

**PETITION
for
A WRIT of
CERTIORARI**

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Nos. — 199

In the Supreme Court of the United States

OCTOBER TERM, 1954

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GLENSHAW GLASS COMPANY

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM GOLDMAN THEATRES, INC.

PETITION FOR A WRIT OF HABEAS CORPUS TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

HERMAN M. COHEN, JR.

Solicitor General

Department of Justice, Washington 25, D. C.

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The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgments of the Court of Appeals for the Third Circuit in the above-entitled cases, which involve the same basic question and, although entirely separate proceedings, were argued together before the court below.¹

¹ See Rule 23 (5). The *Glenshaw Glass Co.* case was briefed and set for oral argument in the court below before

OPINIONS BELOW

The opinion of the Court of Appeals (App. 33a-44a) is reported at 211 F.2d 928. The findings of fact and opinion of the Tax Court in the *Glenshaw Glass Co.* case (App. 1a-23a) are reported at 18 T. C. 860. The findings of fact and opinion of the Tax Court in the *William Goldman Theatres* case (App. 23a-32a) are reported at 19 T. C. 637.

JURISDICTION

These cases involve deficiencies in income tax and originated in the Tax Court by the filing of petitions for review pursuant to Section 272 (a) (1) of the Internal Revenue Code (26 U. S. C. 272). The judgments of the Court of Appeals were entered on April 9, 1954 (App. 45a-46a). The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

the *William Goldman Theatres* case was briefed. When counsel in the *William Goldman Theatres* case filed a petition for leave to file an *amicus curiae* brief in the *Glenshaw Glass Co.* case, the court below denied the petition but ordered that the two cases be listed for argument on the same day before the court *en banc*. For the purposes of this petition we shall cite the portion of *Glenshaw Glass Co.* record printed as an appendix in the court below and filed with this court as "G1." and the *William Goldman Theatres* appendix as "Go." The opinions of the Tax Court in each case, the order of the court below referred to above, the opinion of the court below covering both cases, and the judgment entered by the court below in each case are printed as an appendix to this petition, *infra*, pages 1a-46a, which we shall cite as "App."

QUESTION PRESENTED

Each taxpayer received compensatory and punitive damages as the result of litigation in which it claimed injury to its business on the basis of lost profits. The question in each case is whether the amount received as punitive damages constitutes taxable income.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.22 (a)-1. *What Included in Gross Income*.—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in prop-

entire interest, rent, dividends, and gain, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

STATEMENT

In a single opinion the court below affirmed the holding of the Tax Court in each of these two cases that punitive damages do not constitute taxable income. The facts relating to the receipt of the punitive damages by each taxpayer are reflected in findings of fact of the Tax Court (App. 2a-14a, 24a-26a) which are largely based upon stipulations of fact and may be summarized as follows:²

GLENSHAW GLASS CO.

The taxpayer (hereinafter usually referred to as "Glenshaw"), a Pennsylvania corporation having its principal place of business in Glenshaw, Pennsylvania, has been continuously engaged in the manufacture of glass bottles and glass containers. Many years ago it entered into certain

²In the *Glenshaw Glass Co.* case the Tax Court's findings of fact are based upon a stipulation of facts (Gl. 3a-12a) and oral testimony and exhibits, but the oral testimony had a bearing primarily on an allocation question as to which the Commissioner did not appeal. In the *William Goldman Theatres* case the facts are all stipulated. (Go. 3a-7a.)

royalty and license agreements with the Hartford Empire Company (App. 2a). As a result of fraudulent suits brought by Hartford with respect to these agreements, Glenshaw asserted claims against Hartford in two proceedings seeking damages for injuries to its business, treble damages under the antitrust laws, and punitive damages (App. 6a, 7a). Before one of these proceedings had reached trial and while the other was on appeal, a settlement was reached, both suits were terminated, and Hartford paid Glenshaw a total of \$813,358.24 (App. 12a). The taxpayer allocated \$324,529.94 of this settlement to punitive damages and did not include it and other portions of the settlement as income in its tax return for the year during which it was received. The Commissioner determined a deficiency in the amount of \$126,361.66 (App. 1a) on the ground that the entire amount of the settlement sum constituted taxable income, against which legal fees of \$225,000 are deductible.³

The Tax Court held that the total amount of the settlement sum received as compensatory damages was taxable income as having been received on the basis of claims for lost profits, rather than for lost capital (App. 19a), but that the amount received as punitive damages by virtue of those claims for lost profits did not constitute taxable

³The grounds for the Commissioner's deficiency determination are reflected in the deficiency notice, which was attached to Exhibit A to Glenshaw's petition in the Tax Court but has not been included in the printed record.

income (App. 16a). The Tax Court also accepted Glenshaw's allocation of the settlement sum (App. 20a), with the result that \$324,529.94 of that sum was held to be excludible from Glenshaw's taxable income as constituting punitive damages.* On appeal by the Commissioner, the Court of Appeals affirmed the Tax Court's holding that punitive damages do not constitute taxable income.

WILLIAM GOLDMAN THEATRES

The taxpayer (hereinafter usually referred to as "Goldman") is a Delaware corporation having its principal place of business in Philadelphia, Pennsylvania. During 1948 its business consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations (App. 24a).

* With respect to the deductibility of \$225,000 in legal fees incurred in the litigation and settlement of the claims against Hartford, the parties agreed in the Tax Court that the fees should be allocated between the various claimed items of damages in the same proportion as the settlement proceeds are allocated, that the amount of fees allocated to the claims that gave rise to taxable income is deductible as an ordinary and necessary business expense, and that the amount of fees allocated to the claims that did not give rise to taxable income is not deductible. (App. 22a.)

On appeal we did not question the correctness of the Tax Court's allocation of the settlement sum as between compensatory and punitive damages except to the extent that the allocation is unnecessary under our contention that the punitive damages constituted taxable income.

On December 8, 1942, Goldman instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania (Civil Action No. 2877) against certain motion picture distributors, alleging violation of the federal anti-trust laws and seeking treble damages of \$1,350,000 based on an allegation that, as a result of the discrimination which the defendants accomplished through the alleged monopoly, Goldman suffered damage in the amount of \$450,000 by being unable to operate its Erlanger Theatre. The District Court entered judgment for the defendants (*William Goldman Theatres v. Loew's, Inc.*, 54 F. Supp. 1011) but on appeal the Court of Appeals held that a conspiracy existed as charged and reversed the judgment (150 F. 2d 738 (C. A. 3d)). Thereafter the District Court heard evidence directed solely to the question of damages. On September 10, 1946, it made its findings with respect to damages, finding that Goldman had suffered damages by way of a loss of profits at its Erlanger Theatre in the amount of \$125,000 and was entitled to treble damages in the amount of \$375,000 (69 F. Supp. 103). On December 18, 1946, the District Court entered judgment based on its findings. On appeal, the judgment was affirmed on January 6, 1948, in a *per curiam* opinion (164 F. 2d 1021 (C. A. 3d)), and certiorari was denied, 334 U. S. 811 (App. 26a).

On May 28, 1948, the defendants paid Goldman the \$375,000 judgment award. Goldman included only \$125,000 in its gross income for 1948 (App. 26a) and the Commissioner accordingly determined a deficiency against Goldman for 1948 based upon the inclusion of the other two-thirds in Goldman's gross income (App. 23a, 27a). The Tax Court held that the other two-thirds (\$250,000) constituted punitive damages which are not taxable income (App. 31a) and the Court of Appeals affirmed (App. 46a).

REASONS FOR GRANTING THE WRIT

These cases present an important question, which should be decided by this Court, namely, whether punitive damages, either for fraud or for violation of the antitrust laws, constitute taxable income to the recipient within the meaning of Section 22 (a) of the Internal Revenue Code. Obviously, the question is a recurring one and, since the courts of appeals, the Court of Claims, and the Tax Court have adopted different interpretations of the decisions of this Court, the question is one that only this Court can finally settle.

Under the Sixteenth Amendment Congress has power to tax, without apportionment, income "from whatever source derived * * *." The statutory definition of gross income in Section 22 (a) of the Internal Revenue Code includes "gains or profits and income derived from any source whatever."

The same language is repeated in Section 29.22 (a)-1 of Treasury Regulation 111. However, the court below read the broad language of these provisions as modified by *Eisner v. Macomber*, 252 U. S. 189, 207, where this Court used as a definition of income "gain derived from capital, from labor, or from both combined." This definition has recently been referred to and repeated by this Court in *Commissioner v. Culbertson*, 337 U. S. 733, 740.

There is a disagreement in the lower courts on whether the definition in *Eisner v. Macomber* limits the meaning of "gross income" in the statute for all purposes, or was merely intended in the context in which it was used to determine whether there was a realization of gain. The court below found support for its position in its earlier decision in *Central R. Co. v. Commissioner*, 79 F. 2d 697. Although that case did not involve the narrow question of punitive damages, but instead the "windfall" accruing to a corporation when it took over, as part of a settlement, assets which had been acquired by an unfaithful officer, it was made applicable to punitive damages for business injury by the Board of Tax Appeals in *Highland Farms Corp. v. Commissioner*, 42 B. T. A. 1314, 1322.

⁶ In its *Glenshaw Glass Co.* decision, the Tax Court stated that "it has long been established" that punitive damages do not meet the test of taxable income set forth in *Eisner v. Macomber*, citing its *Highland Farms Corp.* decision and the

A contrary interpretation of *Eisner v. Macomber* appears in *Park & Tilford Distillers Corp. v. United States*, 107 F. Supp. 941 (C. Cls.), certiorari denied, 345 U. S. 917. In that case an officer-director of the taxpayer-corporation owning more than 10 percent of the stock of the corporation had purchased and sold stock of the corporation on the open market within a six-month period and realized what are called "insider profits." Under Section 16 (b) of the Securities Exchange Act of 1934, c. 404, 48 Stat. 881, he was required to turn over to the corporation his profits from the sales and upon demand by the corporation did so. As to the officer-decision of the court below in *Central R. Co.* (App. 16a). In its *William Goldman Theatres* decision the Tax Court stated that "Until such time as the *Glenshaw Glass Co.*, the *Central R. Co.*, and the *Highland Farms* cases are overruled, or until Congress by legislation requires that punitive damages be taxable as income, we must follow the established decisions." (App. 31a.)

However, there is little, if any, basis for considering the *Central R. Co.* and *Highland Farms Corp.* decisions as representing a long-standing rule that punitive damages do not constitute taxable income. While these two decisions are relatively old, their rationale was inconsistent from the outset with other decisions. Moreover, the Commissioner's published nonacquiescence in the Tax Court's holding in *Highland Farms Corp.* (1941-1 Cum. Bull. 5) served notice that the holding was not being accepted by the Treasury. Not until the instant cases was there again any attack in the courts on the Commissioner's position that punitive damages constitute taxable income. Now that the attack has been made, however, there are other cases in which the question has been raised, as we show in the text.

director, the payment to the corporation constituted a penalty. See *Smolow v. Delendo Corp.*, 136 F. 2d 231 (C. A. 2d), certiorari denied, 320 U. S. 751; *Davis v. Commissioner*, 17 T. C. 549. The question was whether the payment constituted taxable income to the taxpayer-corporation. In holding that it did, the Court of Claims regarded the payment as a "penalty" to the payor and a "windfall" to the recipient-corporation and held that it "could not rationally be suggested that Congress lacks the power to tax windfalls as income" (107 F. Supp. at 943), that the payment was "income derived from any source whatever" under Section 22 (a) of the Code (p. 942), that it saw "no reason for not giving the statutory language its natural meaning" (p. 942), that "If Congress were to select one kind of receipt of money which, above all others, would be a fair mark for taxation, it might well be 'windfalls'" (p. 942), that it was "unwilling to surmise" that by the *Eisner v. Macomber* definition this Court intended to read "income derived from any source whatever" out of Section 22 (a) (p. 943), that the fact that the payment was a penalty to the payor had no bearing on the question of taxability to the recipient (p. 944), and that "Cases such as *Central R. Co. of New Jersey v. Commissioner*, 3 Cir., 79 F. 2d 697, and *Highland Farms Corporation*, 42 B. T. A. 1314, 1319, which seem to rest only upon the definition of income given

by the Supreme Court in *Eisner v. Macomber*, do not seem to us persuasive" (p. 945).

More recently the Court of Appeals for the Second Circuit in *General American Investors Company v. Commissioner*, 211 F. 2d 522, in which a petition for certiorari is now pending, No. 114, followed the lead taken by the Court of Claims in *Park & Tilford* in another case arising with respect to profits turned over to a corporation pursuant to Section 16 (b) of the Securities Exchange Act of 1934. The taxpayer-corporation there also "relie[d] principally" upon the *Eisner v. Macomber* definition of income, which the court stated did not cover the payments involved. "If this definition is to be regarded as all inclusive, and to be applied literally" (p. 523). In answering the taxpayer's argument, the court stated that the *Eisner v. Macomber* definition "has met the common fate of generalities" (p. 523), that "it will not help to characterize these payments as a 'windfall' to the corporation or as in the nature

¹ On petition for a writ of certiorari in the *Park & Tilford Distillers Corp.* case the taxpayer alleged a conflict with the decision of the court below in *Central R. Co.* In the Brief in Opposition, No. 544, October Term, 1952, it was stated that the Government believed the *Central R. Co.* case "was incorrectly decided," that "its reasoning, which turns on the dictum of *Eisner v. Macomber*, no longer has vitality in the law," and that "Regardless, therefore, of whether its facts are distinguishable from those in the case at bar, we believe that the alleged conflict does not require resolution by this Court." (Pp. 10-11.) The decision below gives renewed vitality to the *Central R. Co.* decision.

of a 'penalty' imposed upon the director and the stockholder" (p. 524), and that "if we consider the words 'gains or profits and income derived from any source,' in their plain popular meaning, as we think they should be, how can there be any doubt that these Section 16 (b) payments are 'income'?" (p. 524).

Moreover, this Court has not considered the *Eisner v. Macomber* definition of income as limiting the taxability of gains according to their source. In a number of decisions the Court has quoted the Section 22 (a) definition of gross income as including "gains or profits and income derived from any source whatever" and held certain gains to come within that clause which are not covered by the *Eisner v. Macomber* definition. See, e. g., *Rutkin v. United States*, 343 U. S. 130; *United States v. Safety Car Heating Co.*, 297 U. S. 88; *Helvering v. Bruun*, 309 U. S. 461; *Douglas v. Willcuts*, 296 U. S. 1, 9; *United States*

* The court below regarded the *Park & Tilford Distillers Corp.* and *General American Inv. Co.* decisions as distinguishable from the present cases (App. 41a), stating, among other things, that it did not agree with the Court of Claims in the *Park & Tilford Distillers Corp.* case that the recovery there was purely a windfall (App. 40a). The distinction drawn by the court below between those cases and the instant cases seems to be that under the statute involved in those cases the profits were required to be passed on, and inured, to the corporation. But as the Second Circuit stated in its *General American Inv. Co.* decision, such reasoning "will not bear analysis," for the "payments were not 'profits' to petitioner, although they represented 'profits' realized by the director and the stockholder." (P. 524.)

v. Kirby Lumber Co., 284 U. S. 1; *Taft v. Bowers*, 278 U. S. 470; *Cooper v. United States*, 280 U. S. 409. For example, the *Rutkin* case, *supra*, involved the question whether money obtained by extortion constitutes taxable income. The extorted money (\$250,000) not only was not derived by the taxpayer-extortioner from capital or labor or both combined but was money the receipt of which was unlawful. The Court concluded, however, that Section 22 (a) "reaches these receipts," stating that the power of Congress to tax the receipts "is unquestionable" and that the broad language of Section 22 (a) "supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income" (pp. 138-139). In the *Safety Car Heating Company* case a sum received in settlement of a suit for profits lost by reason of the infringement of a patent was considered income, and in *Helvering v. Bruun* the gain realized by the taxpayer from the erection of a building on his property was very much in the nature of a "windfall."

Even in its narrow aspect, as limited to punitive damages, the issue in this case is a recurring one. There are now pending at least four cases in which it is involved. *Obear-Nester Glass Co. v. Commissioner*, 20 T. C. 1102, now pending on appeal to the Seventh Circuit; *Telefilm, Inc. v. Commissioner*, 21 T. U. No. 77; *Maurice W. Kinzel, Trustee in Liquidation for Theatre Investment Co. v. United States* (W. D. Wash.),

Civil No. 3650; *Maurice W. Kinzel, Trustee in Liquidation for Venetian Theatre Co. v. United States* (W. D. Wash.), Civil No. 3651. Since the receipt of punitive damages is by no means unusual, other cases will undoubtedly arise in the near future. In its broader aspect, that is, whether the statutory definition of income is to be limited by the source of the gain, the issue arises with even greater frequency. Review of the present cases is necessary in order to obviate the confusion and expense in the administration of the revenue laws incident to further litigation of the question.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted.

SIMON E. SOBELOFF;
Solicitor General.

JULY 1954.