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TAXATION AMOUNT RECEIVED FOR FUTURE DAMAGES

A recent case¹ dealt with whether an amount received by a taxpayer from a motion picture company as a release of all claims against the company was income on which the individual must pay tax. Plaintiff was the manager of a baseball club about which a motion picture was made by a Hollywood producer. The manager was presented in an unfavorable light, which showed him fighting with and cursing the fans and players. The plaintiff, although his name was not mentioned in the movie, felt uneasy about its effect on his reputation. The company, for \$2,500, obtained a release of any and all claims he might have against the company. Plaintiff petitioned for a refund of the tax paid on this amount, claiming it to be liquidated damages for injury to his reputation and invasion of his privacy, and therefore exempt under income tax law. The Government contended the amount was received for services rendered and was income to the Plaintiff.

In denying plaintiff's petition for a refund, the District Court for the Eastern District of Tennessee held that the money was received as a payment for possible future damages, not damages actually sustained, and was fully taxable.

The decision in the *Meyer* case above is merely an extension of existing tax philosophy and is consistent with the few tax rulings and decisions on this particular subject. It is difficult to see why the Government attempted to show the payment in the *Meyer* case was for services rendered (a very weak case, as the Government conceded), as the Revenue Service could clearly have won its case on the basis of past decisions by contending, as the District Court itself found, that the payment was "an attempt to pay liquidated damages for possible future injuries to (Meyer's) reputation, resulting from invasions of his privacy."

In general, damages are excluded from income on which the individual must pay tax, where it is compensation for some

¹ *Meyer v. United States*, 173 F. Supp. 920 (1959).

actual injury to the taxpayer and where the compensation is designed to make the taxpayer whole.² There can be no income tax because there is no income, no profit, to the taxpayer. He is in precisely the same position before his injury as he is after the receipt of such damages.³ It is settled that no tax will be due on money received as damages for libel and slander;⁴ breach of promise to marry;⁵ defamation of character or alienation of affection;⁶ loss of life;⁷ or annulment of marriage on the ground of fraud and deceit.⁸ Formerly, it was held⁹ that damages received for the surrender of the custody of a minor child by a parent for consideration was exempt from income, but this doctrine now appears to have been overruled¹⁰ through recognition that such a payment is given for the relinquishment of a right presently possessed, for a future period, and is not a damage payment. No wrong has been committed which the damages attempt to make whole; the payment is for giving up a legal right. Compensation for the loss of personal rights, as where the taxpayer receives a payment from the United States Government under the War Claims Act of 1948 for violation, while the taxpayer was a prisoner of war, of personal rights guaranteed under the Geneva Convention, also is non-taxable.¹¹ This should be distinguished from a contractual surrender of a legal right, as the surrender of the custody of a child, or a contract to refrain from competition, the payment for which does represent income.¹² Again, the payment made here for the surrender of the right is not an attempt to make the taxpayer whole, but represents com-

² C. A. Hawkins, 6 B.T.A. 1023 (1927).

³ Central R. Co. of N. J. v. Comm'r., 79 F. 2d 697, 698 (1935).

⁴ C. A. Hawkins, *supra* note 2.

⁵ Mrs. Lyde McDonald, 9 B.T.A. 1340 (1928).

⁶ *Sol. Op.* 132, C.B. June 1922, p. 92.

⁷ IT 2420, C.B. Dec. 1928, p. 123.

⁸ IT 1852, C.B. Dec. 1923, p. 66.

⁹ *Sol. Op.* 132, *supra* note 6.

¹⁰ Ehrlich v. Higgins, 52 F. Supp. 805 (1943).

¹¹ Rev. Rul. 55-132, C.B. 1955-1, p. 213.

¹² Central R. Co. of N.J., *supra* note 3; Ehrlich v. Higgins, *supra* note 10.

pensation paid to induce the taxpayer to give up something and, especially where no property right is transferred,¹³ constitutes income.

The Supreme Court attempts to determine the nature of the item for which the damages are a substitute, in order to pass on their taxable status.¹⁴ If the amount received as damages is purely compensatory, for actual damage sustained, it is non-taxable. If, however, no damage was sustained, or the payment is in excess of such damage, or is in exchange for the taxpayer giving up some legal right, then the taxpayer is not merely made whole but is in a better pecuniary position, and such payment is taxable to the extent of such excess. In general, double, treble and punitive damages are held to constitute income to the recipient, as they represent payment for which the taxpayer has suffered nothing, and ordinary damages have presumably already compensated the taxpayer for his injury.¹⁵

Thus, the decision in the *Meyer* case¹⁶ is consistent with *Ehrlich v. Higgins*¹⁷ and prior decisions relating to the taxability of amounts received as damages, and merely extends existing rulings to their logical application in the case of payments received as damages for future injuries. It is highly improbable that the courts will ever open the door for the receipt of tax-free income under the guise of damage payments for future injuries which may not occur. The taxpayer must be able to show that he has in fact suffered some actual injury which the damage payment attempts to make whole in order to exclude such a payment from gross income.

J. J. H.

¹³ *Beals' Estate v. Comm'r.*, 82 F. 2d 268 (1936); *Cox v. Helvering*, 71 F. 2d 987 (1934).

¹⁴ *Hort v. Comm'r.*, 313 U.S. 28, 61 S.Ct. 757, (1941).

¹⁵ *Comm'r. v. Glenshaw Glass Co. and William Goldman Theatres, Inc.*, 348 U.S. 426, 75 S.Ct. 473 (1955).

¹⁶ *Meyer v. United States*, *supra* note 1.

¹⁷ *Ehrlich v. Higgins*, *supra* note 10.