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I. Introduction

The objective of Mississippi wrongful death damage theory is to maintain the economic position of surviving beneficiaries as they were in their pretort condition.[1] Maintaining that position means the amount awarded to beneficiaries should not include the decedent's personal living expenses, since those expenses represent payments out of income that would not have been received by beneficiaries in any event.[2] The Fifth Circuit, applying Mississippi law in *Smith v. Industrial Constructors, Inc.*,[3] included in the definition of living expenses the decedent's personal income taxes, also to be deducted from the award.[4] Tax deduction was mandated to ensure that the economic position of beneficiaries was maintained but not enhanced by the decedent's death, i.e., it avoids making the decedent worth more dead than alive.[5]

The court, in attempting to prevent unjust enrichment, unintentionally diminished the fair return due the beneficiaries. For while the damage award to beneficiaries is itself tax free, the interest earnings on the invested award are taxable. When taxation of the decedent's income is also introduced into the award calculation, the total consequences of income taxation on the beneficiaries' position are

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1. Smith v. Industrial Constructors, Inc., 783 F.2d 1249, 1253 (5th Cir. 1986). The *Smith* Court recognized that Mississippi's goal was one "of awarding the beneficiaries the amount, but only the amount, that the decedent reasonably would have, and could have, contributed to them." *Id.* That guideline interprets § 11-7-13 of the Mississippi Code Annotated, which provides:

> In such action the party or parties suing shall recover such damages allowable by law as the jury may determine to be just, taking into consideration all the damages of every kind to the decedent and all damages of every kind to any and all parties interested in the suit.

MISS. CODE ANN. § 11-7-13 (Supp. 1994).

2. *Smith*, 783 F.2d at 1254-55.

3. 783 F.2d 1249 (5th Cir. 1986).

4. *Id.* at 1253.

5. Louisville & N. Ry. v. Garnett, 93 So. 241, 243 (Miss. 1922).

quite serious. Those effects have not been analyzed thoroughly, being mentioned in only a few court decisions[6] and analyzed in several economic studies.[7]

This Article tracks Mississippi case history on the tax deduction rule. It examines the legal justification of that rule as it relates to maintaining the economic position of beneficiaries. A numerical example is developed to demonstrate the effects of double taxation. Without the double tax, beneficiaries are assured the same economic position as before the decedent's death. With the tax, a serious deterioration in the economic position of beneficiaries occurs. If the tortfeasor insists on a tax on the decedent's earnings, the court in fairness should increase the defendant's payment to compensate the beneficiaries for the double tax they must pay. If the tortfeasor is required to make that payment to maintain the household's economic position, however, he is no better off with the court imposing a tax on the decedent's income. The effects of double taxation on beneficiaries and the tortfeasor call into question the continuation of the tax deduction rule in Mississippi wrongful death actions.

II. Development of the Income Tax Deduction Rule in Mississippi

The progression of court rulings applying Mississippi law to wrongful death damages crystallized over seven decades into the present interpretation.[8] The first step was the development of rules on "present value" and deduction of "living expenses."

A. *Pre-*Sheffield *Damage Theory Developments*

The early rules developed the damages theory framework: (1) the award must provide only the present value of future income payments to beneficiaries, and (2) the living expenses of a decedent must be deducted in award calculation. The first step was announced in the 1920 decision *New Deemer Manufacturing Co. v. Alexander.*[9] The jury was instructed to reduce to present value any "reasonable compensation" the decedent would have earned during the remainder of his life.[10] *New Deemer* also hinted at a requirement to deduct living expenses of the decedent

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6. *See* Norfolk & W. Ry. v. Liepelt, 444 U.S. 490 (1980); McWeeney v. New York, N.H. & H.R.R., 282 F.2d 34 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960); Southern Pac. Co. v. Guthrie, 180 F.2d 295 (9th Cir. 1949), *cert. denied*, 341 U.S. 904 (1951); Huddell v. Levin, 395 F. Supp. 64 (D.N.J. 1975), *vacated*, 573 F.2d 726 (3d Cir. 1976); Meehan v. Central R.R., 181 F. Supp. 594 (S.D.N.Y. 1960); Leming v. Oilfields Trucking Co., 282 P.2d 23 (Cal. 1955); Margevich v. Chicago & N.W. Ry., 116 N.E.2d 914 (Ill. App. Ct.), *cert. denied*, 348 U.S. 861 (1953); Dempsey v. Thompson, 251 S.W.2d 42 (Mo. 1952).

7. *See* Robert H. Feldman, *Personal Injury Awards: Should Tax-Exempt Status Be Ignored?*, 7 Ariz. L. Rev. 272 (1966); Yehuda Kahane & Aaron Yoran, *Compensation for Loss of Income and Its Taxation: A Policy Analysis*, 32 Nat'l Tax J. 117 (1979); Robert J. Nordstrom, *Income Taxes and Personal Injury Awards*, 19 Ohio St. L.J. 212 (1958); Joseph J. Benich, Jr., *The Reverse Tax Effect in Wrongful Death or Injury Cases*, Trial, May 1981, at 16-20, 58; Dennis Brady, et al., *Calculating the Effects of Income Taxes on Lost Earnings*, Trial, Sept. 1982, at 65-68, 84; John O. Ward & Gerald W. Olson, *The Economic Impact of Income Tax on Damage Awards*, Trial, Aug. 1981, at 47.

8. Smith v. Industrial Constructors, Inc., 783 F.2d 1249, 1252 (5th Cir. 1986).

9. 85 So. 104 (Miss. 1920).

10. *Id.* at 106.

from the award. The trial court's jury instruction had allowed "not only what he would have earned, without diminution for his own support, but also such additional amount as it would take to support his wife and children."[11] The jury instruction was found to be in error by the Mississippi Supreme Court because it could be interpreted as allowing an award of both the decedent's earnings and the support the decedent would have provided.[12] The error apparently was not in including the present value reduction of the award or subtracting a "living expense" from the award.[13]

In *Hines v. Green*,[14] the same court expanded the award calculation requirements. The court first spelled out the procedure for determining the present value of an award, using the current legal rate of interest of six percent as the discount factor for future earnings.[15] Then, the court said, from the value so found "must be deducted the expenses that would have been incurred by the deceased on his own account in living and supporting himself during the period of his [life] expectancy."[16]

The following year, in *Louisville & Nashville Railway v. Garnett*,[17] the court elaborated on those principles. It rejected the trial court's award determination because the lower court had authorized the jury to determine the "present cash value of the amount [the] deceased would have earned during his life expectancy without making any deduction for his living expenses."[18] The *Louisville* Court went on: "It is argued that measuring [the] deceased's life expectancy in the manner authorized by . . . [the jury] instruction made him more valuable to his family dead than alive, and that is true."[19] The court cited *New Deemer* and *Hines* in support of its prescribed method for determining the present value of the decedent's future earning capacity.[20]

The court did not maintain perfect consistency over the years in its position on deducting living expenses. In 1956, in *Illinois Central Railroad v. Sanders*,[21] for example, the court held rather emphatically that living expenses were not a deductible item in determining "value of the life expectancy."[22] The court stated that

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11. *Id.* at 107.

12. *Id.* at 106.

13. *Id.* at 107.

14. 87 So. 649 (Miss.), *cert. granted sub nom.* Davis v. Green, 257 U.S. 627 (1921), *and rev'd*, 260 U.S. 349 (1922).

15. *Hines*, 87 So. at 653.

16. *Id.*

17. 93 So. 241 (Miss. 1922).

18. *Id.* at 242.

19. *Id.* at 243.

20. *Id.*

21. 90 So. 2d 366 (Miss. 1956), *overruled by* Sheffield v. Sheffield, 405 So. 2d 1314 (Miss. 1981).

22. *Sanders*, 90 So. 2d at 373.

"[t]he earning capacity of a man is what he is capable of earning and is not what he is capable of saving."[23]

This about-face on the theory of deductibility of living expenses the court had crafted in litigation preceding and including *Louisville* was itself reversed in *Dickey v. Parham.*[24] There, the court again stated that for the decedent, the proper element of damage was "the present net value of his own life expectancy."[25]

B. The Sheffield *Rule on Living Expenses*

The second step in development of Mississippi law on wrongful death damages was the Mississippi Supreme Court's definitive resolution of the differences in decisions[26] on the rule of deductibility of living expenses. In *Sheffield v. Sheffield,*[27] the court established the rule that "the living expenses of the deceased should be deducted from the present cash value of the deceased's life as set forth in *Louisville.*"[28] The court ruled further that "[u]pon request of the defendant, a jury instruction embracing the living expenses deduction principle will be granted."[29]

The *Sheffield* rule was the essential next step in the analysis of tax deductibility from the earnings of a decedent since the Mississippi Supreme Court thereby removed any question on the requirement that living expenses be deducted.[30] That ruling set the stage for the third step, that income taxes on the decedent's earnings are included as part of living expenses.

C. Smith v. Industrial Constructors, Inc.*: Income Taxes As Living Expenses*

In *Smith v. Industrial Constructors, Inc.*,[31] the Fifth Circuit made explicit the state law basis for its ruling—that in diversity cases, " 'state law governs the measure of damages.' "[32] The court also admitted at the outset of its analysis that there

23. *Id.* This comment suggests several things. The court may have found that all of the decedent's income was being used for his maintenance (i.e., the decedent saved nothing), so that deduction of living expenses would leave a zero net income for award purposes. On the other hand, the court may have been conscious of a distinction between all living expenses and those considered necessary to support life and an ability to earn.

24. 295 So. 2d 284 (Miss. 1974).

25. *Id.* at 285 (footnote omitted). The term "present net value" was not explained, but presumably means future lost earning capacity net of living expenses.

26. In Sheffield v. Sheffield, 405 So. 2d 1314, 1318 (Miss. 1981), the court noted rulings not requiring deductibility of living expenses in Jeffreys v. Clark, 168 So. 2d 662 (Miss. 1964), and Illinois Central Railroad v. Sanders, 90 So. 2d 366 (Miss. 1956), *overruled by* Sheffield v. Sheffield, 405 So. 2d 1314 (Miss. 1981), in contrast to the text-cited cases requiring deductibility.

27. 405 So. 2d 1314 (Miss. 1981).

28. *Id.* at 1318.

29. *Id.*

30. *Id.* (citing Hines v. Green, 87 So. 649 (Miss.), *cert. granted sub nom.* Davis v. Green, 257 U.S. 627 (1921), *and rev'd*, 260 U.S. 349 (1922); New Deemer Mfg. Co. v. Alexander, 85 So. 104 (Miss. 1920)).

31. 783 F.2d 1249 (5th Cir. 1986). Only two issues were contested on appeal: the allowance of prejudgment interest and the reduction of a wrongful death award by the amount of income tax payable on earnings. *Id.* at 1250-51.

32. *Id.* at 1250 (quoting Murphy v. Georgia Pac. Corp., 628 F.2d 862, 869 (5th Cir. 1980) (quoting Weakley v. Fishbach & Moore, Inc., 515 F.2d 1260, 1267 (5th Cir. 1975))).

was "no explicit Mississippi authority" to guide the court's determination of awards for future earnings by an income tax reduction.[33]

The *Smith* Court then recounted the pertinent provisions of Mississippi's wrongful death statute: " 'In such action the party or parties suing shall recover such damages as the jury may determine to be just, taking into consideration all the damages of every kind to the decedent and all damages of every kind to any and all parties interested in the suit.' "[34]

The objective of this statute the *Smith* Court found in the *New Deemer* decision: " 'to furnish compensation for the injuries received to the parties suing for the death of the deceased, they having the right to sue for the value of the life under the statute.' "[35] Out of that objective, the *Smith* Court delineated a specific "guiding principle, a more specific damage standard for wrongful death," in three elements, the third of which it found to be most pertinent: "[t]he sum the deceased might have received as the present net value of his own life expectancy."[36]

The court then formulated the rule of recovery: "[T]his measure consists of the present value of the decedent's estimated future wages less the decedent's estimated living expenses, calculated over the decedent's life expectancy."[37] In stating the theory of damages under the Mississippi wrongful death statute within those guidelines, the *Smith* Court then mandated the subtraction of income taxes from the decedent's earnings.[38] It analogized to the Mississippi rule that subtracts living expenses from a damage award: "If we were to add the phrase 'income taxes' to the phrase 'living expenses' . . . it would also complement the Mississippi goal of

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33. *Id.* at 1252.

34. *Id.* (quoting MISS. CODE ANN. § 11-7-13 (Supp. 1994)).

35. *Id.* (quoting New Deemer Mfg. Co. v. Alexander, 85 So. 104, 107 (Miss. 1920)).

36. *Id.* The two other "elements of damage suffered," noted but not emphasized by the court, were: "(1) [g]ratuities that the [statutory beneficiaries] had a reasonable expectation of receiving[; and] (2) [l]oss to all the beneficiaries of the deceased's society and companionship." *Id.* (alteration in original) (footnote omitted).

37. *Id.* (citing Louisville & N. Ry. v. Garnett, 93 So. 241, 243 (Miss. 1922)). In a nutshell, this dictum identifies the four key economic elements in an award calculation:

(1) estimated wages (or earning capacity) paid periodically;

(2) an estimated deduction of the decedent's living expenses (to give the net figure required);

(3) some measure of life expectancy; and

(4) all future values are reduced to present value.

38. *Id.* at 1253. The statement of the "measure of recovery" in a Federal Employer's Liability Act case is also clear in Norfolk & Western Railway v. Liepelt, 444 U.S. 490, 493 (1980): " 'the damages . . . [that] flow from the deprivation of the pecuniary benefits which the beneficiaries might have reasonably received.' " *Id.* (alteration in original) (quoting Michigan Cent. R.R. v. Vreeland, 227 U.S. 59, 70 (1913)).

awarding the beneficiaries the amount, but only the amount, that the decedent reasonably would have, and could have, contributed to them."[39]

The court later reaffirmed this critical point:

> The portion of the decedent's earnings that would have gone toward income taxes could not have been contributed to the beneficiaries if the decedent had lived. Like the decedent's estimated future living expenses, the failure to subtract estimated future income taxes from the award would place the beneficiaries in a better position because of the decedent's death.[40]

The emphasis here clearly was on the award not exceeding the amount the decedent would have contributed to the beneficiaries. Perhaps this concern that "the decedent's beneficiaries . . . would be in a better position because of his death than they would have been had he lived"[41] caused the court to ignore the prospect that its ruling could cause the beneficiaries to receive less than the proper amount.

III. Analysis of the Tax Deduction Issue: Three Arguments for Nondeduction Rejected in *Smith*

The *Smith* Court discussed briefly three arguments against deducting income taxes from damage awards, and rejected all three. Those arguments are especially relevant to a fourth argument (the effect on the award sum of a tax on award earnings) that was only implicit in the discussion, but which has implications for the validity of the tax deduction rule.

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39. Smith v. Industrial Constructors, Inc., 783 F.2d 1249, 1253 (5th Cir. 1986). Perhaps in knowing the direction it wanted to go on living expenses and not the final destination, the *Smith* Court, maybe unwittingly, revealed the importance of the tax deduction. The court did not identify explicitly the possibility of a "second tax." It is in that direction, however, that the consequences of taxation in terms of beneficiaries being in the same, better, or a poorer position because of the tax are found. Indeed, the court presented a telling passage:

> Of course, evidence on the decedent's future taxes is only evidence – evidence subject to challenge just as other evidence is subject to challenge. If, for example, because of the nature of the income or otherwise, the decedent was entitled to tax exemptions, deductions, credits or the like, such evidence is clearly admissible to show that tax liability on lost earnings would not have reduced the decedent's contributions to the beneficiaries to the extent contended, if at all. . . . This estimate [of tax liability] could then be challenged with evidence that the decedent's personal situation required higher or lower rates.

Id. at 1254 (citation omitted).

While this passage does not provide explicit consideration of any tax consequences after the grant and the (presumed) investment of the award on the beneficiaries' position, it moves in the direction of at least making implicit those consequences.

40. *Id.* at 1253-54. The ruling of the Fifth Circuit on deductibility of income taxes from a decedent's earnings was reaffirmed in another case applying Mississippi law, Beville v. Burlington Northern Railroad, 960 F.2d 546 (5th Cir. 1992). In Jones v. Shaffer, 573 So. 2d 740 (Miss. 1990), the Mississippi Supreme Court ordered a new trial where the jury apparently did not weigh in its decision expert testimony involving the present value of a decedent's income (as reduced by a personal consumption factor of 26%). *Id.* at 742. The award figure so computed did not, however, "take into account any taxes that might be paid during the decedent's life, had he lived." *Id.*

41. *Smith*, 783 F.2d at 1252. The effect of the *Smith* rule is not inconsequential. First, once an income tax on the decedent's earnings is introduced, the position of the beneficiaries typically deteriorates. Second, in fairness, the consequences of taxation in award calculation should be followed all the way through award disposition to the "second tax."

A. *The "Congressional Intent" Argument*

First, the court addressed the argument that, since under the Internal Revenue Code the damage award is nontaxable to the recipient, Congress intended to exempt jury awards, and that exemption should not be circumvented by reducing such awards by the amount of income taxes the decedent would have paid on his earnings.[42] The court dismissed this argument because "[t]he commentators ha[d] generally rejected this argument from legislative history and analysis."[43] Perhaps a better rejection argument is to "take apart" a damage award by examining its theory, i.e., why it is constructed as it is, and thereby reveal the confusion that has arisen over award taxation in any form. The purpose of a wrongful death award is not to recreate the household preinjury environment. Obviously that is impossible. It is not even possible to recreate the total effects of the decedent's employment on the household. There are lost psychic and social benefits of the decedent's work experience on the household that cannot be restored, in addition to the purely financial benefits that can be approximated.

Instead, a wrongful death award is purely economic. It blends two economic trends or variables into a lump sum value. One trend is "positive," the earnings growth rate that normally would be experienced by a worker over the time of his earning capacity. The other trend is "negative," the discount rate used to reduce those future earnings to present value. The discount of future earnings is required because money, as in a lump sum award, has earning power. If there were no discount of that future income stream, the plaintiff would be overcompensated, since the lump sum award could be invested and earn at some positive rate of interest.[44]

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42. *Id.* at 1255. Robert J. Nordstrom points to the considerable confusion among commentators and courts between nontaxation of the award being received and taxation of a component in the award's construction (taxing the decedent's earnings). Nordstrom, *supra* note 7, at 219. Nordstrom then suggests that "nearly unanimous" rulings using gross rather than net earnings in calculating the award are the result of knowing awards are "tax free," and that such knowledge suggests (erroneously) that no tax consideration at all, i.e., applied at no stage of award disposition, should be given. *Id.* at 219-28. In short, Nordstrom suggests that the confusion arises over extending the tax-free passing of an award from the tortfeasor to the beneficiaries onto the (potential) tax on the decedent's earnings in calculation of the award sum. *Id.* That point is a valid and significant distinction of this whole taxation issue.

However, eliminating the confusion should not in itself prompt the conclusion that a tax amount equal to the decedent's earnings should be deducted when the award is calculated. One could argue also that if mental energy is to be devoted to elucidating that distinction, similar energy should be devoted to elucidating the full tax consequences of the "second tax."

43. *Smith*, 783 F.2d at 1255 (citing Nordstrom, *supra* note 7, at 219; D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 8.8 (1973)). While the court was not always clear as to whether it was the award per se that was to be taxed or whether the decedent's income was to be taxed (a case in point on the confusion Nordstrom observed, see *supra* note 42), the decision in Huddell v. Levin, 395 F. Supp. 64 (D.N.J. 1975), *vacated*, 573 F.2d 726 (3d Cir. 1976), provides generally good background to the tax issue in wrongful death award calculations. In countering the defendant's argument for deduction of the income tax from the decedent's earnings in calculating the award, the *Huddell* Court observed that if Congress taxed the award, which it could, then the "defendant[ ] would pay the entire loss" (i.e., the entire amount of the award), and the plaintiffs would get the entire loss, which in fact they already do if there is no tax. *Huddell*, 395 F. Supp. at 85. The plaintiffs then pay tax on the interest from investment of that award. The *Huddell* Court concluded: "Thus, the question is not whether plaintiffs are 'over-compensated,' but which party to the litigation should receive the benefit of the exemption of personal injury awards from taxation." *Id.*

44. Thomas O. Depperschmidt, *Meeting the Defense Challenge to the Earning Power of a Lump Sum Award*, 3 J. LEGAL ECON. 89, 91 (1993).

With appropriate trend values incorporated into the formula, the sum so calculated is assumed to be invested. The yearly interest on that investment provides an amount sufficient to pay the decedent's yearly, replicated "income" figure as well as increase the fund so that future investment earnings will always be sufficient to pay the yearly income. At the end of a designated time period corresponding to the earning capacity of the decedent, the fund is exhausted.[45]

A valid distinction on congressional intent can now be seen in the difference between the freedom from taxation of an award component in award construction and freedom from taxation of the award sum itself received by beneficiaries. Imposing a tax on the decedent's earnings in the award construction can be viewed as subtracting a living expense of the decedent that is not rightfully the beneficiaries' in any event. However, receipt of a properly-constructed lump sum award tax free can be viewed as the net value of the decedent's contribution to them and "rightfully theirs." That rationale supports the conclusion that a tax might be levied (in theory) on the decedent's earnings at the same time the tax is not imposed on the award itself. That rationale, moreover, exists apart from the problem introduced by another tax on the beneficiaries in the form of the tax on interest income from the award.

B. *The Argument: "The Tax Is None of the Defendant's Business"*

Second, the income tax is " 'a matter between the plaintiff and the government and is none of the defendant's business.' "[46] The *Smith* Court discarded this argument as "inappropriate" by rejecting the implicit income tax deduction comparison to the collateral source rule as it affects the defendant.[47] Hence, just as the collateral source rule "prevents a defendant from claiming the benefit of [a] decedent's relationship to a third party, . . . this rule prevents the defendant from reducing the award by virtue of the decedent's relationship to the government."[48]

Several points of clarification are pertinent here. The *Smith* Court declared a distinction between the collateral source rule and the income tax deduction at the outset. The court then approved the well-known benefits of employing the collateral source rule (for example, it encourages potential victims to buy insurance) without addressing directly the demerits of the income tax deduction.[49] Despite

45. *Id.* The court in McWeeney v. New York, New Haven & Hartford Railroad, 282 F.2d 34, 37 (2d Cir.) (quoting Stanley C. Morris & Robert J. Nordstrom, *Personal Injury Recoveries and the Federal Income Tax Law*, 46 A.B.A. J. 274, 328 (1960)), *cert. denied*, 364 U.S. 870 (1960), described the award amount as " 'that sum of money which if invested at a fair rate of return will yield annually the amount by which the plaintiff's earning capacity has been lessened and which will at time of end of the plaintiff's life expectancy be reduced to zero.' "

46. *Smith*, 783 F.2d at 1255 (citation omitted) (quoting DOBBS, *supra* note 43, § 8.8).

47. *Id.*

48. *Id.* Insurance benefits purchased by the plaintiff are probably the most common form of collateral source benefit and the one cited by the *Smith* Court. *Id.*

49. *Id.*

this "negative identification" as a collateral source,[50] the tax deduction does affect the size of the defendant's payment.

The argument that the "matter of taxes" is "none of the defendant's business" has in the past addressed the uncertainty of the payment amount by the plaintiff, not its dissimilarity to the collateral source rule. The amount of the decedent's tax deduction in this sense is the "business of the defendant," since the size of the defendant's payment obligation is material.[51]

In fact, the argument regarding the tax not being the business of the defendant is raised in what the *Smith* Court identified as the "third argument," not the second.[52] The *Smith* Court cited *Norfolk & Western Railway v. Liepelt*[53] for the United States Supreme Court's ruling in a Federal Employers' Liability Act case allowing inclusion of the effect of income taxes on a decedent's future earnings.[54] Specifically, the Court said:

> 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 family.[55]

The dissenting Justices in *Liepelt* argued persuasively for nondeduction of the income tax from the decedent's earnings precisely because they felt the tax was "none of the defendant's business."[56] Why did they think it was not the defendant's business? The dissent argued that no one can say with certainty in a specific case what the plaintiff's tax obligation is, given the "uncertainties, estimates, assumptions and complexities involved in computing and effectuating that subtraction."[57] Therein lies the essence of the argument that the tax is "none of the defendant's business." Because a tax obligation, of unknown magnitude, may or may not exist for the plaintiff in an "award construction" setting, the defendant should not routinely obtain relief from its payment obligation in the face of that uncertainty. Indeed, the *Liepelt* dissent insisted that the tax deduction certainly was not a circumstance from which the tortfeasor should benefit.[58]

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50. "The same economic and equitable justifications are clearly not applicable to income taxes." *Id.*

51. Clearly, the benefit gained by the defendant in having the award reduced by the amount of the decedent's income tax is not a gain or loss to the government. The defendant gains in having a smaller payment obligation. There is no actual revenue gain to the government in the deduction of income tax from the decedent's earnings, however, since the decedent obviously will not be working and earning income subject to tax in the future. With the "second tax," there is a "welfare loss" to the beneficiaries, while the government gains the amount of tax paid on interest earned from the invested award.

52. Smith v. Industrial Constructors, Inc., 783 F.2d 1249, 1255 (5th Cir. 1986).

53. 444 U.S. 490 (1980).

54. *Id.* at 493.

55. *Id.*

56. *Id.* at 499 (Blackmun, J., dissenting).

57. *Id.*

58. *Id.*

C. *The Argument that Tax Calculation Is Too Speculative*

Third, the *Smith* Court noted the argument that the calculation of a person's income taxes is "too speculative" an adjustment and "judicially time-consuming."[59] In approving language in *Liepelt* and in following that decision on this point (the jury could consider evidence on income taxes as relevant), the *Smith* Court rejected the "too speculative" argument largely on the counter-contention that juries can handle the "exact sort of evidence" presented on tax issues.[60]

D. A Fourth Argument: Liepelt *and* McWeeney *on the "Second Tax"*

The majority position in *Liepelt* approved by the *Smith* Court was significant, however, not only for its conclusion approving the deduction of income taxes, but for what it did not say about the *McWeeney v. New York, New Haven & Hartford Railroad*[61] decision it cited. The *Liepelt* decision does hint at the effect on award size caused by taxation of award interest. Justice Stevens noted that the respondent "point[ed] out that in discounting the estimate of future earnings to its present value, the tax on the income to be earned by the damages award . . . [was] omitted."[62] To this observation which affected most significantly the economic position of the beneficiary, the Court's response was obscure:

> Logically, it would certainly seem correct that this amount, like future wages, should be estimated on an after-tax basis. But the fact that such an after-tax estimate, if offered in proper form, would also be admissible does not persuade us that it is wrong to use after-tax figures instead of gross earnings in projecting what the decedent's financial contributions to his survivors would have been . . . .[63]

The antecedent to "this amount" in the first sentence seemingly is "the tax on the income to be earned by the damages award."[64] However, the only sense to be made of "this amount" is that Justice Stevens was referring to the net (i.e., "after tax")

59. Smith v. Industrial Constructors, Inc., 783 F.2d 1249, 1255 (5th Cir. 1986).

60. *Id.* Nordstrom suggests the reason courts have left the tax issue alone is that the calculation process is lengthy, complicated, and speculative, and courts are content with "close enough." Nordstrom, *supra* note 7, at 228.

Fear of speculation forthcoming from a jury on the tax issue has caused one court to hedge the issue. It reasoned that although the jury should be instructed that a personal injury damages award is not taxable, it should not also be instructed that any income realized from the award is taxable, the reason being that the latter instruction would cause the jury to enter into a field of speculation and would tend to confuse and distract the jury. Dempsey v. Thompson, 251 S.W.2d 42, 46 (Mo. 1952).

In a commendably frank attempt at fairness in this matter, the court in Meehan v. Central Railroad, 181 F. Supp. 594, 624 (S.D.N.Y. 1960), said: "It is, of course, impossible to determine with exactness the future tax rate, but just as it was necessary to face the reasonably probable realities in determining the future income tax to be paid . . . , so must such realities be considered here."

This comment "answers" the *Dempsey* Court, which said: "In the case of income tax liability on future income realized from investment of the award there is the additional imponderable of what income, if any, a particular plaintiff would probably earn from investment thereof." *Dempsey*, 251 S.W.2d at 46.

61. 282 F.2d 34 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960).

62. Norfolk & W. Ry. v. Liepelt, 444 U.S. 490, 495 (1980).

63. *Id.*

64. *Id.*

contribution that would have been made by the decedent to the household, not to the tax itself. In stating the issue that way, the Court does not follow through with the implications on the economic position of the household survivors of both the decedent's income and the award interest earned being measured "after-tax." Had it done so, it arguably would have reached a much different conclusion on whether the decedent's income should be taxed.

Indeed, the second quoted sentence suggests that Justice Stevens missed entirely the point of the respondent's observation. For the question raised by the respondent was not about the rightness or wrongness of using after-tax figures per se, or on the admissibility of using "after-tax estimate[s]."[65] Obviously, the Court could have deemed whatever evidence as admissible that it wanted to, i.e., it could have treated the key components in award calculation on a pretax or an after-tax basis or, as in *Liepelt*, treated one component (the decedent's income) after-tax and one component (award interest) pretax, and so ignore the implications of the "after-tax" treatment of award interest. The respondent instead was encouraging consistency in treatment of taxes by the Court, i.e., asking the Court to consider the economic position of survivors when the full consequences of double taxation are analyzed.

Indeed, the respondent presumably would not have disagreed at all with the use of after-tax earnings in the calculation process, so long as the after-tax effect of both taxes—the tax on award interest and the tax on the decedent's income—were recognized and factored into the calculation. The respondent's argument regarding "opening the door" to tax consideration[66] sought consistent application of the tax rules. "Other equally relevant evidence" included the full implications (double taxation) of a rule requiring taxation in wrongful death award calculations, especially including the economic position of the surviving householders.[67]

Despite ignoring these implications, the Court cited the Second Circuit's 1960 decision in *McWeeney* as support for the respondent's criticism of the taxation of

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65. *Id.*
66. *Id.*
67. *Id.*

the award's earnings.[68] The *McWeeney* Court's observations on taxation of interest earnings on a damage award went right to the heart of the issue. After describing what an award does,[69] the court noted:

> This [award sum] takes into account the fact that money earns interest each year; and it should be remembered that this interest is taxable. Therefore, if a court is going to use income after taxes as a measure of [a] plaintiff's loss, it must add back the taxes which would be due on the interest earned—else the award would not fully compensate for the loss.[70]

The *McWeeney* Court's insight is crucial to providing equitable tax treatment in damage award calculations. Had it looked further into and behind *Liepelt*, the *Smith* Court would have found that "fourth argument," one that it probably could not have dismissed so easily. When beneficiaries are taxed on award interest earned and on the decedent's income, that amounts to double taxation. The tortfeasor benefits primarily in having the award reduced by the amount of the tax on the decedent's income, and that reduction is at the expense of the plaintiff's award. The plaintiff pays taxes twice, however, and no household should be taxed twice on the same income. If a court ignores the tax on award earnings, it closes its eyes to that double taxation.

IV. The Effects of the Two Taxes on Beneficiaries

Are the effects of the two taxes on award calculation substantial? Does ignoring a "second tax" change the position of beneficiaries significantly? The answers to these questions are best demonstrated with numerical examples.

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68. In reviewing the confusion surrounding taxation of wrongful death awards, the court in Meehan v. Central Railroad, 181 F. Supp. 594, 623-24 (S.D.N.Y. 1960), observed:

> However, this non-taxability applies to the award itself, not necessarily to any income earned as a result of the investment of the award. . . . [T]here is no indication that the interest on the award which represents the discounted amount will not be subject to taxation. Neither party disputes the contention that the percentage of the total amount received over the period of 33 years which represents interest on the award will be taxable.

In Leming v. Oilfields Trucking Co., 282 P.2d 23, 32 (Cal. 1955), the Supreme Court of California noted the existence of the "second tax" in rejecting the defendant's argument that an award was excessive:

> They further do not take into consideration the facts that the computation of his wages, both past and future, is based on only the sum he was receiving after taxes and "all various items" were deducted, and that he would be obliged to pay taxes from any return upon invested moneys.

In Southern Pacific Co. v. Guthrie, 180 F.2d 295, 302 n.7 (9th Cir. 1949), *cert. denied*, 341 U.S. 904 (1951), the trial court identified the existence of the "second tax" but downplayed its significance: "[I]t must be assumed that the income from investments acquired with that sum would be taxable. If estimated tax is properly deducted at one end, it should be added at the other."

Although the reference to the "second tax" in award disposition is relatively rare among courts, see also Huddell v. Levin, 395 F. Supp. 64 (D.N.J. 1975), *vacated*, 537 F.2d 726 (3d Cir. 1976); Margevich v. Chicago & N.W. Ry., 116 N.E.2d 914 (Ill. App. Ct.), *cert. denied*, 348 U.S. 861 (1953); Dempsey v. Thompson, 251 S.W.2d 42 (Mo. 1952).

69. McWeeney v. New York, N.H. & H.R.R., 282 F.2d 34, 37 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960).

70. *McWeeney*, 282 F.2d at 37 (quoting Morris & Nordstrom, *supra* note 45, at 328).

A. The Impact of Income Taxes on the Postinjury Household

There are two ways the surviving householder's position deteriorates because of the court-imposed tax liability. First, the household is penalized in having the interest income on its award taxed. The household is penalized further if the court uses a tax on the decedent's income to reduce the base income amount for award calculation purposes.

1. Taxation of Award Interest

As noted earlier, the household receives the award amount tax free. However, the theory of the award is that it is invested and yields interest sufficient to replicate the decedent's earnings stream. The award balance that remains after each yearly payout earns interest at some designated rate, and the whole fund is exhausted at the end of some designated time corresponding to the lifetime earning capacity of the decedent.

The problem is those interest earnings on the award. They are taxable as ordinary interest income. The household's earnings are decreased each year by the tax paid on those earnings, so the relevant income position of the household is diminished. This tax on award interest is a reasonable certainty. It exists once an award is given and invested, i.e., it happens without the court doing anything in respect to taxation of the decedent's income.

Suppose that the decedent was a male, thirty-five years old. He had earned $40,000 a year[71] as the only household income. The wife and two children in the surviving household receive an award, tax free, that yields $36,000 interest per year, assuming a personal maintenance deduction for the decedent of ten percent of gross income.[72] As shown in Table 1, when the tax (using 1993 rates) is applied to this household's interest income (i.e., earnings on the award) in a three-person household with a standard deduction, the net, after-tax income of the household is reduced to $19,975.

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71. This income figure closely approximates the 1992 median income for a "householder" in the 35-44 age range of $40,090. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, SERIES NO. P60-184, MONEY INCOME OF HOUSEHOLDS, FAMILIES, AND PERSONS IN THE UNITED STATES: 1992 tbl. 1 (1993).

The assumption of a 10% of gross (pre-living expense) income of $40,000 for a personal maintenance value for the decedent accords with a value of 12.31% on "net" income of $36,000. The value of 12.31% of pretax income for a decedent in a four-person household is a good estimate, based on Department of Labor data. *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER EXPENDITURES IN 1990 tbl. 4 (Nov. 22, 1991).

72. While objective accuracy in determining the personal maintenance deduction is always desirable, it should be noted that within normal ranges of personal maintenance values used in wrongful death litigation, the actual figure is immaterial to the conclusion in these sample calculations. However, an extremely high personal maintenance deduction effectively would eliminate most postinjury net income and perhaps all income tax liability (if tax is considered by the court). Indeed, where a high personal maintenance value is used, there typically is not much argument about taxation of any aspect of the award construction or disposition, since the net award typically is minimal anyway. An example of a very high personal maintenance deduction is in Butler v. United States, 726 F.2d 1057 (5th Cir. 1984), where the Fifth Circuit, applying Mississippi law and citing Sheffield v. Sheffield, 405 So. 2d 1314 (Miss. 1981), allowed a personal maintenance factor of 94% of income where there were no surviving children or spouse. *Butler*, 726 F.2d at 1067.

Table 1

$40,000	
-4,000	10% personal maintenance of decedent
$36,000	net income
7,050	three exemptions (wife & two children)
5,450	standard deduction, head of household
$23,500	taxable income
3,525	tax
$19,975	net, after-tax income

An important question arises concerning the household's relative economic position posttort compared to pretort. Since the household's relative economic position does deteriorate due to the tax, should the tortfeasor reimburse the household, or should the household sustain that tax liability? There is intuitive appeal to the argument that a household should pay tax on income. A tax obligation exists on all who earn income. Households earning their income from award interest should not be exempt from taxation under that reasoning.

2. The Tax on the Decedent's Income

Recall that once the tax of $3525 is imposed, damage theory suggests that this net, after-tax income of $19,975 in Table 1 is the correct base amount for award calculation purposes. After subtracting the decedent's personal living expenses and the tax applied to the household's interest income postinjury, and increasing the amount by an earnings growth rate over the years, $19,975 will maintain the surviving family beneficiaries in the same relative economic position as before the tort.

Consider now the defendant's argument for a second tax on the decedent's income. By proposing that an additional tax be applied to the decedent's income, the tortfeasor suggests that the position of the household should deteriorate even further (below $19,975). A serious tax equity problem is found in the second tax, since the household in its pretort condition was not required to pay two income taxes.

Looking at the calculation from the tortfeasor's angle, the tortfeasor effectively "saves" in award size the amount of the annual income tax subtracted from the award interest (as household income). If the second tax (on the decedent's income) is imposed, the defendant saves again in having the net, base earnings rate reduced for award calculation purposes. However, to keep the household in the same relative economic position as before the tort, income must be raised back to $19,975, i.e., a payment by the tortfeasor of the amount of the second tax is needed. The adding and subtracting of the second tax becomes a meaningless exercise, of course, and not worthy of the court's time.

The tortfeasor is responsible for the unfortunate situation created. Because of the tortfeasor's action, there is a need for economic compensation in the form of an award, the need for earnings on the invested award (as income) to support the household, and the need for the household to pay taxes on the award interest. The tortfeasor may argue that the tax obligations of the surviving household are not his concern. But that argument undermines the defense argument for the tax on the decedent's earnings in the first place.

B. Complications in the Tax Model

Handling the tax and personal maintenance calculations is awkward in theory and very difficult in practice. In developing Table 1 to illustrate tax derivation, several simplifying procedures were used to avoid complications in applying income taxes to wrongful death awards. Indeed, those complications lie at the root of the concern of several courts that introducing taxation of the decedent's income into award calculation invites speculation and uncertainty.[73]

First, there is a complication that must be addressed by any court that mandates the subtraction of income taxes as living expenses. It is a fundamental, "catch 22" kind of problem. Which of the two deductions should be made first from gross income?

If the income tax is deducted first from gross income,[74] the surviving household is overtaxed by the amount of the tax on that portion of the award representing the decedent's personal maintenance expenditures, since the household should not pay tax on the amount of income to which it would not have had access in any event. If the personal maintenance expenditures are deducted first from gross income, the practical rule is violated that personal maintenance should be calculated as a percentage of after-tax income. That is, the decedent realistically could not have consumed any portion of his income used for income taxes.

The procedure adopted in Table 1 to illustrate the tax inequity also illustrates the difficulty of developing a model. The decedent's personal maintenance is calculated "after tax." However, to derive that after-tax value, it is necessary to "pre-calculate" the tax on some gross income value, e.g., $40,000. A tax of $4125 results if that gross income figure is used (instead of $36,000). That figure overtaxes the surviving household by $600 ($4125 less the tax of $3525 found in Table 1) since the $40,000 gross income includes the decedent's living expenses, which are not income to the household. Effectively, the postinjury household is taxed as if the decedent were still in the household.

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73. *See* Johnson v. Penrod Drilling Co., 510 F.2d 234, 236-37 (5th Cir.), *cert. denied*, 423 U.S. 839 (1975), *overruled by* Culver v. Slater Boat Co., 688 F.2d 280 (5th Cir. 1982); McWeeney v. New York, N.H. & H.R.R., 282 F.2d 34, 36 (2d Cir.), *cert. denied*, 364 U.S. 870 (1960); Huddell v. Levin, 395 F. Supp. 64, 89 (D.N.J. 1975), *vacated*, 537 F.2d 726 (3d Cir. 1976); Hall v. Chicago & N.W. Ry., 125 N.E.2d 77, 86 (Ill. 1955); Dempsey v. Thompson, 251 S.W.2d 42, 45 (Mo. 1952).

74. In the search of reported cases where calculation was made of the deduction for the decedent's income tax, nothing but gross income was used as the base. *See* Norfolk & W. Ry. v. Liepelt, 444 U.S. 490, 493 (1980); Marcel v. Placid Oil Co., 11 F.3d 563, 571 (5th Cir. 1994); Southern Pac. Co. v. Guthrie, 180 F.2d 295, 303 (9th Cir. 1949), *cert. denied*, 341 U.S. 904 (1951); Muckleroy v. OPI Int'l, Inc., 834 F. Supp. 937, 948 (S.D. Tex. 1993), *aff'd in part*, 42 F.3d 641 (5th Cir. 1994); Huddell v. Levin, 395 F. Supp. 64, 85 (D.N.J. 1975), *vacated*, 537 F.2d 726 (3d Cir. 1976); Meehan v. Central R.R., 181 F. Supp. 594, 619 (S.D.N.Y. 1960).

Recall that this intractable problem which overtaxes the survivors thereby reduces the income figure used as the base in award calculation. Hence, problems in the calculation process undercompensate the survivors at the outset.

The decedent's living expenses are a second complication. They are in fact an unseparated part of the preinjury household's total expenses paid out of gross income. (Effectively, the other members of the household already realize a lesser per capita income preinjury by the amount of the decedent's personal consumption.) They are separated in Table 1 to meet the requirement of Mississippi law that living expenses be identified and deducted and to distinguish the preinjury and the postinjury household conditions.

C. A Simple, Correct Approach to the Tax Issue

Table 1 is designed to show that, since the beneficiaries must pay tax on the award interest[75] (though not on the award itself) and thereby reduce their economic position, taxing the decedent's income further diminishes their position. The award reduced by that deduction is not adequate to accomplish what it is supposed to do: keep the beneficiaries in the same relative economic position as before the injury. To keep the household in that same position (i.e., considering only the deduction of the decedent's personal living expenses), the household should be treated for award calculation purposes as if no tax at all were levied on the decedent's income.

This solution also overcomes the complicated and speculative aspects of award calculation arising from the introduction of taxes. As noted earlier, those concerns have been raised by many courts,[76] although their significance was downplayed by the *Smith* Court.

The caution of the 1922 Mississippi Supreme Court in *Louisville & Nashville Railway v. Garnett*,[77] about "making the decedent worth more dead than alive" if living expenses of the decedent are not considered, is well taken. The flaw in the legal argument that developed from that caution is that income taxes on the decedent are like any other living expense when considering the theory of award calculation. However, taxes are unlike those living expenses precisely because the court is tempted to impose them explicitly in the form of a tax on the decedent's income on top of the tax already required on award interest received as income by the household.

For fairness all around and for economy of effort without forsaking accuracy of calculation, the tax on the decedent's earnings should not be levied. The obvious

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75. The assumption that the amount of award interest earnings each year is just equal to the replicated income payment is, for tax purposes, no longer unrealistic. It assumes that the award interest earnings can be sheltered from tax and that only the annual replicated income payout is taxed when it is received as income.

The problem with the assumption is not the payout amount itself, but the composition of that payout. Some of the award principal must be paid out each year in order to reduce the principal over time and allow it to be "zeroed out" at the end of the decedent's lifetime earning capacity.

76. *See supra* note 73.

77. 93 So. 241 (Miss. 1922).

solution to the tax issue surrounding the decedent's income in damage award calculation is to ignore that tax entirely.

V. Conclusion

The purpose of compensation in Mississippi wrongful death litigation is to maintain the same relative economic position of beneficiaries—no more, no less—than what it was while the decedent lived. That position is found by determining the decedent's net contribution to the surviving householders. The net contribution is the decedent's income, less personal living expenses to which the household would not have had access.

There is a first-impression, appealing argument that since the decedent was taxed on his income while living, the calculation of a wrongful death award designed to replicate his income for survivors should include a similar tax as a living expense of the decedent. The identification of an income tax as "just another living expense" supports that impression.

If the intent of the "tax as living expense" rule is to ensure the proper contribution amount the decedent would have made to beneficiaries had he lived, it does not achieve that purpose. Indeed, despite its seeming attention to fairness, the ruling works seriously to the detriment of the plaintiff. No household is obliged to pay tax on income twice, but that is exactly what the tax on the decedent's income requires.

Just as the *Smith* Court and courts in other jurisdictions now hold that it is proper to allow only the present value of the decedent's estimated future earning capacity to plaintiffs—not the actual, undiscounted amount—so also they should adapt to the need for equity in tax treatment. In the present value discussion, the change occurred because it was recognized that, due to the earning power of money, there would be overcompensation of the plaintiff in theory if future payments were not discounted to present value. On the tax issue, the theory of award calculation clearly demonstrates that, as taxation is introduced into the calculation, the surviving household must pay taxes on interest earnings, reducing its economic position. Imposing an additional tax on the decedent's income mandates a further, unwarranted decrease in the surviving household's economic position. Moreover, the tortfeasor, if required to pay the income increase to permit household payment of the second tax without suffering a decline in its economic position, would actually be as well off without the tax being applied. If the tortfeasor insists on a tax on the decedent's earnings, the court in fairness should increase the defendant's payments to compensate the beneficiaries for that second tax paid.

The Mississippi tax deduction rule, crystallized in *Smith* and requiring deduction of federal income tax from a wrongful death damage award, is deficient to the extent that it does not examine the consequences of income taxation fully. Instead, a policy of ignoring the tax entirely in award calculation is the simpler, more equitable, and more correct approach to handling the income tax deduction question. That conclusion is warranted after examining the consequences of the double income tax on both the surviving householders and the tortfeasor.