worth the effort to estimate the prospective tax liability on behalf of the public fisc, then Congress would not require such an estimate for the benefit of the tortfeasor.³⁸

This reasoning would not be applicable to claims brought under state law. Even the dissent "would not infer a congressional purpose to override the States' traditional power to define the measure of damages applicable to state-created causes of action."³⁹ Thus, if this were the sole reason for enacting the exclusion for damages, states could not rely on congressional intent as a basis for using gross earnings to measure loss of earnings awards.⁴⁰

Second, the dissent assumes that Congress might have intended to confer a humanitarian benefit on the tort victim, reasoning that the exemption diminishes the victim's chances of needing public relief.⁴¹ However, if the tort victim is compensated for his loss in damages that restore him to the same economic position he would have been in if the tortfeasor's wrong had not been committed, then there should be little

36. *Id.* at 501.

37. *Id.* The assumption the dissent makes is quite plausible because the tax rate that would be applicable to the lump sum award, if taxed, could greatly exceed the tax rate that would have applied to the victim's incremental earnings. *See* I.R.C. § 1 (1986).

38. *Liepert*, 444 U.S. at 502 (Blackmun, J., dissenting).

39. *Id.* at 500-01 n.3.

40. In contrast, if the Court had found that Congress enacted the damages exclusion to confer a benefit on plaintiffs, state courts following the collateral source rule would use a gross earnings measure, not because Congress mandated its use, but because an independent state rule requires that the intended benefit be preserved for the plaintiff.

41. *Liepert*, 444 U.S. at 501 (Blackmun, J., dissenting).

chance that the victim will become a public charge. If there is such a chance, it should be no greater than it would have been had the defendant's tortious conduct never occurred. Moreover, in order for the exemption to confer an economic benefit on the victim, the defendant must pay damages. Unlike a deduction which might generate tax savings by offsetting income the victim has from one or more sources, a tax exemption only benefits the victim to the extent that the victim receives income from a source that falls within the exclusion.⁴²

B. *The Majority's Response*

The majority opinion tersely addresses the points made by the dissent. First, the majority notes that there is nothing in the language or legislative history of the damages exemption to suggest that it has any impact on the proper measure of damages.⁴³ Second, the majority holds that netting out taxes which would have been paid on earnings had they been received in the normal course of employment, just like netting out a wrongful death victim's personal expenditures, is necessary to arrive at the pecuniary benefits the plaintiff is entitled to recover in damages.⁴⁴ Thus, the majority opinion focuses primarily on the proper measure of damages and only secondarily on how income taxes relate to that measure. The Court stated:

In a wrongful death action under the FELA the measure of recovery is "the damages . . . [that] flow from the deprivation of the pecuniary benefits which the beneficiaries might have reasonably received . . ." *Michigan Central R. Co. v. Vreeland*, 227 U.S. 59, 70 (1913). The amount of money that a wage earner is able to contribute to the support of his family is unquestionably affected by the amount of the tax he must pay to the Federal Government. It is his after-tax income, rather than his gross income before taxes, that provides the only realistic measure of his ability to support his

42. A third possibility which the dissent does not acknowledge is that Congress might have enacted the exemption to ensure that when the victim receives an award of damages, which the judiciary determines will fully compensate his loss, the victim will not ultimately be undercompensated as a result of taxes imposed on the award and the prevailing practice of excluding evidence of payments the victim will be required to make from the award.

43. *Liepert*, 444 U.S. at 496 n.10.

44. *Id.*

family. It follows inexorably that the wage earner's income tax is a relevant factor in calculating the monetary loss suffered by his dependents when he dies.⁴⁵

The balance of the *Liepelt* opinion addresses the relationship between the Federal Rules of Evidence and the admissibility of evidence of taxes that would have been paid on the plaintiff's earnings if no tort had been committed.

C. Federal Rules of Evidence

In *Liepelt*, the Supreme Court also held that evidence describing the victim's estimated after-tax earnings is not too speculative or complex to be presented to the jury. The Court acknowledged that variables such as changes in the tax laws, the decedent's family size, his spouse's earnings, and extra income or unforeseen deductions may affect the wage-earner's future income tax liability and require estimates and predictions. However, the Court noted that matters such as future employment, health, personal expenditures, interest rates and inflation also require estimation and prediction. The Court reasoned that since the trial bar and bench have developed effective methods of presenting the latter matters in a form understandable by juries, the same will be true with respect to taxation matters.⁴⁶ However, the Court also noted that if the impact of future income tax in calculating the award would be de minimus, the evidence may be omitted because the confusion it might cause would outweigh its relevance.⁴⁷

Next the Court addressed the plaintiff's contention that if evidence of income taxes the plaintiff would have paid is relevant, then other equally relevant evidence, including the tax on income earned on the damage award and the plaintiff's attorney's fees, would also be admissible. The Court pointed out that even though evidence of future taxes on earnings from the award would be admissible, this is no reason to reject tax evidence for purposes of measuring lost earnings.⁴⁸ However, evidence of attorney's fees, the Court stated, is not relevant since in FELA actions there is no statutory authority for

45. *Id.* at 493-94.

46. *Id.* at 494.

47. *Id.* at 494-95 n.7.

48. *Id.* at 495.

awarding attorney's fees to the successful litigant. It would also be improper to offset what may be regarded as an unfair or undesirable rule regarding attorney's fees by ignoring the "demonstrably relevant factor of income tax in measuring damages."⁴⁹

In summary, *Liepelt* and the Court's subsequent decision in *Jones & Laughlin Steel Corp. v. Pfeifer*,⁵⁰ establish that for federal claims, after-tax earnings must be used in calculating personal injury awards for loss of earnings and pecuniary loss awards in wrongful death actions.⁵¹

Moreover, *Liepelt* establishes that Congress did not intend to confer a benefit on injured parties by exempting personal injury awards from taxation. Therefore, state court decisions requiring that gross earnings be used to measure loss of earnings are now unfounded to the extent that they are based on an interpretation of section 104 of the Internal Revenue Code which contradicts *Liepelt*. However, state courts may still exclude tax evidence if the exclusion is proper under the state's own evidentiary rules.⁵²

IV. OTHER RATIONALES FOR EXCLUDING EVIDENCE OF FUTURE INCOME TAXES

The Wisconsin rule that damages based on loss of earnings are to be calculated without deduction of income taxes is ripe for reconsideration because it is premised on the now unfounded interpretation of federal law that Congress intended to confer a benefit on plaintiffs by exempting personal injury

49. *Id.* at 495-96.

50. 462 U.S. 523 (1983).

51. See also *Fanetti v. Hellenic Lines Ltd.*, 678 F.2d 424, 431 (2d Cir. 1982), *cert. denied*, 463 U.S. 1206 (1983).

The Court has left open the question of whether the holding in *Liepelt* would control when a federal claim incorporates state law. *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 487-88 (1981). Several appellate courts have held that it does not. *Hansen v. Johns-Manville Prod. Corp.*, 734 F.2d 1036, 1045 (5th Cir. 1984), *cert. denied*, 470 U.S. 1051 (1985); *In re Air Crash Disaster Near Chicago, Ill.*, 701 F.2d 1189, 1193 (7th Cir. 1983); *Vasina v. Grumman Corp.*, 644 F.2d 112, 118 (2d Cir. 1981); *Croce v. Bromley Corp.*, 623 F.2d 1084, 1096-97 (5th Cir. 1980); *Psychiatric Inst. of Wash. v. Allen*, 509 A.2d 619, 626-27 (D.C. 1986).

52. When grounds for a state law are dependent on federal law, a federal question is presented. If that question is decided contrary to a state court ruling, the state court must provide independent state grounds for its ruling to be sustained. See *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 568 (1977).

and wrongful death awards from taxation. No such benefit was intended and thus, the Wisconsin rule has lost its rationale.

If the Wisconsin Supreme Court chooses to continue applying the current rule,⁵³ it must furnish a new rationale based on the state's own evidentiary rules. However, the possibilities are contrary to other case law in Wisconsin.

A. *Evidence of Future Taxes is Too Speculative*

One rationale which could be adopted to support continued application of the Wisconsin rule is that evidence of future taxes is too speculative or conjectural to be admitted. Several courts have adopted this rationale, finding that there are too many variables that might affect the plaintiff's future tax liability, including changes in the tax rates and exclusions, exemptions and deductions to which the tort victim might be entitled.⁵⁴

Courts that have rejected this rationale acknowledge that future taxes are uncertain, but they also find that other factors, such as the possibility of future employment and life expectancy, are just as unpredictable.⁵⁵ Moreover, it would be unjust to allow the plaintiff to introduce uncertain evidence as to his earning capacity, but cut off any attempt by the defendant to show that those earnings would have been taxed. Professor Nordstrom summarized this position succinctly in his 1958 article when he wrote:

53. Several courts have held that the federal rule admitting evidence of income taxes the plaintiff would have paid is inapplicable to state law claims. *See, e.g.*, *Irwin v. Pacific S.W. Airlines*, 133 Cal. App. 3d 709, 717-18, 184 Cal. Rptr. 228, 231-32 (1982); *Psychiatric Inst. of Wash. v. Allen*, 509 A.2d 619, 626 (D.C. 1986); *McCann v. Lisle-Woodridge Fire Protection Dist.*, 115 Ill. App. 3d 702, ___, 450 N.E.2d 1311, 1314 (1983); *Richardson v. LaBuz*, 81 Pa. Commw. 436, ___, 474 A.2d 1181, 1197 (1984); *Bingaman v. Grays Harbor Community Hosp.*, 37 Wash. App. 825, 685 P.2d 1090 (1984), *rev'd on other grounds*, 103 Wash. 2d 831, 699 P.2d 1230 (1985); *Maicke v. RDH, Inc.*, 37 Wash. App. 750, 683 P.2d 227 (1984).

54. *See, e.g.*, *Johnson v. Penrod Drilling Co.*, 510 F.2d 234, 236-37 (5th Cir. 1975); *McWeeney v. New York, N.H. & H.R.R.*, 282 F.2d 34, 35-37 (2d Cir. 1960); *Stokes v. United States*, 144 F.2d 82, 87 (2d Cir. 1944); *Dempsey v. Thompson*, 363 Mo. 339, ___, 251 S.W.2d 42, 46 (1952); *Dehn v. Prouty*, 321 N.W.2d 534, 535 (S.D. 1982).

55. *See, e.g.*, *Hooks v. Washington Sheraton Corp.*, 578 F.2d 313, 317 (D.C. Cir. 1977); *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 293 (9th Cir. 1975); *O'Connor v. United States*, 269 F.2d 578, 584 (2d Cir. 1959); *Floyd v. Fruit Indus.*, 144 Conn. 659, ___, 136 A.2d 918, 925-26 (1957).

Indeed, which is more conjectural: the existence of income tax in this country along the pattern that we now know it, or the continuance of the plaintiff's salary during exactly the same period? . . . If the plaintiff receives the advantage of the speculation in his favor, why do we bar the defendant from even trying to show what appears to be a smaller speculation in his favor?⁵⁶

With the national debt in excess of two trillion dollars,⁵⁷ these questions are even more pertinent today. The existence of the income tax in the future is a virtual certainty.

In Wisconsin, trial courts allow evidence of impaired future earning capacity that is more speculative and uncertain than would be admissible for proof of historical facts.⁵⁸ The Wisconsin Supreme Court has recognized that "[m]any elements that go to a determination of impairment [of earning] capacity cannot be proven with certainty."⁵⁹ However, Wisconsin has made a policy decision that "the ends of justice will be furthered by recognizing the probabilities in respect to the computation of future damages."⁶⁰ A policy decision such as this would not permit one party to a lawsuit the advantage of evidence based on estimations, while prohibiting the use of similar evidence by the other party.

Another indication that Wisconsin would not adopt the "too speculative" rationale is apparent in *Hardware Mutual Casualty Co. v. Harry Crow & Son*,⁶¹ the Wisconsin Supreme Court decision which enunciated the gross earnings rule. In *Hardware Mutual*, the court only quotes the Illinois Supreme Court's rationale that no reduction is to be made because Congress intended to confer a benefit on plaintiffs by exempting personal injury awards from taxation.⁶² However, in the Illinois decision relied upon, the court also stated that "[w]e are

56. Nordstrom, *supra* note 10, at 227.

57. 44 CONG. Q. WEEKLY REP. 2588 (Oct. 18, 1986).

58. *Fischer v. Cleveland Punch & Shear Works Co.*, 91 Wis. 2d 85, 100, 280 N.W.2d 280, 287 (1979); *Brain v. Mann*, 129 Wis. 2d 447, 459, 385 N.W.2d 227, 232 (Ct. App. 1986).

59. *Reinke v. Woltjen*, 32 Wis. 2d 653, 660, 146 N.W.2d 493, 497 (1966).

60. *McCrossen v. Nekoosa Edwards Paper Co.*, 59 Wis. 2d 245, 262, 208 N.W.2d 148, 158 (1973).

61. 6 Wis.2d 396, 94 N.W.2d 577 (1959).

62. *Id.* at 407, 94 N.W.2d at 582-83 (quoting *Hall v. Chicago & N.W. Ry.*, 5 Ill. 2d 135, 151, 125 N.E.2d 77, 86 (1955)).

of the opinion that the incident of taxation is not a proper factor for a jury's consideration. . . . It introduces an extraneous subject, giving rise to conjecture and speculation."⁶³ The absence of this reasoning from the Wisconsin decision indicates that it is not persuasive and would not be adopted now.

Even if Wisconsin decided inconsistently that evidence of income taxes is too speculative to be admitted, the ruling would have to be confined to evidence of future taxes. As to earnings lost up to the time of trial, the taxes which would have been payable on those earnings had the plaintiff not been injured can be calculated with near precision. The Alaska Supreme Court has limited its exclusionary rule to income taxes relating to future damages.⁶⁴ While perhaps logical, this rule would invite jury confusion since the jury would be required to utilize different rules to measure past and future losses.

B. Complexity and Confusion

Another related rationale Wisconsin could adopt is that computation of a plaintiff's hypothetical tax liability is too complex for the jury and would impair the jury's competence to decide issues of fact.⁶⁵ In reducing the award to its present value, the jury would also have to take into account taxability of income earned from investing the award.⁶⁶

However, jury confusion can be reduced to a minimum by the use of expert testimony, and most jurors today have some personal experience in determining their own tax liability.⁶⁷ Expert testimony is already required in Wisconsin to support

63. *Hall*, 5 Ill. 2d at 151, 125 N.E.2d at 86.

64. *Yukon Equip., Inc. v. Gordon*, 660 P.2d 428, 434-35 (Alaska 1983).

65. WIS. STAT. § 904.03 (1985-86) provides: "Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence." See *Domeracki v. Humble Oil & Ref. Co.*, 443 F.2d 1245, 1250-51 (3d Cir. 1971); *McWeeney v. New York, N.H. & H.R.R.*, 282 F.2d 34, 37 (2d Cir. 1960); *Dehn v. Prouty*, 321 N.W.2d 534, 539 (S.D. 1982).

66. *Johnson v. Penrod Drilling Co.*, 510 F.2d 234, 236-37 (5th Cir. 1975); *McWeeney*, 282 F.2d at 37; *Louissaint v. Hudson Waterways Corp.*, 111 Misc. 2d 122, —, 443 N.Y.S.2d 678, 682 (Sup. Ct. 1981).

67. *Hooks v. Washington Sheraton Corp.*, 578 F.2d 313, 317 (D.C. Cir. 1977); *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 293 (9th Cir. 1975).

an award for loss of earning capacity.⁶⁸ Additionally, as long as the expert is qualified, expert testimony is ordinarily admissible irrespective of the underlying theory on which the testimony is based.⁶⁹

This rationale also has little force where a court is sitting without a jury.⁷⁰ Presumably, trial judges would not determine that they are also incapable of making the required tax computations even with the aid of expert testimony, although some have.⁷¹ Moreover, the Tax Reform Act of 1986⁷² has greatly simplified the computation of tax liabilities for most taxpayers.

C. *Offset of Inflation and Attorney's Fees*

Other courts refuse to reduce the plaintiff's earnings by hypothetical taxes because inaccuracies resulting from failure to make the reduction are offset by ignoring inflation in calculating future earnings and refusing to award the prevailing plaintiff attorney's fees.⁷³ This rationale is not supported by the Wisconsin case law relating to evidence of inflation and attorney's fees.

In Wisconsin, inflation is taken into account in determining damages for future loss.⁷⁴ Therefore, this rationale would be inapplicable in Wisconsin because of its erroneous prem-

68. *Koele v. Radue*, 81 Wis. 2d 583, 590, 260 N.W.2d 766, 769 (1978); *Brain v. Mann*, 129 Wis. 2d 447, 458, 385 N.W.2d 227, 232 (Ct. App. 1986).

69. *State v. Walstad*, 119 Wis. 2d 483, 518, 351 N.W.2d 469, 487 (1984); *Brain*, 129 Wis. 2d at 459, 385 N.W.2d at 233-34 (allowing expert testimony as to loss of earnings based on statistical surveys); *Klingman v. Kruschke*, 115 Wis. 2d 124, 126-28, 339 N.W.2d 603, 604-05 (Ct. App. 1983) (allowing vocational rehabilitation expert's opinion testimony based on data which the expert testified was the type of data reasonably relied upon by vocational rehabilitation experts to evaluate occupational disabilities).

70. *Downs v. United States*, 522 F.2d 990, 1005 (6th Cir. 1975).

71. *See, e.g., Frankel v. United States*, 321 F. Supp. 1331, 1348-49 (E.D. Pa. 1970), *aff'd*, 466 F.2d 1226 (3d Cir. 1972).

72. Pub. L. No. 99-514 (1986).

73. *See, e.g., McWeeney v. New York, N.H. & H.R.R.*, 282 F.2d 34, 38 (2d Cir. 1960).

74. *Cords v. Anderson*, 80 Wis. 2d 525, 550-52, 259 N.W.2d 672, 683-85 (1977); *Maskrey v. Volkswagenwerk Aktiengesellschaft*, 125 Wis. 2d 145, 167-68, 370 N.W.2d 815, 826 (Ct. App. 1985); *see also* Comment, *Future Inflation: A New Element of Damages in Wisconsin*, 61 MARQ. L. REV. 620 (1978); Comment, *Adjusting Damage Awards for Future Inflation*, 1982 WIS. L. REV. 397. For an excellent discussion of methods of accounting for inflation in measuring damages, *see Jones & Laughlin Steel Corp. v. Pfeifer*, 462 U.S. 523, 538-52 (1983).

ise.⁷⁵ Using gross earnings, rather than earnings net of income taxes, would not offset any failure to take inflation into account. Instead, the plaintiff would receive a windfall.

With respect to attorney's fees, courts have reasoned that any overcompensation the plaintiff receives because the award for lost earnings is not reduced by taxes is offset by the fact that the plaintiff does not receive the entire award because he must pay his attorney.⁷⁶ This rationale acknowledges that the gross earnings rule overcompensates the plaintiff but ignores the fact that the defendant's liability is measured by loss resulting from the defendant's tortious conduct. The plaintiff must pay his attorney because of a contractual obligation owed to the attorney. Attorney's fees are therefore irrelevant to the measure of the plaintiff's damages. No one would doubt that if the plaintiff offered direct evidence of his attorney's fees, the evidence would be rejected.⁷⁷

Moreover, Wisconsin continues to follow the "American rule" that a prevailing litigant is ordinarily not entitled to collect attorney's fees from the opposing party as part of damages or costs.⁷⁸ Adopting the rationale that any overcompensation the plaintiff receives is offset by his attorney's fees would indirectly change this rule. As the District of Columbia Court of Appeals noted, the rule should not be changed under the guise of judicial opinion excluding tax evidence; "it should be a step taken consciously by the legislature."⁷⁹ If Wisconsin chooses to no longer follow the "American rule," certainly the new rule should be equally advantageous to all tort victims, not just those who sustain a substantial loss of earnings.

75. See *Hooks v. Washington Sheraton Corp.*, 578 F.2d 313, 318 (D.C. Cir. 1977) (noting inapplicability of this rationale where evidence of inflation is admissible); *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 293 (9th Cir. 1975) (noting inapplicability of this rationale where evidence of inflation is admissible).

76. See, e.g., *McWeeny*, 282 F.2d at 38; *Louissaint v. Hudson Waterways Corp.*, 111 Misc. 2d 122, ___, 443 N.Y.S.2d 678, 682-83 (Sup. Ct. 1981).

77. *Burlington N.*, 529 F.2d at 294.

78. *Watkins v. Labor & Indus. Review Comm'n*, 117 Wis. 2d 753, 758, 345 N.W.2d 482, 485 (1984). Attorney's fees are recoverable as damages only where recovery is authorized by contractual or statutory provisions, *Cedarburg Light & Water Comm'n v. Glens Falls Ins. Co.*, 42 Wis. 2d 120, 124-25, 166 N.W.2d 165, 167 (1969), or where attorney's fees are incurred through litigation with other parties resulting from a wrongful act by the opponent in the case where attorney's fees are sought. *Kohlenberg v. American Plumbing Supply Co.*, 82 Wis. 2d 384, 399, 263 N.W.2d 496, 503 (1978).

79. *Hooks*, 578 F.2d at 318.

D. Wrongful Death Actions

In wrongful death actions, none of the alternative rationales for the Wisconsin rule justifies allowing recoveries for deprivation of support and property accumulations based on lost future earnings without reduction for income taxes. Each rationale excludes evidence of future taxes, not because they are additional damages the plaintiff is entitled to recover, but because the future taxes are too speculative or complex, or offset the failure to take into account inflation or attorney's fees.

Wrongful death actions are purely statutory.⁸⁰ The purpose of the statute is "to compensate survivors for the pecuniary benefits which they would have derived from the earning power of the decedent had he or she lived."⁸¹ The survivors are not entitled to recover the deceased's earnings. Only the value of the support and pecuniary benefit they probably would have received from the deceased plus sums the survivors would have ultimately received from reasonably certain future earnings the deceased would have accumulated are recoverable.⁸² Outlays the deceased would have made for his own support and incidentals must be taken into account in measuring the survivors' award.⁸³

It necessarily follows that taxes the deceased would have paid also reduce the amount of support the deceased could have provided and the amount of earnings he could have accumulated had he lived. The Seventh Circuit Court of Appeals summarized this reasoning when it wrote:

The deceased's beneficiaries could not logically and reasonably have expected to receive the money he would have paid in such taxes had he lived. Only the net income would have been available for their support. And there can be no pecu-

80. *Weiss v. Regent Properties, Ltd.*, 118 Wis. 2d 225, 230, 346 N.W.2d 766, 768 (1984); *Krantz v. Harris*, 40 Wis. 2d 709, 714, 162 N.W.2d 628, 630 (1968); *see also* WIS. STAT. ANN. §§ 895.03-04 (West 1983 & Supp. 1986).

81. *Weiss*, 118 Wis. 2d at 230, 346 N.W.2d at 768; *Nichols v. United States Fidelity & Guar. Co.*, 13 Wis. 2d 491, 497, 109 N.W.2d 131, 135 (1961).

82. *Neuser v. Thelen*, 209 Wis. 262, 268, 244 N.W. 801, 803 (1932).

83. *Maloney v. Wisconsin Power, Light & Heat Co.*, 180 Wis. 546, 550, 193 N.W. 399, 400 (1923); *Sadowski v. Thomas Furnace Co.*, 157 Wis. 443, 454, 146 N.W. 770, 774-75 (1914).

niary loss of income which would not have been available for contribution.⁸⁴

Additionally, punitive damages are not recoverable under Wisconsin's wrongful death statute.⁸⁵ If taxes the deceased would have paid are not deducted in determining the survivor's award, the survivor will be overcompensated. Damages awarded in excess of the survivor's compensatory loss could be considered punitive.⁸⁶

Therefore, in wrongful death actions, recoveries for pecuniary loss which result from deprivation of income the deceased would have earned from employment should be measured by the deceased's projected earnings net of estimated income taxes.

V. PROPOSAL

The Wisconsin rule excluding evidence of taxes a tort victim would have paid if the victim had not sustained a loss of earnings should be reconsidered because the rationale for the rule is based on a now unfounded interpretation of federal tax law. Since other rationales which might justify continued application of this rule are all inconsistent with other Wisconsin case law, the Wisconsin Supreme Court should rule that evidence of taxes that would have been paid on loss of earnings is relevant, admissible evidence. The new rule should be applicable to loss of past and prospective earnings and earning capacity. It should also apply to wrongful death recoveries for loss of support and property accumulations that would have been derived from the deceased's employment earnings.

The court should also rule that the standards applicable to proof of loss of future earnings also apply to proof of taxes that would have been paid on those earnings. The court has stated in this regard:

84. *Cox v. Northwest Airlines, Inc.*, 379 F.2d 893, 896 (7th Cir. 1967); *see also Norfolk & W. Ry. v. Liepelt*, 444 U.S. 490, 493-94 (1980); *O'Connor v. United States*, 269 F.2d 578, 584-85 (2d Cir. 1959); *Gilliard v. New York City Health and Hosp., Inc.*, 77 A.D.2d 532, ___, 430 N.Y.S.2d 308, 309 (1980); *Magnolia Petroleum Co. v. Sutton*, 208 Okla. 488, ___, 257 P.2d 307, 316 (1953).

85. *Wangen v. Ford Motor Co.*, 97 Wis. 2d 260, 314-15, 294 N.W.2d 437, 464-65 (1980).

86. *White v. Benkowski*, 37 Wis. 2d 285, 290-91, 155 N.W.2d 74, 76-77 (1967).

In determining damages to be awarded for impairment of earning capacity or loss of future earnings, in most instances, the finder of the fact must deal in some probabilities. In the case where the claimant is totally [and] permanently disabled from engaging in any gainful employment or activities his impairment of earning capacity can be calculated with a substantial degree of certainty. . . . Many elements that go to a determination of impairment capacity cannot be proven with certainty. Proof of these elements must be permitted by facts or inferences that lead to reasonable probabilities. Some (but not all) of the elements which cannot always be shown with certainty are the length of time a disability will exist, the degree of improvement or additional disability that will ensue, the aptitude and ability of a disabled person to engage in other types of work, and the compensation he will be able to obtain. As to these and other uncertain elements the trier of fact must be allowed to consider the reasonably apparent probabilities as they appear from the evidence, together with such known facts as his age, his education and training, the type work [sic] he was doing before the injury, and the compensation he was receiving, and then in its judgment determine what amount fairly and reasonably represents his loss of earning capacity, reduced to its present value.⁸⁷

Although the court states that the amount of earnings lost as a result of a permanent and total disability can be determined with a substantial degree of certainty, the determination of the amount of loss is by no means exact. Probabilities must still be taken into account such as the life expectancy of the victim, continuance of employment, and possible increases and decreases in compensation that the victim would have received if he had not been injured. Where the victim suffers impairment of his earning capacity, additional variables must also be taken into account in measuring the award. The same variables affect the amount of tax that the victim would have paid on the earnings if the victim had not been injured. Increases and decreases in compensation the victim might have received are estimations just like increases and decreases in taxes that would have been paid on such compensation. Since mathematical certainty is not required in projecting loss of

87. *Reinke v. Woltjen*, 32 Wis. 2d 653, 660, 146 N.W.2d 493, 497 (1966).

earnings, it should not be required in projecting the amount of tax that would have been paid on those earnings. Proof of taxes which would have been payable on earnings lost as of the time of trial should be substantially certain since the tax rate that would have applied to those earnings and other facts relevant to the plaintiff's tax liability will be known.

With respect to future earnings, proof of taxes which would have been payable on those earnings can be raised by inference from (1) the percentage of earnings the plaintiff paid in taxes or the amount of tax paid in past years;⁸⁸ (2) the tax rates applicable at the time of trial;⁸⁹ or (3) evidence of future tax rates, if available.⁹⁰ The same tax rate schedule would also be applicable for purposes of determining the after-tax discount rate to be used in reducing the award to its present value.⁹¹ In most, if not all, cases, expert testimony may be elicited to assist the jury in determining the amount of tax that would have been imposed on the victim's earnings. In other cases, the plaintiff's testimony on direct and cross-examination as to past tax liabilities may suffice.

Regardless of whether past, present or future tax rates are used to measure the tax reduction, the reduction should approximate the amount of tax that would have been paid on the victim's annual earnings received over time rather than the amount of tax that would be payable if lump sum damage awards were taxed. The tax rate applicable to a lump sum award should not be used because it will exceed the tax rate applicable to smaller incremental earnings received over time.⁹² If the victim's loss of earnings represents his total income, the tax reduction can be computed by using the rate

88. *Fanetti v. Hellenic Lines Ltd.*, 678 F.2d 424, 432 (2d Cir. 1982). If past taxes are used to estimate future taxes, an adjustment must be made in the year the plaintiff was injured if that year does not reflect an entire year of earnings. *Id.* at 432 n.8.

89. *See Cox v. Northwest Airlines, Inc.*, 379 F.2d 893, 896 (7th Cir. 1967) (adopting this approach); *O'Connor v. United States*, 269 F.2d 578, 584 (2d Cir. 1959) (adopting this approach).

90. *Fanetti*, 678 F.2d at 432. At the risk of sounding naive, counsel might also stipulate as to the amount of future taxes.

91. An after-tax discount rate is determined by multiplying the discount rate which would be applicable if no tax were imposed on income generated from investment of the award by the difference between one and the effective tax rate which will be applicable to the earnings. For example, if the pre-tax discount rate is 5% and the tax rate is 15%, the after tax discount rate is 4.25%.

92. *See I.R.C. § 1* (1986).

schedule that would have been applicable if the earnings had been received in the normal course of employment.⁹³ However, if the victim is expected to have, or in a wrongful death case would have had, income from a source other than the victim's own labor, these other sources of income must be taken into account to determine the average (effective) tax rate that would have applied to all sources of earnings. The average tax rate is determined by dividing the total tax on all sources of income by the amount of such income. The effective rate is lower than the top marginal rate.⁹⁴

If this proposal is adopted, tax evidence will not necessarily be introduced in every case where a recovery of lost earnings is sought. Evidence of taxes could be excluded where the facts indicate that even if the jury gave the plaintiff the highest award which would be supported by the evidence, little or no tax would be paid.⁹⁵ For example, when the provisions of the Tax Reform Act of 1986 are fully phased in, a married individual with two dependent children would pay no taxes on gross earnings of \$13,000. The taxpayer would be entitled to four exemptions of \$2000 each⁹⁶ and a \$5000 standard deduction.⁹⁷ To alleviate the need for plaintiffs of lesser means to hire a tax expert, perhaps the burden of proving that taxes would have been payable on the plaintiff's earnings should be placed on the defendant. The defendant would then introduce tax evidence only if the plaintiff's projected tax liability exceeds the cost of discovering such evidence and the cost of hiring a tax expert.

The Tax Reform Act of 1986 has greatly simplified the computation of tax liabilities for the average taxpayer. Instead of fifteen marginal tax rates potentially applicable to an individual,⁹⁸ there will be only two in 1988.⁹⁹ For a married

93. *Id.*

94. For example, assume that a victim's loss of earnings for one year is \$10,000 and during that year he also has \$15,000 of taxable income from other sources. If the tax rate applicable to the first \$10,000 earned is 10% and the rate applicable to all income exceeding \$10,000 is 15%, then the victim would have paid \$3250 in taxes. The victim's effective tax rate on income from all sources is 13%, determined by dividing the total tax (\$3250) by the victim's total income (\$25,000).

95. See *supra* note 63 for text of WIS. STAT. § 904.03 (1985-86).

96. I.R.C. § 151 (1986).

97. *Id.* at § 63(c)(2)(A).

98. *Id.* at § 1 (1954 as amended in 1984).

individual who files a joint return, the tax rate applicable to taxable income which does not exceed \$29,750 is fifteen percent.¹⁰⁰ For taxable income in excess of \$29,750, the rate is twenty-eight percent.¹⁰¹ Even if there is a possibility that these rates will increase, it should not preclude the defendant from showing that the plaintiff would have paid at least the amount of tax computed using these rates. As stated by the Connecticut Supreme Court:

It would be difficult to conceive of a more unjust, unrealistic or unfair rule than one which would lead a jury to base their allowance of reasonable compensation for the destruction of earning capacity on the hypothesis that no income taxes would be paid on net earnings. For all practical purposes, the only usable earnings are net earnings after payment of such taxes.¹⁰²

VI. CONCLUSION

The Wisconsin Supreme Court should overrule *Hardware Mutual Casualty Co. v. Harry Crow & Son*,¹⁰³ and join the United States Supreme Court in holding that the proper measure of loss of earnings in personal injury and wrongful death actions is after-tax earnings. As stated by the Ninth Circuit Court of Appeals, reducing gross earnings by taxes the plaintiff would have paid "more accurately harmonizes with fair economic reality, more justly achieves the goal of compensating claimants for the actual loss suffered, and safeguards against the injustice of overcompensation."¹⁰⁴ The net earnings rule is the fair, logical and just approach.¹⁰⁵

99. *Id.* at § 1 (1986).

100. *Id.*

101. *Id.*

102. *Floyd v. Fruit Indus.*, 144 Conn. 659, —, 136 A.2d 918, 925 (1957). Although *Floyd* involved a wrongful death action, the court probably would have applied the same rule since the Connecticut wrongful death statute was a "survival-type" statute pursuant to which the plaintiff recovers damages that approximate what the deceased would have recovered had he lived. *Id.* at —, 136 A.2d at 929.

103. 6 Wis. 2d 396, 94 N.W.2d 577 (1959).

104. *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 298 (9th Cir. 1975).

105. *Id.* at 294.