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Recommended Citation

Daniel Candee Knickerbocker Jr., *Income Tax Treatment of Damages A Study in the Difficulties of the Income Concept*, 47 Cornell L. Rev. 429 (1962)

Available at: <http://scholarship.law.cornell.edu/clr/vol47/iss3/4>

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THE INCOME TAX TREATMENT OF DAMAGES: A STUDY IN THE DIFFICULTIES OF THE INCOME CONCEPT

Daniel Candee Knickerbocker, Jr.†

One of today's most frequently recurring themes is the need for tax reform. In political circles it is almost as necessary to decry our present system of raising revenue as it is to oppose sin. The result is that many Congressmen have joined in the demand for changes that will, it is said, more equitably distribute the burden of financing government.¹ This is not to say, of course, that the battle for reform is already won, or, indeed, that it will be won in the near future. Having accepted the principle, our lawmakers have yet to discover the specifics that will implement it.

Some of the failure can doubtless be explained on the cynical ground that politicians are always more eager in their championship of the general good than in their attack on special privilege.² Nevertheless, perhaps the greatest obstacle to the cause of reform is the lack of agreement among its advocates, both on their ultimate goals and on the means they will use to achieve them. What is the objective of a sound tax system? What in our present system conflicts with its attainment?³

Suppose we start with a simple premise: We are going to tax every dollar of income and we are going to do this in such a way that from any two taxpayers with the same income exactly the same amount of tax will be collected. If we really mean what we have said, we have already carried the discussion beyond a goodly number of arguments. For example, we have agreed that the amount of tax to be paid will not be affected by the size of the taxpayer's family, his marital status, his age, or the state of his health;⁴ we have agreed too that we will not differentiate among the several sources of income, that we will treat each

† See Contributors' Section, Masthead, p. 442, for biographical data.

¹ See generally Hearings Before the House Committee on Ways and Means on the President's 1961 Tax Recommendations, 87th Cong., 1st Sess. (1961); House Comm. on Ways & Means, 86th Cong., 1st Sess., Tax Revision Compendium (Comm. Print. 1959).

² The politicians are fair game, but they may not be the only ones at fault. We should remember in this connection Saki's observation that "it is one of the consolations of middle-aged reformers that the good they inculcate must live after them if it is to live at all." Saki, *The Byzantine Omelette*, in *Short Stories* 352 (1941).

³ Eisenstein, *The Ideologies of Taxation* 16-33 (1961).

⁴ The reference here, of course, is to such provisions of existing law as that permitting income splitting on the joint returns of spouses (Int. Rev. Code of 1954, § 2), and that providing personal exemptions for the taxpayer and each of his dependents, and for the taxpayer or his wife if either or both of them is over 65 or blind (Id. § 151). Also called in question by this sort of reform would be the retirement income credit (Id. § 37), the "unlimited" deduction for medical expenses incurred in respect of taxpayers or their dependents who have reached 65 (Id. § 213), the child care deduction (Id. § 214), and, perhaps, the alimony deduction (Id. § 215).

dollar of our taxpayer's capital gains, or oil royalties in such a way as to gladden the heart of the tax collector just as much as—and no more than—each dollar of his salary.

Needless to say, unanimity on all these points is impossible, even among the ranks of the arch-reformers.⁵ There seems a deficiency of the quality the Germans call *Aufrichtigkeit*, and we cannot bring ourselves to be completely hard-hearted with *all* taxpayers.

Once we have agreed to tax all income, the thorniest question of all must still be considered. We must determine what is income. The purpose of this paper is to illustrate the difficulties of the income concept by showing its wavering course down a single, very narrow path of the tax law, that of damages for personal injury.

Almost from the beginning it appears to have been settled that at least some awards in, or the proceeds of settlements of, actions for personal injuries are not subject to tax. An unpublished ruling, T. D. 2747, held that an amount received as a result of a suit on, or the compromise of, a personal injury claim was not taxable under the Revenue Acts of 1916 and 1917. In the airy way of the early rulings and decisions, the ground for this opinion appears not to have been stated.⁶

An Attorney General's opinion issued June 27, 1918, held similarly that the proceeds of an accident insurance policy were not subject to tax.⁷

Congress considered the question in connection with the enactment of the Revenue Act of 1918. It decided that it was "doubtful" whether recoveries of the sort here considered were "required to be included in gross income" and therefore provided, in section 213 of the Act, that gross income does not include

(6) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness; . . .⁸

Save for a minor change made necessary by the creation of the medical expense deduction in 1942,⁹ this remained the statutory form until 1954.¹⁰

⁵ Eisenstein, *supra* note 3, at 41-43.

⁶ Cited in S.M. 1384, 1920-2 Cum. Bull. 71.

⁷ *Ibid.*

⁸ Revenue Act of 1918, ch. 18, § 213, 40 Stat. 1066.

⁹ Revenue Act of 1942, ch. 619, § 127, 56 Stat. 825.

¹⁰ Revenue Act of 1921, ch. 136, § 213(b)(6), 42 Stat. 238; Revenue Act of 1924, ch. 234, § 213(b)(6), 43 Stat. 268; Revenue Act of 1926, ch. 27, § 213(b)(6), 44 Stat. 24-25; Revenue Act of 1928, ch. 852, § 22(b)(5), 45 Stat. 798; Revenue Act of 1932, ch. 209, § 22(b)(5), 47 Stat. 179; Revenue Act of 1934, ch. 277, § 22(b)(5), 48 Stat. 687; Revenue Act of 1936, ch. 690, § 22(b)(5), 49 Stat. 1658; Revenue Act of 1938, ch. 289, § 22(b)(5), 52 Stat. 458; Int. Rev. Code of 1939, § 22(b)(5), as amended by Revenue Act of 1942, ch. 619, § 127, 56 Stat. 825 (1942).

The statute and its accompanying committee report led, one must say inescapably, to the conclusion that the only objects of the legislative solicitude were recoveries on account of physical injuries. This conclusion apparently was the view of a brief 1919 ruling that damages paid pursuant to a judgment in a libel action constituted income under the 1918 Act¹¹ and, the next year, of the Solicitor of Internal Revenue in a somewhat elaborate opinion that a recovery in an action for alienation of affections was not within the law's exclusion.¹² Citing the earlier Treasury Decision and Attorney General's opinion, as well as the Supreme Court's decision in *Doyle v. Mitchell Bros.*,¹³ the ruling asserts that these opinions "rest[ed] . . . upon the theory of conversion of capital assets" and, since, "from no ordinary conception of the term can a wife's affections be regarded as constituting capital," the recovery in question was not "within the exemption."¹⁴

It will be noted that Congress in legislating did not think it necessary to characterize the amounts considered as income or nonincome, either in a philosophic or constitutional sense. The Solicitor appears to have regarded section 213(b)(6) as an exemption—that is, as a freeing from tax of something which would otherwise quite properly be taxed.

In that same year, the Supreme Court handed down its decision in *Eisner v. Macomber*.¹⁵ There, it will be recalled, the Court reiterated Mr. Justice Pitney's definition of "income" as "the gain derived from capital, from labor, or from both combined."¹⁶ It was on the renewed strength of this formulation that the Service decided in 1922

that there is no gain, and therefore no income, derived from the receipt of damages for alienation of affections or defamation of personal character. In either case the right invaded is a personal right and is in no way transferable The rights on the one hand and the money on the other are incomparable things which can not be placed on opposite sides of an equation. If an individual is possessed of a personal right that is not assignable and not susceptible of any appraisal in relation to market values, and therefore receives either damages or payment in compromise for an invasion of that right, it can not be held that he thereby derives any gain or profit This also applies to money received in consideration of the surrender of the custody of a minor child. Holding otherwise would be equivalent to treating as chattels the wife whose affections were alienated and the child whose custody was surrendered.¹⁷

Although this ruling was headed by a cross-reference to section 213

¹¹ S.M. 957, 1919—1 Cum. Bull. 65.

¹² S.M. 1384, 1920—2 Cum. Bull. 71.

¹³ 247 U.S. 179 (1918).

¹⁴ 1920—2 Cum. Bull. at 72.

¹⁵ 252 U.S. 189 (1920).

¹⁶ *Stratton's Independence Ltd. v. Howbert*, 231 U.S. 399, 415 (1913). The question arose under the Corporation Tax Act of 1909, 36 Stat. 112 (1909).

¹⁷ Solic. Op. 132, I—1 Cum. Bull. 92, 93-94 (1922).

of the 1918 Act and purported to modify the 1919 ruling and revoke that of 1920, it did not in terms look to the statute for its authority. This is true also of a 1923 ruling that the proceeds of settlement of an action for annulment of a marriage on grounds of fraud and deceit were not taxable.¹⁸

We can probably assume that the statutory exclusion, the form of which, as above noted, remained unchanged through repeated reenactments right up to 1954, was regarded by the Service as restricted to recoveries for physical injuries. During part of the period the Treasury Regulations stated the rule as part of their discussion of life insurance proceeds, saying:

The amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate, and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead.¹⁹

Regulations subsequently issued do not even contain this brief discussion; evidently, the law was thought clear enough to require no explanation.²⁰

The converse appears equally true. With the exception of two rulings dealing with payments received under state wrongful death acts,²¹ and those hereinafter mentioned with respect to payments to the victims of Nazi persecution,²² there appears to have been no holding by the Service that a recovery based on physical injuries was excludible except on statutory grounds. And these rulings, which take the position not that the amounts involved are excluded from income, but rather that they are "not embraced in the general concept of the term 'income,'"²³ can probably be explained on the theory that the recovery in each case was designed to compensate for far more than physical harm. Moreover, there have been several holdings that payments on account of physical injuries which did not conform to the statutory description could not be excluded. Included here, for example, are payments by an employer to his employees on account of nonwork-connected disabilities and sickness

¹⁸ I.T. 1852, II—2 Cum. Bull. 66 (1923).

¹⁹ Treas. Reg. 77, Art. 82 (1933).

²⁰ Treas. Reg. 118 (1953), Treas. Reg. 111 (1943), Treas. Reg. 94 (1936) and Treas. Reg. 86 (1935) contain no administrative interpretation of § 22(b)(5) of the several tax laws they explain.

²¹ Rev. Rul. 54-19, 1954—1 Cum. Bull. 179; I.T. 2420, VII—2 Cum. Bull. 123 (1928).

²² Rev. Rul. 56-518, 1956—2 Cum. Bull. 25, clarified, Rev. Rul. 57-505, 1957—2 Cum. Bull. 50, amplified, Rev. Rul. 58-500, 1958—2 Cum. Bull. 21. Cf. Julian C. Stanford, 34 T.C. 1150 (1960).

²³ See, e.g., VII—2 Cum. Bull. at 124 (1928).

for which the employer had no liability, either in law or by contract.²⁴

So too in the courts. The question of taxing the proceeds of settlement in a libel action first arose in *C. A. Hawkins*.²⁵ Admitting that the *Eisner v. Macomber* definition might not be the final word on the subject, the Board of Tax Appeals nevertheless held that what Mr. Hawkins had received was not income:

So far as the evidence shows, the amount . . . received was wholly by way of general damages for the personal injury suffered It was compensation for injury to his personal reputation for integrity and fair dealing. . . . This is the ordinary basis for compensatory damages. . . . Here there is only the compensation which the law sanctions as the only remedy which has thus far been devised for an injury which in its nature is wholly personal and nonpecuniary. Even to the economist, character or reputation or other strictly personal attributes are not capital or otherwise measurable in terms of wealth, notwithstanding that all will recognize them as important factors in economic success. They are not property or goods. Such compensation as general damages adds nothing to the individual, for the very concept which sanctions it prohibits that it shall include a profit. It is an attempt to make the plaintiff whole as before the injury.²⁶

The Board chose to rely on this holding when, a year later, it was called upon to consider the income tax status of damages awarded in a breach of promise action and, for the same reason as that given in *Hawkins*, held that the taxpayer-plaintiff had realized no income.²⁷ There are two questionable aspects of this decision. In the first place, the damages in the lady's case had not been limited to "wholly personal and nonpecuniary" injuries. The judge in her breach of promise suit had charged the jury to consider as elements of damages, among other things, the "loss of benefits which the injured party might have derived from the union including loss of station to which the marriage would have advanced plaintiff, and loss of a permanent home and worldly advantages."²⁸ The other peculiarity, as has been pointed out elsewhere, is that the case extends the doctrine into the field of contract actions—although this may be explained by the tortious nature of the breach complained of.

Solicitor's Opinion 132 expressly distinguished between damages for ordinary defamation of character and those for business libel. It reserved decision as to the income tax status of the latter. *Hawkins* too may be read as confining itself to recoveries on account of noncommercial injuries, even though the receipts there in issue had been paid in settle-

²⁴ G.C.M. 23511, 1943 Cum. Bull. 86. Compare *H. N. Henry*, 47 B.T.A. 149 (1942).

²⁵ 6 B.T.A. 1023 (1927), acq., VII—1 Cum. Bull. 14 (1928).

²⁶ *Id.* at 1024-25.

²⁷ *Mrs. Lyde McDonald*, 9 B.T.A. 1340, acq., VII—2 Cum. Bull. 26 (1928).

²⁸ The Board of Tax Appeals quoted the portion of the charge relating to damages in its entirety. 9 B.T.A. at 1340-41.

ment of an action that began as a business controversy. Nevertheless, it was not long before the courts considered recoveries in actions based on injuries to business reputation and held them not taxable. In *Farmers and Merchants Bank v. Commissioner*,²⁹ about \$20,000 had been paid by one of the Federal Reserve Banks to settle an action brought by a non-member bank alleging harms to its goodwill because of the Federal Reserve Bank's efforts to stop the nonmember's practice of charging for cashing checks on other banks. This payment was held not to have constituted income but rather a return of capital.

Hawkins also stands for the proposition that only compensatory damages do not represent income. In *Highland Farms Corp.*,³⁰ an action founded on the attempt by a bank president to destroy the credit of a mortgagor, part of the recovery consisted of punitive damages because of the deliberate nature of the act, and these were held not includible in the taxpayer's income.

Finally, in *Central R.R. of N.J. v. Commissioner*,³¹ it was held that the value of property received from a corporate officer in settlement of an action based on his breach of fiduciary duty did not represent income. There the argument had been made and accepted that the recovery could not be income because "what was received by the taxpayer was in the nature of a windfall. It was something which Joyce for public reasons was not permitted to keep and to which the petitioner, not on its own account but in the public interest, became entitled."³²

A case which plagued the Service for a long time was that of *Edward H. Clark*.³³ A tax advisor had made an error in the preparation of a tax return by reason of which the taxpayer overpaid his taxes. The overpayment could not be recovered and the advisor himself therefore undertook to make the loss good. The Commissioner took the position that the taxpayer's receipt of the money involved was income and subject to tax. The Board of Tax Appeals held it was not. Clearly, this determination was not more difficult to reach than any of those that had preceded it. Perhaps, in economic terms, it was less difficult. Before receiving the payment, the taxpayer was out of pocket a number of dollars which he had had to pay only by reason of the advisor's error and the payment did no more than restore him to the position he should have been in anyhow. What disturbed the Service and, for seventeen years, prevented its acquiescence in the *Clark* case was the nature of the loss that had been

²⁹ 59 F.2d 912 (6th Cir. 1932).

³⁰ 42 B.T.A. 1314 (1940).

³¹ 79 F.2d 697 (3d Cir. 1935).

³² *Id.* at 699.

³³ 40 B.T.A. 333 (1939), nonacq. withdrawn and acq., 1957—1 Cum. Bull. 4.

restored. One of the postulates tax men live by is that if one person pays the taxes owed by another, the latter has realized income. Moreover, what Mr. Clark paid and then had reimbursed were taxes he actually owed. The error consisted in the inadvertent making of an irrevocable election; within the limits of such election the tax liability was correctly computed. In fact, therefore, as well as in form Mr. Clark had had his taxes paid for him.

To add to our confusion, the Service, at the same time it withdrew its nonacquiescence and announced its acquiescence in *Clark*, published a ruling that considered a closely analogous, but not identical, situation.³⁴ Here, too, a taxpayer had been reimbursed by his tax advisor for the amount of an overpayment made by reason of the advisor's error. But this overpayment was beyond recovery only because of the failure to discover it before the statute of limitations had run. This case is a very different matter, for limitations do not destroy rights; they merely bar remedies. By hypothesis, then, the taxpayer of Revenue Ruling 57-47 did not have his taxes paid for him. Rather such taxes had served only as a measure for determining his damages.

Some of these happy taxpayer victories have not withstood the test of time, and even those decisions and rulings that may still be cited with some confidence must be regarded as confined strictly to their facts. At a relatively early date the courts began tracing receipts to their sources in the original litigation in order to ascertain their true nature for income tax purposes. Thus, it became recognized that if the ground for not taxing a recovery were its character as a return of capital, it could escape tax only to the extent that the taxpayer had—and could prove—his basis for the property alleged to have been lost.³⁵ In *Theodate Pope Riddle*,³⁶ the Board of Tax Appeals analyzed the compensation paid for the taxpayer's sufferings and loss of property in the sinking of the *Lusitania* and held that the interest element thereof was fully taxable income. Revenue Ruling 57-47,³⁷ in addition to its consideration of the tax advisor's reimbursement of his client's tax overpayment, examined two other payments made by him, namely, interest on the amount reimbursed, and a refund of the fee paid by the client for preparing the return on which the error had been made. Both of these items were held taxable, the latter because the client had claimed a deduction therefor and had thus realized a tax benefit. When a tenant pays his landlord a lump sum as

³⁴ Rev. Rul. 57-47, 1957—1 Cum. Bull. 23.

³⁵ *Raytheon Prod. Corp. v. Commissioner*, 144 F.2d 110 (1st Cir.), cert. denied, 323 U.S. 779 (1944); *Telefilm, Inc.*, 21 T.C. 688 (1954), nonacq., 1954—2 Cum. Bull. 6, rev'd on other grounds, 55—1 U.S. Tax Cas. ¶ 9453 (9th Cir. 1955).

³⁶ 27 B.T.A. 1339 (1933).

³⁷ 1957—1 Cum. Bull. 23.

consideration for the cancellation of his lease, the landlord must for tax purposes treat the amount paid him just as if it were the rent he would otherwise have collected.³⁸ Also, where, as in *Phoenix Coal Co. v. Commissioner*,³⁹ the damages claimed in an action alleging a conspiracy to destroy the taxpayer's business represent profits lost by reason of the conspiracy, such damages are treated when received as if they were the profits and fully taxed.

The question of taxing damages for business libel which was reserved in Solicitor's Opinion 132 and later decided in the taxpayer's favor in the *Farmers and Merchants Bank* case, was reconsidered in *Nathan Agar*.⁴⁰ This time, the amount in dispute was held to be income because

the closest this record comes to establishing injury to petitioner's personal reputation is a claim that, on more than one occasion, William Doniger called him an obscene name; a name whose use under some circumstances might have no opprobrious connotations at all. Actually, the abuses of which petitioner complains took the form, if anything, of attacks upon his *business judgment*. Thus, the damages . . . would not fall within the exemption from tax afforded payments for injuries to *personal reputation*. Rather, they would more properly be characterized as payments made in satisfaction of injuries to petitioner's *business reputation* as compensation for past or future income which may have been or might be lost, and thus, being compensatory by nature, would be taxable as ordinary income.⁴¹

The analysis is not complete, of course. One of the necessary measures of damages in any action founded on physical injuries is the earning capacity of the plaintiff, that is, the lost wages for which his damages are a substitute. Nevertheless, there has been no suggestion that recoveries of this sort should be partly taxed. The first of last year's Revenue Rulings held that the entire proceeds of settlement of a railroad employee's claim for personal injuries were excludible from income even though the employee had elected to apportion part of such proceeds to "time lost" in order to obtain credit therefor as compensation under the Railroad Retirement Tax Act.⁴² We may, however, be able to explain these aberrations on grounds of the statute.

One rather curious limitation has been imposed by the courts on the tax-free status of damages and settlement amounts received in lieu

³⁸ *Hort v. Commissioner*, 313 U.S. 28 (1941).

³⁹ 231 F.2d 420 (2d Cir. 1956), affirming 14 CCH Tax Ct. Mem. 96 (1955).

⁴⁰ 19 CCH Tax Ct. Mem. 116 (1960), aff'd, 290 F.2d 283 (2d Cir. 1961).

⁴¹ 19 CCH Tax Ct. Mem. at 119 (emphasis as in original). In an earlier decision, the Tax Court had held that legal fees were deductible as business expense where paid for representation in an action based on injury to business reputation. *Paul Draper*, 26 T.C. 201 (1956). There is more than one hint in the cases here considered that one reason for excluding these recoveries from income is the fact that neither the loss complained of nor the expenses of recovering it are deductible. If no tax benefit can arise from the loss, the compensation therefor should not be taxable. Cf. Int. Rev. Code of 1954, § 111 and Treas. Reg. § 1.111-1(a) (1956).

⁴² Rev. Rul. 61-1, 1961-1 Cum. Bull. 14.

thereof. In one is paid an amount to obtain his prior consent to an act which might constitute an actionable injury, what he receives is income and taxable. This issue has been directly considered by only four cases,⁴³ the oldest of which illustrates and most clearly indicates the rationale of all. The widow of Paul Ehrlich, discoverer of Salvarsan, was taxed on some \$40,000 paid by Warner Brothers on account of an agreement permitting the making of a motion picture based on his life. Pursuant to such agreement Mrs. Ehrlich committed herself not to institute any action against Warner connected with "the exercise of any of the rights granted to Warner, and/or on the ground that Warner has published anything libellous, slanderous or defamatory or of concerning the undersigned, or has used her name, photograph, portrait, picture, physical likeness, representation or impersonation in any improper or unauthorized manner."⁴⁴ The court's ground for decision appears in these words of Judge Fee:

The evidence does not show that Warner has . . . used the name, photograph, portrait, picture, physical likeness, representation or impersonation of plaintiff or any of her daughters in an "improper or unauthorized" manner. The covenant not to sue was under the evidence valueless. This disposes of the argument that this was damages paid in advance for the violation of the personal right of privacy, because it is not shown that such a right was violated. The rule, that damages recovered because of personal injuries and illness are exempt, is irrelevant, therefore. . . . [T]here is no analogy between the situations, because here no wrong has been done. It is true that . . . no judgment need be rendered by a court to make the payments exempt, but no case says that the wrong must not have been committed.⁴⁵

The illogic of this view becomes apparent when we consider the nature of the type of injury to which the court gave its attention. The right to enjoin or recover damages for a breach of privacy is, at least in New York, strictly statutory. It arises whenever a "name, portrait or picture" is used within the state "for advertising purposes or purposes of trade" without prior written consent.⁴⁶ It would seem beyond dispute, therefore, that Mrs. Ehrlich was certain of her injury the minute the proposed motion picture was completed and entered the channels of distribution. Surely we should not so exalt form over substance as to require a taxpayer to wait for certain injury in order to escape tax on his damages, any more than we insist that he go through the motions of actually filing a lawsuit after the injury. A number of rulings have made it clear that the

⁴³ *Maurie Starrels*, 35 T.C. 646 (1961); *Helen D. Miller*, 35 T.C. 631 (1961), *aff'd*, 9 A.F.T.R.2d 628 (2d Cir. 1962); *Meyer v. United States*, 173 F. Supp. 920 (E.D. Tenn. 1959); *Ehrlich v. Higgins*, 52 F. Supp. 805 (S.D.N.Y. 1943).

⁴⁴ *Ehrlich v. Higgins*, *supra* note 43, at 807. A popular account of Ehrlich's career may be found in *DeKruif, Microbe Hunters* 334 (1930).

⁴⁵ 52 F. Supp. at 808.

⁴⁶ N.Y. Civ. Rights Law § 51.

institution of legal action is not a condition precedent to the nontaxability of settlement proceeds.⁴⁷ Nor is it relevant, obviously, that in an action based on breach of her right of privacy Mrs. Ehrlich might have been hard put to show damages equivalent to the amount actually paid her. Neither the statutory exclusion of damages nor any of the holdings herein cited requires a showing that a settlement amount did not exceed the damages a court might have awarded.

It has also been pointed out that in the physical injury cases most clearly within the statutory exclusion it is customary to consider, as one of the measures of damages, the future, as well as the past, pain and suffering of the plaintiff and to include something on account thereof in his award.⁴⁸ Is there any difference between these damages and those paid before the event to Mrs. Ehrlich?

The Tax Court held stubbornly to its view of punitive damages as not constituting income until the bitter end.⁴⁹ Other courts were not as generous.⁵⁰ Finally, with its decision in 1955 in the *Glenshaw Glass* case,⁵¹ the Supreme Court settled the matter once and for all, saying with respect to the treble damages awarded in a civil antitrust suit:

Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion. The mere fact that the payments were extracted from the wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to the recipients.⁵²

So too with windfalls. The most frequently seen receipts of this sort in recent times have been the profits in short-swing transactions which officers, directors, and certain stockholders have been required to turn over to their corporations in accordance with section 16(b) of the Securities Exchange Act.⁵³ In this instance the Tax Court accepted the view already expressed in the Court of Claims⁵⁴ that they were income, and the Second Circuit and Supreme Court thereafter affirmed in *General American Investors Co.*⁵⁵

Glenshaw and *General American Investors* resolved their immediate questions, but they did not carry us any farther in our quest for a definition of income. As a matter of fact, they may actually have caused us to lose ground in this area of damages. Following a rather ambiguous footnote to the *Glenshaw* opinion which appeared to approve and dis-

⁴⁷ See, e.g., Rev. Rul. 61—1, 1961—1 Cum. Bull. 14; Rev. Rul. 58—578, 1958—2 Cum. Bull. 38; Rev. Rul. 103, 1953—1 Cum. Bull. 20.

⁴⁸ 32 Rocky Mt. L. Rev. 425 (1960).

⁴⁹ *Glenshaw Glass Co.*, 18 T.C. 860 (1952).

⁵⁰ *Commissioner v. Obear-Nester Glass Co.*, 217 F.2d 56 (7th Cir. 1954).

⁵¹ 348 U.S. 426 (1955).

⁵² *Id.* at 431.

⁵³ 48 Stat. 896 (1934), 15 U.S.C. § 78(p) (1958).

⁵⁴ *Park & Tilford Distillers Corp.*, 107 F. Supp. 941 (Ct. Cl. 1952).

⁵⁵ 19 T.C. 581 (1952), *aff'd*, 211 F.2d 522 (2d Cir. 1954), *aff'd*, 348 U.S. 434 (1955).

tinguish the holdings that compensatory damages for personal injury are not income,⁵⁶ recent rulings in this field rely on extremely dubious grounds. Thus, compensation paid to former prisoners of war for the violation by an enemy government of the Geneva Convention of 1929,⁵⁷ or by the West German Government to the victims of Nazi persecution on account of "damage to life, body, health, liberty or professional or economic advancement,"⁵⁸ has been held nontaxable because the payments "are in the nature of reimbursement for the deprivation of civil or personal rights." In Revenue Ruling 60-279,⁵⁹ the question was whether relocation payments to persons displaced by urban renewal were includible in gross income. It was held that they were not if the monies received were actually used for the purposes for which they were provided, namely, for "any actual direct losses of property resulting from [the recipients'] displacement from their personal residences by an urban renewal project."⁶⁰ This very limited exclusion is explained by the theory that the individuals are merely being reimbursed for expenses incurred in their discharge of a government function. However, it is only a government function to the extent of the reimbursement, for "any expenses incurred . . . for the relocation . . . in excess of the amounts provided therefor are nondeductible personal expenses."⁶¹

There is also an indication that the Internal Revenue Service now regards all of these exclusions as statutory. In its rearrangement of existing law in 1954, Congress chose to separate the provisions relating to the exclusion of workmen's compensation payments, accident and health insurance proceeds, and damages for personal injury recoveries.⁶² The Regulations evidently take this to mean that the injuries referred to in the last instance may be more than the purely physical, and define "damages" in this context as "an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution."⁶³

If, as is here suggested, the Regulations evince a change in the Service's approach to the problem of damages, the burden on tax lawyers in this particular area may be somewhat eased. As long as we were working with a variety of grounds for keeping these receipts free of tax, we

⁵⁶ 348 U.S. 426, 432 n.8 (1955).

⁵⁷ Rev. Rul. 56-462, 1956-2 Cum. Bull. 20; Rev. Rul. 55-132, 1955-1 Cum. Bull. 213.

⁵⁸ Rev. Rul. 56-518, 1956-2 Cum. Bull. 25, clarified, Rev. Rul. 57-505, 1957-2 Cum. Bull. 50, amplified, Rev. Rul. 58-500, 1958-2 Cum. Bull. 21. See also Rev. Rul. 58-370, 1958-2 Cum. Bull. 14, relating to similar payments made by the Austrian government.

⁵⁹ 1960-2 Cum. Bull. 11.

⁶⁰ *Id.* at 12.

⁶¹ *Ibid.*

⁶² Int. Rev. Code of 1954, § 104(a).

⁶³ Treas. Reg. § 1.104-1(c) (1956). Punitive damages are expressly included in gross income in Treas. Reg. § 1.61-14(a) (1957).

could not be at all sure that a change in the law or in judicial thinking might not result in our client's recovery being taxed. To illustrate this, consider the tax benefit basis for nonincome treatment already adverted to.⁶⁴ If the reason for not taxing damages is that they represent recoupment of a nondeductible loss, have you not cut the ground out from under the exemption if you allow the deduction? This was certainly the view of Congress when, on creating the medical expense deduction, it reduced the amount excludible from income on account of compensation for sickness and personal injuries.⁶⁵ The Tax Court's decision in *Nathan Agar*⁶⁶ suggests also that it will not save the exemption to show that what has been allowed as a deduction is necessarily a much smaller amount.

Other changes in the law raise equally difficult questions. When alimony was made taxable to its recipients, did this impart a different flavor to the proceeds of what our journalists used to call "heart-balm suits"?

The picture that emerges from this survey is a cluttered one and permits of neither generalizations nor conclusions. Our inquiry into the nature of income has not been much advanced. This, one suspects, will be the result no matter where we look in the tax law. We can readily ascertain what receipts are taxable under present law, or at least, what receipts have so far been taxed; we may safely assume that what is taxed is income.⁶⁷ We can even, perhaps, go a step farther and predict with some assurance what will next be taxed. But when we look beyond this point, when we examine the receipts that have not been taxed and seem unlikely to be, the outline blurs and we are no longer certain. Which of these receipts are not income and which are merely (and strictly as a matter of legislative or administrative grace) ignored for income tax purposes? If we find the dividing line between income and nonincome items, must we still determine with respect to the latter which are not income in the constitutional sense and which are not only in a legislative one?⁶⁸

These questions are unanswerable except in procrustean terms. And this discouraging view suggests that, however equitable the forthcoming reformed tax system may prove, its logic will be less than perfect.

⁶⁴ See note 41 supra.

⁶⁵ S. Rep. No. 1631, 77th Cong., 2d Sess. 96 (1942).

⁶⁶ 19 CCH Tax Ct. Mem. 116 (1960).

⁶⁷ Note, 40 Cornell L.Q. 345 (1955), is probably as accurate in its summary of the rules today as it was when written. The question, however, is not what the rules are, but rather, whether they have any logical—and therefore predictable—basis.

⁶⁸ Note, 69 Harv. L. Rev. 119, 196-97 n.470 (1955), refers to the Supreme Court's "frequent and unfortunate repetition of the idea that Congress in enacting § 22(a) [of the 1939 Code] intended to reach all income taxable under the sixteenth amendment" which has "led to its inclusion in the legislative history of the 1954 Code," and adds that there may be no such thing as income in the constitutional sense. Delightful as these suggestions are, it is very much feared that we cannot yet stop asking ourselves, on the one hand, what Congress has no power to tax, and, on the other, what Congress has chosen not to tax.