APPENDIX

The Tax Court of the United States

OPINION

GLENSHAW GLASS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[18 T. C. 860]

Docket No. 30821. Promulgated August 13, 1952

1. Where a lump sum of money is received in settlement of various claims, an allocation of specific amounts to each of the several claims is necessary and proper.

2. Sums received in settlement of punitive damages do not constitute taxable income.

3. Sums received in settlement of claims for anticipated profits are taxable as ordinary income.

Sidney B. Gambill, Esq., for the petitioner.

Albert J. O'Connor, Esq., for the respondent.

The respondent has determined deficiencies of $31.82 and $126,361.06 in the petitioner's income tax liability for the taxable years ending September 30, 1947, and September 30, 1948, respectively.

The petitioner contests the deficiency determined for the taxable year 1948 which results from the inclusion as ordinary income of the proceeds received in a compromise settlement of various claims.

All stipulated facts are found as stipulated.

Findings of fact

The petitioner is a Pennsylvania corporation organized in 1900 as a successor to a limited association formed in 1895. Its principal office and place of business is in Glenshaw, Pennsylvania. From the date of its incorporation to the present time, the petitioner has been continuously engaged in the manufacture of glass bottles and glass containers. For the taxable year 1948 the petitioner's income tax return was filed with the collector of internal revenue for the twenty-third district of Pennsylvania.

For some years prior to 1923, the petitioner was licensed by Howard Automatic Glass Feeder Company to use royalty-free Howard feeder machines in its manufacturing operations. Except with respect to the manufacture of milk bottles, the Howard license agreements were without restrictions as to the type of glass containers that could be manufactured by the petitioner.

Early in 1923, Hartford-Empire Company (hereinafter referred to as Hartford) representing that it had acquired control of the Howard patents, induced the petitioner to cancel its royalty-free license agreements and to enter into new license agreements with Hartford covering the use of both Howard and Hartford feeder machines. The Hartford license agreements imposed upon the petitioner the obligation to pay royalties computed upon ware production, and also prohibited the petitioner from using the feeders to manufacture a wide variety of glassware and containers, including fruit jars, prescription and proprietary medicine ware, milk bottles,

and certain other items. Each Hartford license agreement contained a provision permitting its termination by petitioner upon the payment of a prescribed lump sum minimum royalty. From 1923 until 1931, petitioner used and operated only glass feeding machines under the Hartford license agreements, and pursuant to such agreements petitioner paid royalties to Hartford from 1923 through the fiscal year ended September 30, 1931.

The royalty payments and the restrictions upon its manufacturing operations led the petitioner to endeavor to free itself from the Hartford license agreements. In 1931, the license agreements covering the Howard feeders expired, and the petitioner took the position that those feeders, having been originally purchased by the petitioner, remained its property and could be retained and freely used upon the expiration of the license agreements. Accordingly, the petitioner embarked upon the manufacture of fruit jars through the use of those feeders in July 1931, and a 5-year exclusive distribution contract for the sale of its entire fruit jar output was executed with a distributor in September of that year. In December 1932 the royalty-free, unrestricted use of the Howard feeders by the petitioner was terminated as the result of litigation instituted by Hartford for that purpose.

In 1931 and in the forepart of 1932, the petitioner, the McKee Glass Co., George R. Haub, and others formed a corporation, the Shawkee Manufacturing Company, for the purpose of building and selling a new glass feeder. During that period, Haub developed and built in peti-

tioner's plant a new feeder known as the Shawkee feeder. Petitioner received a nonexclusive license to use the Shawkee feeder free from the payment of any royalties. By October 19, 1934, the date of the permanent injunction hereinafter referred to, petitioner had seven royalty-free Shawkee feeders in operation in its plant and was manufacturing 65 per cent of its total production on these machines. It had by then replaced five Howard (Hartford licensed) feeders. The Shawkee feeder proved to be an efficient, workable feeder, equal to those covered by the Hartford licenses.

On May 31, 1933, Hartford filed suit against the petitioner, Shawkee, and others, in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co.* v. *Shawkee Manufacturing Co., et al.*, Docket No. 2791. On the basis of an earlier decision, in *Hartford-Empire Co.* v. *Hazel-Atlas Glass Co.*, 59 F. 2d 399, the complaint charged that the Shawkee feeder infringed the patent owned by Hartford. Relying on the *Hazel-Atlas* decision, the District Court, on June 27, 1933, entered a preliminary injunction which restrained the defendants from selling Shawkee feeders, but did not apply to the continued use of Shawkee feeders by the petitioner.

Relying upon its earlier decision in the *Hazel-Atlas* case, the Circuit Court of Appeals for the Third Circuit affirmed the order for the preliminary injunction, with an opinion reported at 68 F. 2d 726. Pursuant to the mandate of the Circuit Court, the United States District Court for the Western District of Pennsylvania

entered an order for a permanent injunction on October 19, 1934. The permanent injunction enjoined the use of Shawkee feeders by petitioner for the manufacture of any and all glassware, and ordered an accounting. Upon the entry of the permanent injunction, the royalty-free Shawkee feeders were dismantled by petitioner. In order to do business and comply with the injunction, it was necessary for the petitioner to reinstall, and it did reinstall, the Hartford licensed feeders and to pay royalties. Were it not for the permanent injunction, the petitioner would have continued to install royalty-free Shawkee feeders to replace the Hartford licensed feeders.

The accounting directed by the permanent injunction, was finally concluded by a settlement between the parties in 1939, whereby petitioner paid Hartford the sum of $11,167.85. A final decree in Docket No. 2791 was thereupon entered in 1939.

In 1939, the United States instituted a civil action in the United States District Court for the Northern District of Ohio, in which Hartford was ultimately held to have violated the Federal antitrust laws. *United States* v. *Hartford-Empire Co.*, 46 F. Supp. 541. The judgment of the District Court finding and holding that Hartford had violated the antitrust laws was affirmed by the United States Supreme Court. *Hartford-Empire Co.* v. *United States*, 323 U. S. 386; 324 U. S. 570.

After December 1940, petitioner decided to discontinue all further payments of feeder royalties to Hartford. This decision resulted from information disclosed in the antitrust proceedings prosecuted against Hartford by the United States.

Hartford thereupon filed an action for royalties against petitioner in 1941 in the United States District Court for the Western District of Pennsylvania, entitled *Hartford-Empire Co. v. Glenshaw Glass Co.*, Civil Action No. 1650. Following the disclosures made in the Government's antitrust case, the petitioner filed an answer and counterclaim asking for a return of certain royalties and treble damages for destruction of certain lines of its business in violation of the antitrust laws. Hartford's motion to strike the petitioner's counterclaim on the ground that it stated no cause of action was denied in 1942. No further proceedings were had in Civil Action No. 1650 prior to the settlement hereinafter referred to.

Also, following the disclosures in the Government's antitrust case, petitioner instituted proceedings to reopen and set aside the permanent injunction entered against it in 1934 in Docket No. 2791. Petitioner charged that the judgment which Hartford had obtained against Hazel-Atlas Glass Company had been secured through fraud, and that the Hazel-Atlas judgment was fraudulently employed to secure the permanent injunction against petitioner in 1934. Simultaneously, Hazel-Atlas Glass Company filed its petition making the same charges of fraud in the procurement of the judgment against it. The proceedings were consolidated for hearing, and the applications to vacate the judgments were denied by the Circuit Court of Appeals for the Third Circuit, by a divided court. On appeal, the Supreme Court of the United States in 1944 ordered both the judgment against Hazel-Atlas and the judgment against the petitioner set aside upon the ground

of fraud. The Supreme Court ordered that the fraudulently obtained injunction entered against the petitioner in 1934 be annulled and set aside, that Hartford's complaint be dismissed, and that the petitioner be permitted to bring appropriate proceedings for restitution and damages.

Pursuant to the decision of the United States Supreme Court, the petitioner filed a counterclaim in the United States District Court for the Western District of Pennsylvania, in the original Hartford injunction proceedings, Docket No. 2791, seeking compensatory damages in the amount of $1,500,000, and exemplary damages in a like amount, based upon the findings of fraud made by the Supreme Court. The District Court denied all of the petitioner's claims for damages except the claim for $11,167.85 paid by petitioner to Hartford in 1939, in settlement of the accounting order above referred to.

The District Court found as a fact that on or about June 6, 1939, the petitioner paid $11,167.85 to Hartford in settlement of the accounting ordered by the District Court in 1934; that royalties paid by the petitioner to Hartford between January 1, 1934, and October 1944 aggregated $397,199.42; that subsequent to the beginning of suit, the petitioner expended $21,850.47 in litigation and travel expenses; that the expenses incurred by the petitioner in dismantling the Shawkee feeders totaled $11,920.15. The District Court made no specific finding of fact with respect to the amount of the loss on the fruit jar business.

The evidence relative to the damage claimed for destruction of the fruit jar business was directed toward a showing of lost profits. Testi-

mony and exhibits were introduced to support the estimate of the profits lost during the period beginning 1934 and ending in 1940, the year in which Hartford's license restrictions on the manufacture of glass jars were removed.

Both petitioner and Hartford appealed to the United States Circuit Court of Appeals for the Third Circuit from the judgment entered by the District Court. In the Circuit Court, petitioner pressed its demands for the following items and amounts of damages, all of which claims were opposed by Hartford:

Item	Amount	Interest at 6 percent to Jan. 1, 1947	Total
Settlement of accounting order	$11,167.85	$5,074.22	$16,242.07
Reimbursement of royalties paid to Hartford after Jan. 1, 1934 ($397,199.42 – $26,283.33) [1]	370,916.09	189,085.55	560,001.64
Litigation and travel expenses	21,850.47	2,872.50	24,722.25
Loss on dismantling Shawkee feeders	11,920.15	8,727.50	20,647.65
Loss on destruction of fruit jar business	292,500.00	162,373.54	454,873.54
Total	708,354.56	368,133.31	1,076,487.15
Punitive damages (in an amount equal to the total amount of restitution and compensatory damages)			

[1] This $26,283.33 item is not involved in the present proceeding.

In the brief submitted on its appeal from the District Court's judgment entered in 1946, the petitioner stated that "Recovery was sought in the counterclaim for the loss of the fruit jar business and reasonably anticipated profits." In a memorandum to the petitioner dated October 1, 1948, counsel for the petitioner in both suits against Hartford stated that in Civil Action No. 1650, "The principal items of damage were (i) injury to business by limitations and exclusions from various fields (ii) loss of profits and (iii) royalty and other expenses."

The Circuit Court of Appeals, on August 14, 1947, filed its opinion and held as follows:

(a) Settlement of accounting order. The judgment of the District Court allowing petitioner's claim in the amount of $11,167.85, with interest at 6 percent, was affirmed.

(b) Royalties. Petitioner's claim for royalties, plus interest, was upheld. However, the court stated that "There may be elements which might possibly affect the amounts of royalties to be refunded and we express no opinion as to this." The case was remanded for the taking of additional testimony, and a determination by the District Court of the specific amounts of royalties to be refunded.

(c) Litigation and travel expenses. Petitioner's claim was upheld.

(d) Dismantling Shawkee feeders. Petitioner's claim was upheld.

(e) Destruction of fruit jar business. The finding of the District Court that the evidence as to this loss was too speculative was affirmed as having "substantial justification" in the record.

(f) Punitive damages. The Court said that "This case calls for such damages although it is for the District Court, as the trier of fact, to assess them, taking into consideration the whole wretched scheme as ascertained and etched in unmistakable terms by the Supreme Court." The Court further stated that the trial court could be governed by "the enormity of [the] offense rather than the measure of compensation."

Hartford had earned large profits as a result of its fraudulent practices.

Both Hartford and the petitioner filed petitions for rehearing with the Circuit Court of Appeals, and Hartford filed "comments" upon the petitioner's petition for rehearing. Hartford's petition for rehearing argued for complete freedom from liability under all of petitioner's claims. The petition filed by petitioner sought to persuade the Court to direct the entry of a judgment for the full amount of the royalties it had paid, plus interest. Petitioner also asserted that the Court's ruling denying recovery for the destruction of the fruit jar business rested on errors of law, as well as fact, and disregarded controlling decisions of the United States Supreme Court. In reply, Hartford continued to assert its position that it was entitled to substantial credits against the royalties to be refunded to petitioner. The petitions for rehearing were denied by the Circuit Court of Appeals on October 1, 1947.

While the petitions for rehearing were pending, settlement discussions between petitioner and Hartford were commenced. Petitioner's executive officers and counsel had agreed among themselves to ask for $1,530,000, consisting of the following items:

Accounting, settlement: litigation and travel expenses: dismantling Shawkee feeders		$45,000
Reimbursement of royalties paid to Hartford		370,000
Loss on destruction of fruit jar business		250,000
Punitive damages in Docket No. 2791		500,000
Civil Action No. 1650 (antitrust suit):		
Loss on destruction of lines of glassware other than fruit jar business	$55,000	
Punitive damages	110,000	
		165,000
Interest on refund of royalties and other reimbursement items		200,000
		1,530,000

Petitioner's counsel, in Civil Action No. 1650 and Docket No. 2791, was convinced and so advised the petitioner's president at the time negotiations for settlement began and at the time Hartford's final offer in settlement was received that upon remand of Docket No. 2791 to the District Court, the petitioner would probably receive punitive damages of approximately $500,000 to $750,000 and possibly $1,000,000 or $1,500,000; and, further, that if the District Court awarded as punitive damages a sum of $250,000 or less, it would very likely be reversed upon appeal to the Circuit Court of Appeals. Counsel was of the view that such a large award would be made in view of such factors as the Circuit Court of Appeals' scathing denunciation of the fraud practiced by Hartford, the large profits it earned during the years the fraud was practiced, and the Circuit Court of Appeals' statement that the District Court, in assessing the punitive damages, could be governed by the enormity of the offense rather than the measure of compensation. The claims for punitive damages under Civil Action No. 1650 and Docket No. 2791 were serious claims, and figured prominently in the final settlement.

The $250,000 claim for loss on the fruit jar business was included in the total sum of $1,530,000 asked by the petitioner in settlement, mainly for bargaining purposes. Since the claim was disallowed by the District Court and the disallowance was affirmed on appeal, the petitioner was prepared to abandon it immediately. Throughout the negotiation proceedings, the representatives of Hartford took the position that

the question of the allowance of that claim had been resolved by litigation and they would, therefore, pay no attention to it.

The claim for compensatory and punitive damages under Civil Action No. 1650 (antitrust suit) in the amount of $165,000 consisted of $55,000 as the value placed on the claims for destruction of lines of glassware business other than the fruit jar line, and $110,000 as the value assigned to the punitive damages claim. The claims for destruction of the fruit jar line and for return of royalties had also been alleged in Civil Action No. 1650.

The itemized proposal was communicated to representatives of Hartford at a meeting in September 1947. Hartford expressed a willingness to pay a sum in the area of $200,000 but any discussion of settlement in that range was declined. Thereafter, in October 1947, Hartford made a lump sum settlement offer of $600,000 to petitioner, which was rejected. In November 1947 Hartford offered the lump sum of $813,358.24. This offer was accepted by petitioner, and the settlement agreement was executed on December 15, 1947, prior to the expiration of the period for the filing of a petition for certiorari in the United States Supreme Court.

The settlement terminated the litigation in Civil Action No. 1650 and Docket No. 2791, referred to above, and was evidenced by a settlement agreement and two mutual releases. Pursuant to the settlement agreement, Hartford paid petitioner the sum of $813,358.24 on December 23, 1947. No agreement was made by the parties to the settlement as to the allocation of

that amount among the various claims involved in the litigation and settlement negotiations.

In the fiscal year ended September 30, 1948, petitioner paid legal fees in connection with the Hartford litigation and settlement in the total amount of $225,000.

In its income tax return for the taxable year 1948, the petitioner reported the total proceeds of $813,358.24 from which it deducted $225,000 for attorney fees, leaving a balance of $588,358.24 as the net proceeds. This balance was allocated to the various claims by according to each claim that proportion of the net settlement proceeds ($588,358.24) which the value give to such claim (under the breakdown given to Hartford in the original settlement offer of $1,530,000) bears to the total value of $1,530,000 assigned to all claims. The computation was as follows:

	Value under $1,530,000 offer	Percentage of total value of $1,530,000 assigned to all claims	Allocated net proceeds of $588,358.24
Settlement of accounting order litigation and travel expenses, dismantling Shawkee feeders	$45,000	[2] 2.9	$17,062.39
Reimbursement of royalties paid to Hartford	370,000	[1] 24.2	142,382.69
Loss on destruction of fruit jar business	250,000	[2] 16.3	95,902.40
Punitive damages in Docket No. 2791	500,000	[2] 32.7	192,393.14
Civil Action No. 1650 (antitrust suit):			
Loss on destruction of lines of glassware business other than fruit jar business	55,000	[2] 3.6	21,180.90
Punitive damages	110,000	[2] 7.2	42,361.79
Interest	200,000	[1] 13.1	77,074.93
Total	1,530,000	100.0	588,358.24

[1] On the schedule attached to the income tax return, these three items were combined at a total percentage of 40.20, and a total sum of $236,720.01.

[2] On the schedule attached to the income tax return, these four items were combined at a total percentage of 59.80, and a total sum of $351,838.23. The two items under Civil Action No. 1650 (antitrust suit) were totaled at $165,000 and referred to as "Damage to Business Covered by Antitrust suit." No part of the $165,000 sum was referred to as punitive damages.

The net effect of the computation was to allocate to each claim an amount equal to approximately 38.45 percent ($588,358.24 ÷ $1,530,000) of the amount assigned to it in the breakdown of the original settlement offered to Hartford.

The sum of $813,358.24 received as a lump sum settlement of all claims that petitioner had against Hartford should be apportioned among the several claims in the ratio that this sum bears to the total sum of $1,530,000 claimed in the petitioner's original settlement offer.

The $225,000 in legal fees incurred by the petitioner in the litigation and settlement of the claims against Hartford should be allocated between the claims in the same proportion as the $813,358.24 received in settlement is allocated to the several claims. The fees allocated to the claims that give rise to taxable income constitute an ordinary and necessary business expense.

In its claims for loss due to destruction of the fruit jar and other lines of glassware business, asserted in the lawsuits and in the settlement negotiations that followed, the petitioner sought recovery for loss of anticipated profits and not for lost capital.

Opinion

ARUNDELL, *Judge:* The basic issue before us is the taxability of a sum of money received by the petitioner in 1947 in compromise settlement of several claims asserted against Hartford-Empire Company (hereinafter referred to as Hartford) in two suits and in subsequent settlement negotiations. The claims were for: (1) reimbursement of the sum paid in settlement of the accounting

order; (2) reimbursement of litigation and travel expenses; (3) reimbursement of loss incurred in dismantling Shawkee feeders; (4) reimbursement of royalties paid to Hartford; (5) interest on refund of royalties and other reimbursement items; (6) loss due to destruction of fruit jar business; (7) loss due to destruction of various lines of glassware business other than the fruit jar business; (8) punitive damages under section 4 of the Clayton Act (15 U. S. C. A., Title 15, section 15) for violation of Federal antitrust laws resulting in destruction of various lines of glassware business other than the fruit jar business, and (9) punitive damages for loss caused by Hartford's fraudulent practices.

The taxable nature of the sum received in settlement of each of those claims is dependent upon the nature of the claim. That is, a sum received in settlement of a claim for a nontaxable item is nontaxable whereas it would be taxable as ordinary income if the item claimed was an ordinary income item, or taxable as a return of capital if the claim was for recovery of lost capital. *Raytheon Production Corporation* v. *Commissioner,* 144 F. 2d 110, certiorari denied 322 U. S. 777; *Durkee* v. *Commissioner,* 162 F. 2d 184, and cases cited therein.

The parties seem to be in agreement that the sums received in settlement of the first five claims are taxable as ordinary income. The respondent has determined that they constitute ordinary income, and petitioner has offered no evidence or argument to the contrary.

The first issue is whether the sums received in settlement of the punitive damages claims consti-

tute taxable income. It has long been established that punitive damages do not meet the test of taxable income set forth in *Eisner v. Macomber,* 252 U. S. 189, 207, as "'* * * 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 * * *." *Central R. Co.* v. *Commissioner,* 79 F. 2d 697; *Highland Farms Corporation,* 42 B. T. A. 1314. This basic definition has been recently cited with complete approval in *Commissioner* v. *Culbertson,* 337 U. S. 733, 740, and has been adhered to by the respondent in his Regulations 111, section 29.22 (a)–1. Therefore, on the authority of those cases, we follow this rule of long standing that has never been questioned in any court and hold that the sums received in settlement of the punitive damages claims do not constitute taxable income.

The taxability of the sums received in settlement of the claims for loss due to destruction of the fruit jar and other lines of glassware business is in issue because the parties disagree as to what the taxpayer sought to recover. The petitioner contends it sought recovery of lost capital only, and the respondent contends that recovery for the loss of anticipated profits was sought. Whether or not the sums received in settlement of those claims are taxable as a return of capital or as ordinary income is dependent upon the resolution of this question of fact. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn,* 186 F. 2d 450; *Mathey* v. *Commissioner,* 177 F. 2d 259, affirming 10 T. C. 1099.

The petitioner, in support of its contention that it sought to recover only lost capital, relies on the fact that in these claims the destruction of the business was alleged. However, destruction of a business is a factual premise that might support a claim based on the loss of anticipated profits as well as the loss of capital. We must, therefore, look further to determine what the petitioner sought to recover.

The pleadings in both suits Nos. 1791 and 1650 fail to refer to any asset, either tangible or intangible, that was damaged or destroyed. There is no allegation that any physical assets became idle or useless because of the prohibition against the manufacture of certain lines of glassware but, on the contrary, we know that the same machinery used to manufacture the prohibited glassware was also used to manufacture other unprohibited lines of glassware. Intangibles such as "good will" or "reputation" are nowhere mentioned and there is no contention that with reference to the prohibited lines of glassware business the petitioner had acquired "good will" or that sums had been expended and capitalized in the development of those lines. *Martin Brothers Box Co.* v. *Commissioner,* 142 F. 2d 457.

No evidence was introduced in the litigated suit or in this proceeding to establish at least that there had been in existence an asset, later destroyed, that could conceivably have been the basis of a claim for lost capital. The petitioner offered no evidence of customers' lists, schedule of valuable established merchandise outlets for those wares, testimony of preference given to those wares by consumers, or similar evidence likely

to be introduced where loss of good will or a similar asset is in issue. In fact, the evidence establishes that the petitioner's fruit jar business was not begun until July 1931 and, further, that in September of that year the petitioner gave to a distributor a 5-year exclusive distribution contract for the sale of its entire fruit jar output.

The evidence in the litigated suit consisted mainly of a showing of loss of anticipated profits. Testimony and exhibits were introduced to support an estimate of the profits that would have been earned during the period beginning 1934 and ending with the removal in 1940 of the prohibitions against the manufacture of fruit jars. The significance of the petitioner's reliance on such evidence is not lessened because evidence of past profits actually earned is sometimes introduced to value good will. See *Raytheon Production Corporation* v. *Commissioner, supra.* It is very unlikely that the petitioner attempted to prove the value of good will by estimated anticipated profits. In any event, such a purpose cannot be inferred when there is no reference to good will or any similar asset that might need to be valued. Finally, we must note that the Circuit Court of Appeals for the Third Circuit characterized that claim as a "claim for loss of profits." *Hartford-Empire Co.* v. *Shaukee Mfg. Co.,* 163 F. 2d 474, 479.

After carefully studying this and all other evidence, especially the exhibits and testimony pertinent to suits Nos. 2791 and 1650, and subsequent discussions between Hartford and the petitioner, we find the posture of the litigation and settlement negotiations to be such that on the record

before us we cannot find that the recovery sought was for lost capital but, on the contrary, find that recovery was sought for the loss of anticipated profits. Therefore, the sums received in settlement of those claims represented recovery for the loss of anticipated profits and are taxable as ordinary income. *Raytheon Production Corporation* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Jones* v. *Corbyn, supra; Mathey* v. *Commissioner, supra.*

However, even if the evidence established that the petitioner sought recovery only in part for loss of anticipated profits, the entire proceeds would represent a recovery for the loss of anticipated profits. The respondent has in effect determined that none of the settlement proceeds represented a return of capital, and the petitioner has relied entirely on the proposition that recovery was solely for lost capital and that the proceeds received in settlement represent a return of capital. The petitioner therefore made no attempt to, and the record does not contain any evidence on the basis of which we could, apportion the settlement proceeds between recovery of lost capital and recovery for loss of anticipated profits. Under such circumstances, the entire sum received in settlement of those claims represents a recovery for loss of anticipated profits and is taxable as ordinary income. *Armstrong Knitting Mills,* 19 B. T. A. 32; *Arcadia Refining Co.* v. *Commissioner,* 118 F. 2d 1010; *H. Liebes & Co.* v. *Commissioner,* 90 F. 2d 932; *Martin Brothers Box Co.* v. *Commissioner, supra.*

Fitally, we must determine what portion of the $813,358.24 settlement proceeds is allocable to the

punitive damages claims and how much is allocable to the remaining claims which give rise to taxable income. Since the entire sum allocable to the remaining claims is taxable as ordinary income, it is not necessary that we determine what portion is allocable to each individual item in that category.

The parties to the compromise settlement merely agreed to a lump sum payment and made no attempt to decide how much was paid and received in settlement of each claim or how much was attributable to the punitive damages claims. Under those circumstances, an allocation is necessary and proper. *Specialty Engineering Co.*, 12 T. C. 1173; cf. *Cramp Shipbuilding Co.*, 17 T. C. 516; see *Helvering* v. *Safe Deposit & Trust Co.*, 316 U. S. 56.

The petitioner proposes that we allocate to the punitive damages claims that proportion of the gross settlement proceeds ($813,358.24) which the value assigned to those claims by the petitioner at the beginning of settlement negotiations bears to the total value ($1,530,000) assigned to all claims at that time. Pursuant to that proposal, petitioner allocated $324,529.94 to the punitive damages claims and the balance to the remaining claims.

We accept the general method of allocation proposed by the petitioner as a reasonable one which in our opinion is fair to the respondent, and in so doing we are not unmindful of the respondent's objection that this method ignores the relative weight possessed by those various claims. However, we do not deem this material

since the respondent does not suffer from the allocation as proposed. The failure to take into account relative weight did not increase, and possibly decreased, the amount of the settlement proceeds allocated to the punitive damages claims. For example, by giving equal weight to the claim for destruction of the fruit jar business, admittedly the weakest claim, the amount allocated to ordinary income was proportionately increased and the amount allocated to the punitive damages claims was proportionately decreased.

Furthermore, not only did the claims for punitive damages possess more weight than the claim for destruction of the fruit jar business but, in addition, we think they possessed at least approximately the same weight as all other claims, other than the first three relatively small claims totaling $44,938.47 and the interest thereon.

The claims for punitive damages, especially the claim in No. 2791, were serious claims that undoubtedly figured prominently in the settlement negotiations and final settlement agreement. In No. 1650, the petitioner pressed a claim for treble damages under section 4 of the Clayton Act. Hartford had already been found guilty of violating Federal antitrust laws and the judgment was affirmed by the United States Supreme Court. In No. 2791, the Circuit Court of Appeals for the Third Circuit ruled that the petitioner should receive punitive damages and prepared the way for a large award by seathingly denouncing the fraud of which the petitioner had been a victim, and by stating that "In those circumstances, the trial court has power to inflict such

damages, 'having in view the enormity of * * * [the] offense rather than the measure of compensation * * *.'" Hartford had earned large profits as a result of those fraudulent practices.

The sum of $813,358.24 received as a lump settlement will be apportioned in the manner set forth in our findings and the tax thereon will be computed as we have determined herein.

The parties have agreed that the legal fees incurred in the litigation and settlement of the several claims against Hartford should be allocated between the claims in the same proportion as the settlement proceeds are allocated. They further agreed that the fees allocated to the claims that gave rise to taxable income are deductible as an ordinary and necessary business expense, and that the fees allocated to the claims that did not give rise to taxable income are not deductible.

Decision will be entered under Rule 50.

Decision

[Caption omitted].

Pursuant to the Opinion of the Court promulgated August 13, 1952, the respondent herein, on December 1, 1952, filed a recomputation for entry of decision, the petitioner's acquiescence in the respondent's recomputation being noted thereon. Wherefore, it is

Ordered and decided that there is no deficiency in income tax for the taxable year ended September 30, 1948, and that there is an overpayment in income tax for the taxable year ended September 30, 1948, in the amount of $85,709.20, all of

which was paid after the mailing of the notice of deficiency.

Entered: Dec. 3, 1952.

(Signed) ERNEST H. VAN FOSSAN,
Judge.

Findings of Fact and Opinion of the Tax Court

WILLIAM GOLDMAN THEATRES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

[19 T. C. 637]

Docket No. 29450. Promulgated January 9, 1953

Income—Punitive Damages.—Petitioner, as an injured party, received a damage judgment in an antitrust suit. *Held*, one-third of the award was compensatory damages for loss of profits and taxable as income. *Held, further*, that two-thirds of the award was punitive damages and not taxable.

Samuel H. Levy, Esq., and *Bernard Wolfman, Esq.*, for the petitioner.

Jules I. Whitman, Esq., for the respondent.

The respondent determined deficiencies in petitioner's income tax for the years 1947 and 1948 in the amounts of $1,847.19 and $92,874.70, respectively. The deficiency determined for the year 1947 is not in issue.

Two of the three allegations of error for the year 1948 were resolved by stipulation of the parties. The sole remaining issue before us is whether a two-thirds portion of the aggregate award received by petitioner in an antitrust suit was taxable income.

Findings of fact

The facts are stipulated and are so found.

The petitioner is a Delaware corporation authorized to do business in the Commonwealth of Pennsylvania and has its principal place of business at Philadelphia, Pennsylvania. Petitioner's income tax return for 1948 was filed with the collector of internal revenue for the district of Pennsylvania.

Petitioner's business during the year 1948 consisted of the operation of motion picture houses and the exhibition of motion pictures produced and distributed by other persons and corporations. On December 8, 1942, petitioner instituted a civil action in the District Court of the United States for the Eastern District of Pennsylvania against certain motion picture distributors; petitioner alleged that the named defendants violated the Federal antitrust laws. The action was brought under section 4 of the Act of Congress of October 15, 1914, entitled "An Act to supplement existing laws against unlawful restraints and monopolies and for other purposes," as amended and supplemented (15 U. S. C. A. 15), commonly known as the Clayton Act, and sections 1 and 2 of the Act of Congress of July 2, 1890, entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (15 U. S. C. A. 1), said Act being commonly known as the Sherman Anti-Trust Act, and the Act of Congress of June 19, 1936 (15 U. S. C. A. 13), commonly known as the Robinson-Patman Act. Petitioner's complaint was in part as follows:

28. As a result of the discrimination against plaintiff which defendants accomplished through said monopoly, plaintiff has been unable to operate the Erlanger Theatre and has thereby suffered great loss and damage, to wit, the sum of $450,000.00.

Wherefore, plaintiff prays:

* * * * *

(c) That the defendants be decreed to pay to the plaintiff triple all such damages as may have been sustained by the plaintiff as above, to wit, the sum of $1,350,000.00.

After the case was presented to the district court a judgment was entered in favor of the defendants. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 54 F. Supp. 1011.

On appeal the United States Court of Appeals for the Third Circuit reversed the judgment of the district court; the Court of Appeals held that a conspiracy existed as charged. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 150 F. 2d 738. Pursuant to an agreement of the parties and pending the court's decision on the question of liability under the Sherman Act, William Goldman Theatres, Inc., offered no evidence relating to the issue of damages at the first stage of the trial. After the Court of Appeals held the evidence sufficient to sustain the charge of conspiracy in restraint of trade the district court heard evidence directed solely to the question of damages.

On September 10, 1946, the district court made its findings with respect to damages. The damages were based solely on the petitioner's loss of profits at the Erlanger Theatre. The court's findings is a follows:

> I, therefore, find as a fact that the plaintiff, but for the wrongful acts of the defendants, would have earned profits at the Erlanger Theatre amounting to $125,000 during the damage period.

William Goldman Theatres, Inc. v. *Loew's Inc.*, 69 F. Supp. 103.

On December 18, 1946, the district court entered a final decree based on the findings as set forth in the opinion of September 10, 1946. Paragraph four of the opinion provides:

> The amount of the plaintiff's damages is $125,000 and the defendant shall pay to the plaintiff threefold that amount, or $375,000. Interest to date is not allowed.

On January 6, 1948, the Court of Appeals for the Third Circuit affirmed the judgment of the district court in a *per curiam* opinion. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 164 F. 2d 1021. Certiorari was denied by the United States Supreme Court, 334 U. S. 811.

On May 28, 1948, the defendants paid the petitioner the sum of $375,000. Of this amount petitioner, on its income tax return for the year 1948, included in gross income the amount of $125,000. The balance of the $375,000 was not included in petitioner's gross income for the year 1948.

Of the aggregate award of $375,000, petitioner received $250,000 as punitive damages and $125,000 for the loss of profits.

Opinion

JOHNSON, *Judge:* Petitioner has reported as taxable income $125,000 of a total $375,000 judg-

ment received upon the successful prosecution of an antitrust suit. The award was made under what is commonly known as section 4 of the Clayton Act (15 U. S. C. A. 15).[1]

Respondent maintains that the excess ($250,000) by which the award exceeds the actual damages ($125,000) constitutes taxable income under section 22 (a) of the Internal Revenue Code and the Sixteenth Amendment. Respondent also contends that the entire award in this case was for loss of profits and therefore the entire amount is taxable. Petitioner, in opposition, relies on the contention that the sum of $250,000 constitutes a penalty which is not income and therefore is not taxable.

Two questions must be answered before we ascertain the correctness of respondent's contention. First, we must determine for what purpose the $250,000 was awarded. Was it received in lieu of profits or capital gain, or was it received as a punitive award under the Clayton Act? Next, if the money were received as a punitive award, is it taxable income?

The district court did not specifically denominate this $250,000 as a particular type of damage; that court, however, did find as a fact that peti-

[1] "§ 15. Suits by persons injured; amount of recovery.

"Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. Oct. 15, 1914, c. 323, § 4, 38 Stat. 731."

tioner's damages from loss of profits amounted to $125,000 and under the statute (Clayton Act) it was entitled to threefold the damages sustained. This decision of the district court does not resolve the issue before us; therefore we must look elsewhere.

The words of the Clayton Act, "and shall recover threefold the damages by him sustained," do not in themselves answer our question; we have, therefore, gone into the legislative history of the Sherman Act (section 7, 26 Stat. 210), and the Clayton Act. We have found that even though Congress did not set forth in the statute the words "punitive" or "exemplary" in describing part of the threefold damages, there can be no doubt that Congress intended part of the threefold damages to be compensatory and part to be punitive.[2]

The courts have also interpreted the award in antitrust suits to be composed of both punitive and compensatory damages. The court in *Clark Oil Co.* v. *Phillips Petroleum Co.*, 148 F. 2d 580, 582, said:

> * * * The Sherman Act and the Clayton Act afford a cause of action for those suffering damages. In their provisions for damages they embody both punitive and compensatory damages but no recovery can be had unless a case for compensatory damages is made. In the event of compensatory damages, then automatically the punitive damages follow. * * *

[2] See Bills and Debates in Congress Relating to Trusts, 1903, S. Doc. No. 147, 57th Cong., 2d Sess.; the History of Bills and Resolutions, 51 Cong. Rec. Index 160, H. R. 15657, 63d Cong., 2d Sess.

Again, it was said in *Johnson* v. *Schlitz Brewing Co.*, 33 F. Supp. 176, 182, affirmed, 123 F. 2d 1016, that section 7 of the Sherman Act "was intended to be punitive in nature and deterrent in effect." Further, in *Bigelow* v. *RKO Radio Pictures, Inc.*, 150 F. 2d 877, 883, reversed on other grounds, 327 U. S. 251, it was said:

> * * * The amount of this verdict [under 15 U. S. C. A. 15] was required by statute to be trebled by the judgment. In this respect neither the jury nor either court had any discretion. The verdict should represent actual damages sustained, and two-thirds of the judgment is a penalty which Congress has seen fit to impose in such cases upon a guilty defendant. * * *

In other instances the courts have been required to determine whether the threefold damages for antitrust violations were penal in the strict and primary sense in that they were redresses for injuries to the public rather than redresses for wrongs to individuals. In these cases the courts held that the treble damages are either exemplary damages or penalties. *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 232 F. 574, 577; *City of Atlanta* v. *Chattanooga Foundry & Pipeworks*, 127 F. 23, 28, affirmed, 203 U. S. 390.

We have found no case which held that the excess over the actual damages, when the excess was severable from the actual damages, was anything but a penalty, punitive or exemplary damages. Cf. *Durkee* v. *Commissioner*, 181 F. 2d 189, affirming a Memorandum Opinion of this Court; *Durkee* v. *Commissioner*, 162 F. 2d 184,

reversing 6 T. C. 773; *Mathey* v. *Commissioner*, 177 F. 2d 259, affirming, 10 T. C. 1099. We shall not attempt to distinguish between punitive or exemplary damages. For our purposes they shall be considered the same. See 15A Words and Phrases 341. It is proper for us to conclude that the part of the award which represents loss of profits is compensatory in that it makes the injured petitioner whole. Likewise that part of the award in excess of compensation is punitive damages. Of the statutory threefold damages, we conclude that one part is compensatory and two parts are punitive; therefore the $250,000 was awarded as punitive damages.

Following the determination that part of the award is a penalty, we must next ascertain whether it is taxable income. The question of whether penalties are taxable is not new or novel. In a recent decision involving a settlement under an antitrust suit, we held that those sums apportioned to penalties were not taxable as income. *Glenshaw Glass Co.*, 18 T. C. 860. In an earlier case, *Highland Farms Corporation*, 42 B. T. A. 1314, a jury awarded the taxpayer damages for slander of title to its property and for interference with its business, and in addition awarded a sum as exemplary damages. We held that the exemplary damages were not taxable income. On p. 1322 we said: "A penalty imposed by law does not meet the test of taxable income set forth in *Eisner* v. *Macomber*, 252 U. S. 189, as 'the gain derived from capital, from labor, or both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets."

See also, *Central R. Co. of New Jersey* v. *Commissioner*, 79 F. 2d 697, where it was held that a penalty imposed by law upon a faithless fiduciary was not taxable income.

Respondent would have us hold that these cited cases are no longer authority to be followed in holding that punitive damages are not taxable income. Respondent has cited a great many cases in support of his contention but has failed to show that punitive damages are taxable as income. 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. We think that *General American Investors Co.*, 19 T. C. 581, is distinguished from our present case. In that case the taxpayer did not receive the money in payment of punitive damages, but pursuant to a statute which provided that certain profits realized by corporate insiders under circumstances there present should "inure to and be recoverable by" the corporation.

We conclude, therefore, that the petitioner shall be sustained as to the $250,000, but the other adjustments in the deficiency notice shall require a Rule 50 computation.

Decision will be entered under Rule 50.

Decision

[Caption omitted]

Pursuant to Opinion of the Tax Court in the above-entitled proceeding promulgated January

9, 1953, respondent filed a computation on March 18, 1953, in which petitioner concurred. Now, therefore, it is

Ordered and decided that there is a deficiency in income tax for the calendar year 1948 in the amount of $523.74.

(Signed) O. P. LeMire,
Judge.

Enter: Entered Mar. 25, 1953.

In the United States Court of Appeals for the Third Circuit

No. 11073

Commissioner of Internal Revenue, petitioner

v.

Glenshaw Glass Company, respondent

(Received and filed August 17, 1953. Ida O. Creskoff, clerk.)

Present: Biggs, *Chief Judge,* and Maris, Kalodner and Hastie, *Circuit Judges*

Order

Upon consideration of the petition of William Goldman Theatres, Inc., for leave to file brief as amicus curiae in the above entitled case, in which it is alleged that the decision in the above entitled case is likely to be determinative of the issue involved in *William Goldman Theatres, Inc.* v. *Commissioner of Internal Revenue,* Tax Court Docket No. 29450, 19 T. C. No. 79, before hearing may be had in the latter case;

It is ordered that the Clerk of this Court list the above entitled case and the case of *William Goldman Theatres, Inc.* v. *Commissioner of Internal Revenue, Petitioner,* for argument on the same day before the Court en banc;

It is further ordered that the petition for leave to file brief as amicus curiae in the above-entitled case be and it hereby is denied.

By the Court:

Biggs,
Chief Judge.

August 17th 1953.

United States Court of Appeals for the Third Circuit

No. 11073

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GLENSHAW GLASS COMPANY, RESPONDENT

No. 11150

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM GOLDMAN THEATRES, INC., RESPONDENT

[211 F. 2d 928]

APPEALS FROM THE TAX COURT OF THE UNITED STATES

Argued December 23, 1953

Before BIGGS, *Chief Judge*, and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

Opinion of the Court

(Filed April 9, 1954)

By BIGGS, *Chief Judge*.

The Commissioner seeks to reverse two decisions of the United States Tax Court in favor of two taxpayers. In Glenshaw a claim for punitive damages based upon a competitor's, Hartford's, fraudulent suits which disastrously affected the taxpayer's business, as well as a claim for treble damages under Section 4 of the Clayton Act, 15 U. S. C. A. § 15, were settled by

the payment of a sum of money. In Goldman a judgment for treble damages was awarded Goldman against Loew's, Inc., also pursuant to Section 4 of the Clayton Act. The sole question presented for our determination is whether moneys paid as punitive or statutory treble damages are taxable as income under Section 22 (a) of the Internal Revenue Code, 26 U. S. C. A. The Tax Court has decided that they are not and the Commissioner of Internal Revenue has petitioned this court for review.[1] Insofar as the issue before us

[1] For the history of the litigation see *Hartford Empire Co. v. Shaeffer Mfg. Co.*, 163 F. 2d 474 (3 Cir. 1947); *Hartford Empire Co. v. Shaeffer Mfg. Co.*, 67 F. Supp. 26 (D. C. W. D. Pa. 1946); *Hartford Empire Co. v. United States*, 323 U. S. 386 (1945); *Hartford Empire Co. v. Shaeffer Mfg. Co.*, 147 F. 2d 532 (3 Cir. 1944); *Shaeffer Mfg. Co. v. Hartford Empire Co.*, 322 U. S. 271 (1944), reversing *Hartford Empire Co. v. Shaeffer Mfg. Co.*, 137 F. 2d 764 (3 Cir. 1943); *Shaeffer Mfg. Co. v. Hartford Empire Co.*, 68 F. 2d 726 (3 Cir. 1934); and *Hartford Empire Co. v. Hocking Valley Glass Co.*, 59 F. 2d 399 (3 Cir. 1932).

See *William Goldman Theatres, Inc. v. Loew's, Inc.*, 164 F. 2d 1021 (3 Cir. 1948).

[2] Section 22 (a) of the Internal Revenue Code, in pertinent part, reads as follows:

"*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. * * *"

[3] The Tax Court opinions are reported at 18 T. C. 1098 (Glenshaw) and 19 T. C. 637 (Goldman). See also *Chase Nester Glass Co.*, 20 T. C. No. 152, and *Dobson, Inc.*, 21 T. C. —, similar cases.

is concerned no valid distinctions can be drawn between a money settlement and money paid in satisfaction of a judgment or between punitive damages levied for fraud and treble damages rendered under the Clayton Act.[5]

The positions of the taxpayers are based in large part upon the definition of "income" set out in *Eisner* v. *Macomber*, 252 U. S. 189, 207 (1920), on the decision of this court in *Central R. Co.* v. *Commissioner*, 79 F. 2d 697 (3 Cir., 1935), the decision of the Board of Tax Appeals in *Highland Farms Corporation* v. *Commissioner of Internal Revenue*, 42 B. T. A. 1314 (1940), and the applicable Treasury Regulations.[6] The taxpayers

[5] The Commissioner and Glenshaw do not now dispute that $324,529.94 was the amount paid in settlement of punitive damages. In the *Goldman* case the amount of actual damage, found to be $125,000, was trebled and a judgment was entered for $375,000. We are concerned solely with the taxability of the sum of $324,529.94 (Glenshaw) and the taxability of $250,000 (Goldman).

[6] The facts of the *Central R. Co.* case are distinguishable from those at bar. In the *Central R. Co.* case the taxpayer received property in settlement of a suit brought by it against an unfaithful officer who violated his fiduciary duty to it and thereby deprived the railroad of revenues. A kind of resulting or constructive trust was imposed upon the fruits of his fraud in favor of the railroad company. Nevertheless this court considered the railroad's gain to be a "windfall," not derived either wholly or in part from the taxpayer's capital or labor and therefore not income at all within the definition of *Eisner* v. *Macomber*.

The decision was followed by the Board of Tax Appeals in *Highland Farms Corporation*, *supra*, where punitive damages were allowed for slander of title to land. The Board of Tax Appeals refused to treat these punitive damages as income, relying also on the test of taxable income set out in *Eisner* v. *Macomber*.

Treasury Regulations 111, in pertinent part provide:

"Sec. 29.22 (a)-1. *What Included in Gross Income.*—

also assert considerations which are based on the general philosophy of income taxation but we will not discuss these specifically in this opinion. But the United States for its part contends that *Eisner* v. *Macomber* does not settle the applicable definition of what constitutes taxable income insofar as the cases at bar are concerned, that the decision of this court in the *Central R. Co.* case is not applicable, but if it is, it was wrongly decided, and that the decision of the Board of Tax Appeals in *Highland Farms* was clearly erroneous. The substance of the government's argument is that all property or money coming into the hands of a taxpayer is income except where specifically exempted by the taxing statute.

In *Eisner* v. *Macomber* the Supreme Court stated: "'Income may be defined as a 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 * * *." In *Eisner* v. *Macomber* the Supreme Court laid emphasis on the ordinary meaning of income in common parlance and said, 252 U. S. at pp. 206–207: "For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment * * *." The second sentence of the

Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See section 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 * * *."

applicable Treasury Regulations adopted the *Eisner* v. *Macomber* definition *in toto*. See note 7 of this opinion. The only qualification of the second sentence of the regulation lies in the phrase "In general" and surely little can be taken from that. Of course, as the United States points out, in *Eisner* v. *Macomber* the Supreme Court was primarily concerned with distinguishing between capital and income, not between sources of property which came into the hands of the taxpayer and we cannot doubt but that the Supreme Court has departed in some degree from the *Eisner* v. *Macomber* definition. This is apparent from *United States* v. *Kirby Lumber Co.*,[8] 284 U. S. 1, 3 (1931) where Mr. Justice Holmes stated: "We see nothing to be gained by the discussion of judicial definitions."

If the property or money paid represents a return of capital or a contribution to capital it is not subject to income taxation. Subsidies paid by a sovereign to aid in the construction and operation of a railroad line were held not to be income in *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628 (1925) and the money and property acquired were treated in effect as an accretion to capital. But compare *Detroit Edison Company* v. *Commissioner*, 319 U. S. 98 (1943) where the Supreme Court has indicated some halt in the doctrine of

[8] The lumber company purchased its own bonds in the open market at less than par and the difference in price was held to be taxable as income. It is clear, however, that compensatory damages for loss of income are taxable as income and that income takes its color from source. See Chapter 10 "Compensatory Payments," *Taxable Income*, Magill, Rev. Ed., 1945, at p. 377 *et seq.*

capital donation expressed in *Edwards* v. *Cuba R. R. Co.*, *supra*. Cf. also *Great Northern Ry. Co.* v. *Commissioner*, 8 B. T. A. 225 (1927), affirmed, 40 F. 2d 372 (8 Cir. 1930). A single gift of money or property probably should not be treated as taxable income even if the specific exemption granted to gifts by statute were unavailable. Periodicity seems to be considered a factor. See *Irwin* v. *Gavit*, 268 U. S. 161, 168 (1925); Magill, *Taxable Income*, *supra*, note 8, at p. 428. The spontaneity of the gift may also serve to relieve the recipient of tax. See *Bogardus* v. *Commissioner*, 302 U. S. 34, 42 (1937); *Washburn* v. *Commissioner*, 5 T. C. 1333 (1945).

The United States lays emphasis on the decision of the Court of Claims in *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941, 943-5 (1952). In this case the issue was whether a recovery under Section 16 (b) of the Securities Exchange Act, 15 U. S. C. A. § 78p (b),[9] constituted income to the recovering corporate taxpayer. The Court of Claims held that the recovery was taxable as income and specifically rejected the reasoning of this court in *Central R. Co.* v. *Commissioner* and the decision of the Board of Tax Appeals in *Highland Farms*. The Court of Claims stated: "The money came in from an outside source, it went into the plaintiff's treasury, it did not replace something which went out of

[9] Sums of money won by way of contest awards are taxable. See *Robertson* v. *United States*, 343 U. S. 711 (1952). But these cases are readily distinguishable from a mere gift since services are rendered. Lottery prizes are also distinguishable. See *Huntington* v. *Commissioner*, 35 B. T. A. 835 (1937).

plaintiff's ownership as a consideration for it." The Court went on to say that it was unwilling to surmise that the definition of "income" of *Eisner* v. *Macomber* was sufficient to read out of the taxing statute the phrase "income derived from any source whatever." In our opinion the theory of recovery under Section 16 (b) of the Securities Exchange Act of 1934 is not a purely punitive one. The statute was designed to prohibit profit being made by an "insider" possessing peculiar knowledge of future profitable operations of his corporation. The making of a profit by the "insider" is the mainspring of the statute, a profit required by law to be passed on to the corporation probably because the corporation is the most convenient receptacle. An "outsider" purchasing stock in the open market, theoretically at least, would be compelled to pay a higher price because an insider was purchasing stock in the market against him. But, under the operation of the statute, all of the stockholders, save only the "insider" whose operations were prohibited by statute, would receive via the corporate entity the profit made by the prohibited transaction.[10]

[10] The nature of Section 16 (b) of the Securities Exchange Act of 1934 is referred to in 66 Harv. L. Rev. at p. 408 as follows:

"We are unaware of any other statute that offers a precise analogy to this subsection. It has within it elements of an ordinary shareholder's derivative suit for damages based upon a breach of fiduciary duty, elements of a statutory action for punitive damages, and elements of an informer's statute. It appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is made liable to the corporation for the profits he realizes. Unlike the 'corporate opportunity' cases, however, the action may be brought even though the insider has not competed with his corporation in the use of the information. The courts have found each of these analogies useful, but none furnishes compelling authority."

We do not agree with the position of the Court of the Claims that Park & Tilford's recovery was purely a "windfall".

In *General American Investors Company, Inc.* v. *Commissioner*, 19 T. C. 581 (1952), affirmed, 211 F. 2d 522 (2d Cir. 1954), the Tax Court followed the Park & Tilford decision of the Court of Claims but distinguished its decision from that in the instant *Glenshaw Glass Company* case and the decisions in *Central R. Co.* and *Highland Farms* employing the definition of taxable income of *Eisner* v. *Macomber*. Judge Murdock in his concurring opinion pointed to the provisions of Section 16 (b) of the Securities Exchange Act of 1934, viz, that "any profit realized" under the circumstances presented by the *General American Investors* case "shall inure to and be recoverable by the issuer", i. e., the corporation. Judge Murdock took the position that the profits were to come to General American Investors within the purview of Section 22 (a) of the Internal Revenue Code "since they were 'profits' either from 'sales or dealings in property * * * growing out of the ownership of * * * or interest in such property' or 'from any source whatsoever'."

The facts of the Park and Tilford and the General American Investors decisions are distinguishable both from those at bar and from *Central R. Co.* v. *Commissioner, supra.*

The United States contends that the "source of gain" should not be controlling in view of the final phrase of Section 22 (a) dealing with gains or profits or income "derived from any source whatever"; that the phrase last quoted expresses congressional intent that the source of income or gain is immaterial—a complete negation of the concept of source in relation to taxable income. The government in substance asserts that any money or property coming into the hands of any person is taxable as income unless specifically exempted. But we have found no case in which the court did not look to source as at least coloring or bearing upon the incidence of taxation.

Punitive damages seem to be *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear that they do not fall within the definition of *Eisner* v. *Macomber* and if we could be certain that the definition of that case was controlling we would have no difficulty with the issue at bar. It is easy to say what punitive damages are not but difficult to say what they really are. They smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo*. An analogy seems to us to lie in those cases where contributions are made by the sovereign in the general public interest to an individual. Cf. *Edwards* v. *Cuba Railroad Company*, *supra*. Where the injuries were gross, the doctrine of punitive damages comes into play. The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer.

The Supreme Court has never expressly departed from the definition of income of *Eisner* v. *Macomber*. In fact it has reiterated it fairly recently. See *Merchants Loan and Trust Company* v. *Smietanka*, 255 U. S. 509, 519 (1921) and *Commissioner* v. *Culbertson*, 337 U. S. 733, 740 (1949). And see *Helvering* v. *Griffiths*, 318 U. S. 371 (1943) in which the Supreme Court expressly declined to overrule *Eisner* v. *Macomber* on the facts there presented. The *Culbertson* decision cites not only Treasury Regulation 101, Article 22 (a)–1 but also 1 Mertens, Law of Federal Income Taxation, 159 *et seq.* See the authorities set out in note 9 cited to § 5.02 of Mertens. We concede that no definition is too helpful, *United States* v. *Kirby Lumber Co.*, *supra*, and that the decisions relating to income tax law contain charts rather than definitions, as Mr. Mertens has aptly stated. But it should be borne in mind that in *Eisner* v. *Macomber*, albeit where severability was the primary issue, the Supreme Court said, 252 U. S. at pp. 206–207, that "only a clear definition of the term 'income' as used in common speech * * *" was required. We do believe that a "windfall"—and

the payments at bar were "windfalls"—would not be regarded as "income" within the terms of common speech. Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor. We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him. This is perhaps an over-simplification but we are of the opinion that the ordinary man using terms of common speech would not regard punitive damages as "income."

We must further concede that the decision of this court in *Central R. Co.* v. *Commissioner* cannot be deemed to be overwhelmingly persuasive for the sources of the moneys in that case can be distinguished from the sources of the moneys sought to be taxed in the instant cases but the decision has been followed frequently and has been applied to the issue of taxation of punitive damages. See *Highland Farms, supra.* There is as yet no decision which has adopted the contentions made by the Government here. The position of the United States would indeed, if adopted, bring symmetry into this aspect of the law of income taxation. See "The Taxability of Punitive Damages," 101 U. of P. L. Rev. 1052 (1953). Cf. *Keasbey and Mattison Co.* v. *Rothensies,* 133 F. 2d 894, 897 (3 Cir. 1943). But we think if such a result is to be achieved after nearly two decades it should be effected by the Supreme Court and not by this tribunal.

The decisions of the Tax Court will be affirmed.

In the United States Court of Appeals
for the Third Circuit

No. 11073

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GLENSHAW GLASS COMPANY, RESPONDENT

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: BIGGS, *Chief Judge,* and MARIS, McLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

Judgment

This cause came on to be heard on the record from the Tax Court of the United States and was argued by counsel.

On consideration whereof, it is now ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF,
Clerk.

APRIL 9, 1954.

Received and filed April 9, 1954. Ida O. Creskoff, Clerk.

United States Court of Appeals for the Third Circuit

No. 11150

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WILLIAM GOLDMAN THEATRES, INC., RESPONDENT

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: BIGGS, *Chief Judge*, and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, *Circuit Judges*

Judgment

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF,
Clerk.

APRIL 9, 1954.

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