Roemer v. Commissioner

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COMMENT

ROEMER V. COMMISSIONER

TAXATION—The Ninth Circuit Court of Appeals reversed a lower Tax Court's decision to differentiate between defamation to an individual's personal and professional reputations for purposes of section 104(a)(2) by determining the nature of the tort of defamation as based on state law; the entire award including both compensatory and punitive damages is non-taxable in a defamation suit; the appropriate distinction for section 104(a)(2) is between personal and nonpersonal injuries. 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983).

"But he that filches from me my good name Robs me of that which not enriches him, And makes me poor indeed."

W. Shakespeare, Othello

Since the inception of the federal tax system in the United States, the Internal Revenue Service ("IRS") has adopted the underlying proposition that all income is includable in gross income as defined in the Internal Revenue Code ("IRC"). Congress, however,

1. W. SHAKESPEARE, OTHELLO, Act III, Scene III.
2. [T]he term "gross income" — 
   (a) 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 . . . ; 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. . . .

Revenue Act of 1918, ch. 18, § 213(a), 40 Stat. 1057, 1065 (1919). This section was redesignated in 1928 as § 22(a), Rev. Act of 1928, ch. 852, § 22(a), 45 Stat. 791, 797; it contained substantially the same language as § 213(a). In 1939, § 22(a) was codified as part of the Internal Revenue Code. I.R.C., ch. 2, § 22(a), 53 Stat. 1, 9 (1939). Over the years this language has been simplified. The current definition is: "Except as otherwise provided . . ., gross income means all income from whatever source derived . . . ." I.R.C. § 61(a) (1976). This section corresponds to § 22(a) of the 1939 Code and, despite the simplified language, the prior section's all-inclusive nature of statutory gross income is unaffected. Section 61(a) is in fact as broad in scope as its predecessor. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 432 & n.11 (1955) (citing H.R. REP. No. 1337, 83d Cong., 2d Sess.
has enacted specific exceptions to this rule.\textsuperscript{3} For example, IRC section 104(a)(2) excludes from gross income “the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness.”\textsuperscript{4} The language in this Code section is quite broad\textsuperscript{5} and the courts have interpreted the phrase “personal injuries” to include both physical and nonphysical injuries.\textsuperscript{6} As a result, damages for wrongful death,\textsuperscript{7} breach of a promise of marriage,\textsuperscript{8} invasion of privacy,\textsuperscript{9} alienation of affection,\textsuperscript{10} and surrender of custody


\textsuperscript{4} I.R.C. § 104(a)(2).


6. In fact one ground for reversal in Roemer was the lower court’s misplaced reliance upon a distinction between physical and nonphysical injuries in construing § 104(a)(2). 716 F.2d 693, 696-97 (9th Cir. 1983). See Seay v. Commissioner, 58 T.C. 32, 40 (1972), acq. 1972-2 C.B. 3.

The Treasury Regulation construing § 104(a)(2) also fails to make a distinction between physical and nonphysical injuries. It states, in pertinent part: “The term ‘damages received (whether by suit or agreement)’ means an amount received . . . through prosecution of a legal suit or action based upon tort or tort type rights . . . .” Treas. Reg. § 1.104(c) (1956) (emphasis added).


rights\(^1\) have all been held to be excludable from gross income.

Although damages for the defamation of an individual's reputation have also been held to be excludable from gross income,\(^2\) the courts have established a dichotomy in their treatment of damage awards for defamation to an individual's personal reputation and to his professional reputation.\(^3\) A personal reputation can be defined as the name or general estimation attributed to an individual in the community in which he lives.\(^4\) In contrast, a professional reputation—grounded on one's personal reputation—\(^5\) not only includes an individual's personal traits but also encompasses his competence and ability in the profession in which he practices.\(^6\) Although a damage award for the defamation of an individual's personal reputation has been held to be non-taxable,\(^7\) the taxability of a damage award for an individual's professional reputation continues to remain unsettled—despite a recent Ninth Circuit ruling.\(^8\)

In *Roemer v. Commissioner*,\(^9\) the Tax Court held that the entire award received for the defamation of an individual's professional reputation was outside the scope of section 104(a)(2) and was there-

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11. According to Rev. Rul. 77, 1974-1 C.B. 33, the surrender of custody rights is non-taxable. However, in Ehrlich v. Higgins, 52 F. Supp. 805, 808 (S.D.N.Y. 1943), the court indicated that this represented a payment for relinquishment of a legal right which was distinguishable from damages received for an injury, and was therefore taxable.


16. 716 F.2d 693, 700 (9th Cir. 1983). In differentiating between an individual's reputation and character the Ninth Circuit concluded that while an individual can maintain both professional and personal relationships, in a defamation suit "all of the harm that is done flows from the same personal attack on the defamed individual." *Id.*


For purposes of this comment, the term non-taxable will mean that the amount received is not includable in gross income.

18. Roemer v. Commissioner, 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983); Wolfson v. Commissioner, 651 F.2d 1228 (6th Cir. 1981) (injury to medical student's reputation is taxable), aff'g 47 T.C.M. (P-H) 1852 (1978) (where the court left open the question as to the appropriate tax status of an award for defamation to an individual's professional reputation).

19. 79 T.C. 398 (1982), rev'd, 716 F.2d 693 (9th Cir. 1983).
fore taxable. The court failed, however, to explain adequately how an individual’s professional reputation is sufficiently distinguishable from his personal reputation so as to be afforded different tax treatment.\textsuperscript{20} The Court of Appeals for the Ninth Circuit reversed the Tax Court because it “concluded that the tax court’s analysis [with regard to personal and professional reputations] confuses a personal injury with its consequences and illogically distinguishes physical from nonphysical personal injuries.”\textsuperscript{21} The court noted that “[t]he relevant distinction [in section 104(a)(2)] is between personal and nonpersonal injuries, not between physical and nonphysical injuries.”\textsuperscript{22} While focusing on the nature of a defamation tort, the court determined that under California state law, defamation of an individual is a personal injury and therefore, the award should be excludable from gross income under section 104(a)(2).\textsuperscript{23}

The legal analysis in this opinion, although reaching the correct result, did not directly address the consequences of a defamation suit involving an individual’s business reputation outside the confines of the State of California.\textsuperscript{24} Moreover, the circuit court neither incorporated an analysis of the relevant Tax Court decisions in its opinion nor corrected the lower court’s misinterpretation of prior federal tax decisions involving defamation suits. Thus, the purpose of this comment is to set forth a supplemental analysis to the circuit court’s decision, in order to provide future courts with the basis for understanding and correlating section 104(a)(2) with the applicable tax court case law. In so doing, it is hoped that the Ninth Circuit’s decision will not be limited in its future application merely to a case involving the interpretation of state law, but rather that the ensuing analysis may illustrate the underlying policies as well as the Congressional intent which necessitate the nontaxable status of such awards, regardless of what particular state jurisdiction the case arises in.

This comment is divided into three parts: (1) A general discussion of the facts as well as the majority and two dissenting Tax

\begin{footnotes}
\item[20] The court merely stated that “a distinction must be made.” \textit{Id.} at 405.
\item[21] 716 F.2d at 697.
\item[22] \textit{Id.}
\item[23] \textit{Id.} at 700. Since the punitive damages were awarded for the same personal injuries as the compensatory damages, the punitive damages were also excludable. \textit{Id.}
\item[24] Under this court’s approach, it appears that a court in a different jurisdiction will also have to determine the nature of its defamation law. Perhaps the court could have avoided this by deciding the case using federal tax decisions. See \textit{infra} notes 155-63 and accompanying text.
\end{footnotes}
Court opinions in *Roemer*, (2) an in-depth analysis of two possible policies underlying section 104(a)(2) and its treatment of nonphysical injury awards, followed by a separate discussion of defamation awards; and (3) a detailed examination of how the Tax Court in *Roemer* misinterpreted prior case law. This comment concludes that a social sympathy Suffered-Enough Concept is the rationale for the underlying policy of section 104(a)(2). Furthermore, as a result of courts' treatment of awards under section 104(a)(2), there is no reason, for tax purposes, to differentiate between an award for defamation to an individual's personal reputation and professional reputation. Finally, this comment concludes that since damages in *Roemer* were awarded due to a personal injury, the Tax Court reached an incorrect decision and was properly reversed on appeal.

I. THE ROEMER DECISION

A. The Facts

In 1965, Paul F. Roemer, Jr., an established insurance broker, commenced a lawsuit against Retail Credit Company ("Retail") for submitting defamatory reports to Roemer's prospective employer. One report, the falsity of which was admitted by Retail, stated in part that the "petitioner was ignorant in insurance matters, neglected his clients' affairs, [and] was recently fired from his position as president of an insurance firm. . . ." This report also emphasized that "[f]ormal employment associates indicate[d] there [was] good reason to question this individual's honesty. . . ." As a result of these reports, Roemer was denied additional insurance agency li-

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25. "[T]he taxation of recoveries carved from pain and suffering is offensive, and the victim is more to be pitied rather than taxed." Harnett, *Torts and Taxes*, 27 N.Y.U. L. Rev. 614, 627 (1952). This is a policy concern. Thus, it appears that a "great social feeling engulfs the tax logic." *Id.*


27. The following represents the procedural history of the *Roemer* defamation suit: In *Roemer v. Retail Credit Co.*, 3 Cal. App. 3d 368, 83 Cal. Rptr. 540 (1970), the appellate court reversed a lower court decision for the plaintiff because of an erroneous jury instruction. *Id.* Five years later, in the case of *Roemer v. Retail Credit Co.*, 44 Cal. App. 3d 926, 119 Cal. Rptr. 82 (1975), after retrial, the appellate court affirmed a lower court's award of $290,000. The tax status of this award was litigated in 1982, *Roemer v. Commissioner*, 79 T.C. 398 (1982), and on September 22, 1983 the Ninth Circuit reversed. 716 F.2d 693 (9th Cir. 1983).

28. 79 T.C. at 400.


30. 79 T.C. at 400.

censes. Moreover, Roemer's general reputation also suffered in the community in which he worked and resided because “most of his clients were also his friends.”

In 1975, after prolonged litigation, the California Court of Appeals affirmed a jury award for $40,000 compensatory damages and $250,000 punitive damages. In that same year, Mr. and Mrs. Roemer filed a joint federal income tax return with the IRS, reporting a total of $47,142 originating from the law suit. Subsequently, the plaintiffs received a deficiency notice from the IRS claiming that the entire judgment received should have been included in gross income.

A trial was held in October, 1981, for redetermination of the deficiency. In August, 1982, the Tax Court, with three judges dissenting, held that both the compensatory and punitive damage components of the award received by the Roemers were taxable. In September, 1983, the Court of Appeals for the Ninth Circuit unanimously reversed.

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32. 716 F.2d at 695.
33. Id.
35. 79 T.C. at 399. This amount included $16,020 from the damage portion of the recovery, $7751 for costs and $23,321 for interest. 79 T.C. at 403-04.
36. In his amended petition, Roemer alleged that $23,771, which represented the damage award and costs, was incorrectly reported. 79 T.C. at 404.
37. Of the total award, the net amount received by Roemer was $147,140. Below is a calculation of this amount:

<table>
<thead>
<tr>
<th>Component</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensatory damages</td>
<td>$40,000</td>
</tr>
<tr>
<td>Punitive damages</td>
<td>$250,000</td>
</tr>
<tr>
<td>Interest and costs</td>
<td>$85,601</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$375,601</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Less</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attorney's fees</td>
<td>$220,710</td>
</tr>
<tr>
<td>Costs</td>
<td>$7,751</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$228,461</strong></td>
</tr>
</tbody>
</table>

79 T.C. at 403 n.2.

The opinion does not provide the specific calculations to substantiate the IRS's position as to the amount of the deficiency.

38. The IRS did hold that all costs and attorney fees should be allowed as a deduction. 716 F.2d at 695.
40. 79 T.C. at 407, 408.
41. 716 F.2d 693 (9th Cir. 1983).
B. The Majority Tax Court Opinion

The majority opinion stated that for an individual to be afforded an exclusion under section 104(a)(2) he must prove "that the amounts for damages resulted from injury to his personal reputation."\(^{42}\) In addition, they held that a distinction had to be drawn between harm to an individual's personal and professional reputation.\(^{43}\) Since the court held that the conclusive factor in the determination of whether a damage award is includable in gross income, pursuant to section 104(a)(2), is the nature of the claim settled,\(^{44}\) the Tax Court ruled that the $290,000 award was taxable because "the predominant nature of [the petitioner's]\(^{45}\) claim involved damages to his business and professional reputation as an insurance broker,"\(^{46}\) and not to his personal reputation. The Tax Court rationalized that the compensatory damages were taxable as ordinary income\(^{47}\) because they represented compensation for lost income.\(^{48}\) Since the compensatory award was not received for a personal injury, the punitive damages, therefore, were similarly taxable as ordinary income.\(^{49}\)

The Tax Court determined the nature of the award based on an

\(^{42}\) 79 T.C. at 406 (emphasis in original).

\(^{43}\) Id. at 405.

The majority further stated:

We think the taxation of damages received pursuant to a court judgment in a suit for injury to a person's reputation, caused by defamatory statements constituting libel, depends on whether or not such defamation results in injury to the personal reputation of an individual, as distinguished from libel that injures his business or professional reputation, to the extent it has affected or may affect his income. Id. at 405-06.

Although the Roemer court cited Wolfson v. Commissioner, that decision expressly left open the question as to whether a valid distinction exists between damage to a person's professional reputation and his personal reputation for purposes of I.R.C. § 104(a)(2). 47 T.C.M. (P-H) ¶ 78,445, at 1860 (1978), aff'd and remanded, 651 F.2d 1228 (6th Cir. 1981). For a further discussion of Wolfson, see infra text accompanying notes 247-60.

Even if one assumes that there is a valid distinction, there still remains the question of whether an award for damages to the former, nonetheless, represents a non-taxable return of capital.

\(^{44}\) 79 T.C. at 405.

\(^{45}\) The Tax Court only focuses on Mr. Roemer in its opinion and, consequently, the singular tense is used throughout.

\(^{46}\) 79 T.C. at 406.

\(^{47}\) This comment will not deal with the other aspect of this case, i.e., whether in the alternative, the award should be taxed as ordinary income or a capital gain.

\(^{48}\) 79 T.C. at 406.

\(^{49}\) Id. at 408. The court relied, in part, on an IRS ruling. Rev. Rul. 75-45, 1975-1 C.B. 47 (once an injury can be considered within the scope of § 104(a)(2), then the entire award is non-taxable).
examination of the allegations contained in the petitioner’s libel pleadings as well as the issues and evidence presented at trial. Specifically, Roemer stressed his business losses in the libel suit by presenting evidence of a $136,000 loss in prospective income. Although the Tax Court noted that during the tax proceeding the primary emphasis of the petitioner’s testimony shifted from damage to his business reputation to damage to his personal reputation, it still considered the testimony in the libel trial to be more accurate and probative. Therefore, the Tax Court held that the petitioner failed to prove that the compensatory damages were awarded because of a personal injury.

In determining that the punitive damages received were taxable, the majority reasoned that since “the compensatory damages were

50. 79 T.C. at 406.
51. Id.
52. Id. at 406-07 n.3.
53. Id. at 406-07 n.3. The majority concluded “that the predominant nature of his claims involved damages to his . . . professional reputation as an insurance broker.” Id. at 406 (emphasis added). Perhaps, strategically, Roemer should have focused on his personal reputation damage and merely highlighted the extent of that damage by supplying his monetary losses to the trial court. This would have provided Roemer with a more convincing argument regarding the personal nature of his claim and possibly have precluded the necessity for the court to determine how professional reputation damages should be treated for tax purposes. Furthermore, this argument is buttressed by the Ninth Circuit’s decision, wherein it concluded that the relevant distinction for § 104(a)(2) purposes is between personal and nonpersonal injuries. Roemer, 716 F.2d at 697. Recently, the Tax Court in Church v. Commissioner, Tax Ct. Rep. (CCH) Dec. No. 40,216, 3373 (June 23, 1983), determined that where a former Attorney General for Arizona had been defamed by a front page newspaper editorial calling him a “Communist” the entire award was excludable from gross income. In Church, the IRS contended that the Tax Court’s decision in Roemer mandated a favorable result for the IRS; the Church court concluded, however, that Roemer was clearly distinguishable. After a review of the allegations contained in the various complaints, and the evidence and arguments presented in the state court proceedings, the Church court concluded that “the entire thrust of petitioner’s case was how the libelous editorial affected him personally.” Id. at 3375. The compensatory award for $250,000 and the punitive award for $235,000 were to compensate the petitioner for the “public” embarrassment and humiliation he experienced and the emotional distress, the pain, and the suffering he underwent upon being labeled a “Communist.” Contrasting this situation with that in Roemer, specifically that Church did not allege lost profits, the court held the award received was for a personal injury — even though a substantial part “of the award was to compensate [Church] for the loss of a professional career devoted to politics and public service, . . .” Id. at 3376. The court rationalized that the petitioner still had a career as an attorney and the “shattered dreams, ruined careers, and the mental anguish that follow are just as personal as, for instance, loss of limb.” Id.

54. 79 T.C. at 407.
intended to reimburse the petitioner for lost profits resulting from damage to his business reputation, rather than to his personal reputation, therefore followed that the punitive damages were taxable and thus not awarded 'on account of personal injuries' to the petitioner."

C. The Dissenting Opinions

In his dissent, Judge Forrester was perplexed as to the majority's rationale for differentiating between a business reputation and a personal reputation when, in fact, a reputation is personal by definition. He explained that "[t]he term business or professional reputation does not refer to some intangible other than reputation, generally (or personal reputation)." Rather, he asserted that section 104(a)(2) can and should distinguish between libel suits involving an injury to one's reputation and those involving an injury solely to one's occupation. Judge Forrester suggested several guidelines for courts to follow in determining the specific nature of the injury:

(1) The statements made, i.e., whether they are directed at the person's character (honesty, personal habits, etc.) or at his occupation (incompetence, etc.); (2) the geographic area where the statement is published relative to the taxpayer's business and residence; (3) the nature of the taxpayer's occupation; (4) the definitional nature of the action under local law; (5) the relief sought in the complaint;

55.  Id. at 408. The court noted that according to California law, punitive damages are imposed against the defendant to serve as an example and to punish him, and are not directly related to a plaintiff's injuries. Id. at 408 n.4.

Although the court determined the nature of the claim settled primarily from the fact that the plaintiff stressed his business losses at trial, that need not be determinative. In Farmers' & Merchants' Bank v. Commissioner, 59 F.2d 912, 913 (6th Cir. 1932), the court explained that profits are only one of the major indications of a business' worth. The court stated that "usual earnings before [an] injury, as compared with those afterward, [are] only an evidentiary factor in determining actual loss and not an independent basis for recovery." State Fish Corp. v. Commissioner, 48 T.C. 465, 477 (1967) (the court held that the "element of lost profits was not an independent basis for recovery but only an evidential factor in determining actual damage to and diminution of [the business'] good will"). See also Lloyd v. Commissioner, 55 F.2d 842, 844 (7th Cir. 1932) (although defamatory remarks were addressed to plaintiff's customers and competitors, the court believed that when words are spoken about an individual's reputation the individual is the one who suffers the injury, not his business). Thus, despite the fact the plaintiff stressed his business losses, he did so solely to prove damages. Therefore, the nature of the claim settled could still be a tort-type action covered by § 104(a)(2). See infra text accompanying notes 293-94.

56. 79 T.C. at 411 (Forrester, J., dissenting). Judge Korner joined this dissent.
57.  Id.
58.  Id.
59.  Id. at 411-12 (Forrester, J., dissenting).
(6) the arguments presented to the jury; (7) the classification (if any) of the damages awarded; and (8) the evidence presented to the jury.  

Applying these factors to the instant case, he concluded that the damages awarded to Roemer were for an injury to his reputation and not to his occupation and, therefore, were non-taxable. Additionally, Judge Forrester noted that the petitioner, in stressing his financial loss at trial, did so merely as a means to show how "his personal service business, built upon trust, confidence, and honesty, was financially wounded and nearly destroyed." Finally, he agreed with the majority's analysis regarding the punitive damages issue, but concluded that since the compensatory damages were awarded as a result of personal injuries and were excludable from gross income, it therefore followed that the punitive damages received would also be non-taxable.

A second dissent, written by Judge Wilbur, represented a compromise between the majority's and Judge Forrester's opinions. Judge Wilbur agreed with Judge Forrester as to the non-taxable status of the compensatory damages, but also strongly agreed with the majority opinion regarding the taxability of the punitive damages. Therefore, since a reputation is personal, it is within the scope of section 104(a)(2). Judge Wilbur, however, rationalized that punitive damages do not compensate the petitioner "for a loss within the purview of section 104," and as a result, are non-taxable.

Furthermore, he analogized the Roemer fact pattern to a case where a young surgeon loses a finger and recovers damages which

60. Id. at 412 (Forrester, J., dissenting).
61. Id.
62. Id. at 413 (Forrester, J., dissenting).
63. Id.; see supra text accompanying note 55.
64. 79 T.C. at 412 (Forrester, J., dissenting). As will be explained later, see infra notes 288-98 and accompanying text, this end result is desirable, however, the problem is finding and articulating the specific rationale to justify the conclusion.
65. 79 T.C. at 413 (Wilbur, J., dissenting).
66. Id. at 414 (Wilbur, J., dissenting). Judge Wilbur reached his conclusion despite his awareness of a Revenue Ruling which states, in relevant part, that "under section 104(a)(2) any damages, whether compensatory or punitive, received on account of personal injuries or sickness are excludable from gross income." Rev. Rul. 75-45, 1975-1 C.B. 47.
67. See 79 T.C. at 414 (Wilbur, J., dissenting).
68. Id. Judge Wilbur was unconvinced as to the applicability of the 1975 IRS ruling to this case. He explained that because those facts are sufficiently different, a contrary result can be reached. This comment, however, fails to understand his rationale for such a narrow interpretation of the IRS's position. See infra notes 179-203 and accompanying text.
replaced otherwise taxable future earnings. He explained that the loss in such a case is not bifurcated into its personal and economic components and, therefore, the award is non-taxable. Judge Wilbur concluded that a similar result should be reached with respect to a defamation of an individual's reputation, since it is, by definition, completely personal to the petitioner and according to section 104(a)(2), is not included in gross income.

D. Ninth Circuit Opinion

In reversing the Tax Court's decision, the Ninth Circuit determined that the dispositive inquiry for section 104(a)(2) involves ascertaining whether the award received is for personal or nonpersonal injury. The Ninth Circuit was extremely disturbed by the Tax Court's decision in distinguishing between physical and nonphysical injuries for section 104(a)(2) purposes. It felt that this represented a misinterpretation of the statutory term "personal injury" and hence was illogical. The Ninth Circuit concluded that a personal injury is not restricted to a physical manifestation of conduct. Moreover, it emphasized that for the last sixty years even the IRS has held that certain nonphysical injuries are encompassed under the statutory exclusion of section 104(a)(2).

The Ninth Circuit chose to determine the underlying nature of a defamation suit based solely upon an examination of California state law. It undertook an historical analysis which reflected the significant influence that the English treatment of defamation suits had upon the California statutory scheme at its inception. The Ninth Circuit explained that historically, the principal purpose of a defamation suit focused on damages to the person defamed, "rather than the injury which led to the damage." Thus, despite this confusion as to the labeling of the cause of action "as one for damages rather than for an injury," defamation torts were promulgated in

69. 79 T.C. at 414 (Wilbur, J., dissenting).
70. Id.
71. 716 F.2d at 697.
72. Id.
73. Id.
74. Id. The Ninth Circuit cites to Sol. Op. 132, 1-1 C.B. 92 (1922) as support for this position. For a discussion of how subsequent courts have interpreted this IRS opinion, see infra notes 164-205 and accompanying text.
75. 716 F.2d at 697.
76. Id.
77. Id. at 697-99
78. Id. at 698.
California as part of the regional statutory code under the heading of "Personal Rights." 79 Although their code has been extensively amended, the defamation tort section has basically remained the same since 1872. 80 Furthermore, California law appropriately differentiated between defamation and disparagement or trade libel and the mutually exclusive natures of the different suits are easily ascertainable. 81 Finally, in quoting from Professor Wigmore, the Ninth Circuit concluded "that the personal nature of an injury should not be defined by its effect." 82 Thus, since the entire injury in a defamation suit stems from a personal attack on the individual, a personal injury for section 104(a)(2) purposes has resulted and thereby makes the entire award, including punitive damages, non-taxable.

Although the Ninth Circuit reached this correct result, by relying on state law it ignored all relevant federal tax court decisions. An examination of these decisions would have represented an alternative analysis which could provide other courts with a definitive statement as to the non-taxable status of defamation awards and would obviate the need to scrutinize state law in the future. 83

II. UNDERLYING JUSTIFICATION FOR SECTION 104(a)(2)

Despite minor changes, the substantive language of section 104(a)(2) has essentially remained the same since the time of its enactment. 84 Regardless of this continuity, the legislative history of the section provides little indication as to whether the provision was intended to embrace punitive as well as compensatory damages. 85 Moreover, "[t]he original exemption [for personal injury awards] was enacted, without legislative history, after the Attorney General raised the issue whether personal injury awards were 'income' within the meaning of the Sixteenth Amendment." 86

In 1973, one commentator set forth four policy reasons for the justification of the non-taxable status attributed to awards under sec-

79. Id. at 699.
80. Id. at 698.
81. Id. at 699.
82. Id.
83. See infra notes 155-63 and accompanying text.
84. See supra note 3.
85. The purpose of Part II of this comment is to explore the possible policies behind § 104(a)(2), because the legislative history does not explain the policy behind including compensatory damages in this code section.
tation 104(a)(2). This comment explores two of those policies: (1) Such awards represent a return of capital which is not includable in gross income; and (2) while it can be argued that such awards should be taxable, Congress preferred to confer a humanitarian benefit on the injured party. The latter of these two policies is exemplified by the successor to § 104(a)(2).

87. See Yorio, *The Taxation of Damages: Tax and Non-Tax Policy Considerations*, 62 Cornell L. Rev. 701, 704-05 n.29 (1977). Professor Yorio analyzed four possible policy explanations for the predecessor of § 104(a)(2). Since only two of those policies are explored in the text, the other two are discussed here.

The first policy suggests that compensatory damages for personal injuries were not considered "income" within the meaning of the sixteenth amendment. Yorio explains that the foundation for the Solicitor of Internal Revenue's position was centered on the premise that personal injuries represented an invasion of a non-transferable personal right as opposed to a property right. *Id.* at 704 n.27. Furthermore, the IRS explained, because of the very nature of the right, "there can be no correct estimate of the value of the invaded right [because] [t]he rights on the one hand and the money on the other are incomparable things which cannot be placed on opposite sides of an equation." Sol. Op. 132, I-1 C.B. 92, 93 (1922), *cited in* Yorio, *supra*, at 704 nn.26, 27. Consequently, the award received for a personal injury is non-taxable.

The essential problem with this analysis, as Professor Yorio explains, is: if a recovery is not "income"—when it is not a gain from labor or capital or from both combined—then lost profit recoveries [should] arguably [be] excludable since they represent a gain that failed to materialize because the injured party was prevented from performing services or from engaging in a profitable enterprise. . . . Nonetheless, the cases uniformly held that damages for loss of earnings or profits were taxable . . .

Yorio, *supra*, at 705 (emphasis in original).

This question apparently would not present a problem to the *Roemer* Tax Court because the majority believed that if the plaintiff "bring[s] himself squarely within the exclusion from tax upon which he bases his case, i.e., that the amounts for damages resulted from injury to his personal reputation," 79 T.C. at 406 (emphasis in original), then even if part of the award is for "lost profits" it will still be considered non-taxable. This, however, is of little significance because it merely "begs" the question as to how § 104(a)(2) can be justified.

Despite concluding that defamation to an individual's professional reputation is non-taxable, the Ninth Circuit also did not essentially address the justification for § 104(a)(2). *See infra* notes 132-33 and accompanying text. Even where the court apparently focused on § 104(a)(2) it improperly applied the Suffered-Enough Concept.

The second policy suggests that damages which represent a periodical return to the injured party do not constitute income. Yorio, *supra*, at 714-15. The United States Supreme Court once favored this use. United States v. Supplee-Biddle Hardware Co., 265 U.S. 189, 195 (1924).

Professor Yorio indicated that this theory had been intelligently criticized: "[I]t may be concluded with equal logic that the [periodical] receipts should be taxed at an even higher rate, for the recipient does not depend upon them for subsistence. . . . In addition, no distinction is made between the sporadic income of a prize fighter and the stable income of a college professor." Yorio, *supra*, at 715 (quoting Comment, *Taxation of Found Property and Other Windfalls*, 20 U. Chi. L. Rev. 748, 753 (1953)). Professor Yorio also recognizes that "income bunching" creates difficulties in relation to periodicity and taxation of damage awards. *Id.* at 716. Finally, in Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955), the United States Supreme Court, in rejecting its earlier view, held that punitive damages and other similar windfalls are taxable income despite the fact that they are not received on a regular basis.
fied by the notion that because the victim has “suffered enough” as a result of the original tort, the additional anguish that would be created by the taxation of the award is not justifiable.

A. Personal Injury Awards Represent a Non-taxable Return of Capital

1. The Human Body is Considered Capital.—In 1931, the United States Supreme Court in Burnet v. Logan,88 adopted the principle that the recovery of capital was not a taxable event because it represented a restoration of the value that previously existed.89 Therefore, when a person recovers compensation equivalent to his basis in the asset,90 he is not taxed; any “over compensation,” however, is taxable.91 The justification for applying the recovery of capital principle to personal injuries is that the human body or a reputation is a type of “capital.”92 Therefore, insurance proceeds or damages represent a replacement of the capital due to the injury.93 The return of capital theory, however, does not provide a complete explanation for section 104(a)(2). Punitive damages, although representing an over compensation to its recipient and not merely a return of capital,94 are nevertheless non-taxable when received for personal injuries.95

2. Application of Return of Capital Theory to Nonphysical Injury Suits.—Four years before the Supreme Court adopted the return of capital theory in Burnet, the Board of Tax Appeals applied that analysis to a personal defamation suit in Hawkins v. Commis-

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88. 283 U.S. 404 (1931).
89. Id. at 413.
91. This approach is similar to the explanation that an award is not “income” within the meaning of the sixteenth amendment because if the right is inestimatable then the recovery is equal to its basis and no gain is realized. See Cutler, Taxation of the Proceeds of Litigation, 57 COLUM. L. REV. 470 (1957). Once it has been determined that the award is taxable then the next issue is whether the excess over basis should be taxed as ordinary income or as a capital gain, especially when an intangible asset such as goodwill is involved. Since this analysis is beyond the scope of this comment, see Yorio, supra note 87, at 709-10 and Cutler, supra at 473 for further amplification of this point.
92. See Sol. Mem. 1384, 2 C.B. 71, 72 (1920), where the IRS, although relying on an earlier Attorney General opinion dated June 27, 1918 to conclude that the human body is a form of capital, distinguished alienation of a spouse’s affection and held such an award to be outside the scope of § 104(a)(2) and therefore taxable.
93. Id. at 71-72.
94. See supra note 55.
In that case, the petitioner, an industrial engineer and the president of the C. L. Best Gas Traction Company, was removed from his position. Officers of the company, subsequently "published defamatory statements about him." Hawkins originally filed suit demanding one million dollars for injury to his reputation, business, and health. An out of court settlement, however, was eventually reached. Subsequently, the IRS filed a deficiency notice against Hawkins with respect to this matter. The petitioner then brought suit to establish that the settlement award was non-taxable. The Hawkins court held that compensation for defamation to a person's reputation is not taxable because "[i]t is an attempt to make the plaintiff whole as before the injury." The court determined that the "compensation [in the form of] general damages adds nothing to the individual, for the very concept which sanctions it prohibits that it shall include a profit."

In McDonald v. Commissioner, which was also decided prior to Burnet, Mrs. McDonald had previously recovered a judgment of $40,000 in a suit against Mr. DesPortes for breach of his promise to marry her. In deciding whether the award was taxable, the Board of Tax Appeals concluded that damages for breach of a promise to marry were non-taxable. The McDonald court stated that "the decisions to which we have reference and the principles to be considered are set forth in the opinion adopted by the Board in Hawkins v. Commissioner, and we are content to rest our decision in this proceeding upon the discussion in that case." Presumably, the court analogized the award received by Mrs. McDonald to that which was

96. 6 B.T.A. 1023 (1927), acq. 7-1 C.B. 14 (1928). The court also based its decision on the fact that the recovery is not income. Id. at 1024.
97. Id. at 1023.
98. Id.
99. Id.
100. Id.
101. Id. at 1025.
102. Id.; cf. Durkee v. Commissioner, 162 F.2d 184 (6th Cir. 1947) ("where the settlement represents damages for lost capital rather than for lost profits the money received is a return of capital and not taxable." Id. at 186 (citations omitted)). See Raytheon Prod. Corp. v. Commissioner, 144 F.2d 110 (1st Cir.), cert. denied, 323 U.S. 779 (1944) (The fact, "that the recovery represents a return of capital in that it takes the place of the business good will is not to conclude that it may not contain a taxable benefit." Id. at 114. One must still present evidence of the adjusted basis of the good will to help alleviate taxation. Id.)
103. 9 B.T.A. 1340, acq. 7-2 C.B. 26 (1928).
104. Id.
105. Id. at 1342.
106. Id.
authorized in *Hawkins*, consequently determining that the money received was a return of capital which *only* made the plaintiff/petitioner whole. Specifically, the jury was entitled to award damages to compensate her for “mortification and pain or distress of mind, . . . loss of social standing, . . . injury to future prospects of marriage, . . . loss of benefits which [she] might have derived from the [marriage] including loss of station . . . and loss of a permanent home and worldly advantages . . .”

In 1974, the IRS subsequently determined that, under section 104(a)(2), damages for alienation of affection and for surrender of custody of a minor child were excludable from gross income. The IRS explained that “[n]one of the amounts constituted exemplary or punitive damages.” Arguably, the IRS considered the awards as compensatory and, therefore, applied a return of capital analysis in this nonphysical injury suit. Thus, although the return of capital theory has been applied in cases involving section 104(a)(2) and its predecessors, the absence of a justification for the non-taxable status of punitive damages—which is by definition, over compensation—results in the conclusion that this theory is inadequate to explain section 104(a)(2).

**B. A Suffered-Enough Concept**

The Suffered-Enough Concept involves conferring a humani-

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107. *Id.* at 1341; cf. *Meyer v. United States*, 173 F. Supp. 920 (E.D. Tenn. 1959). The taxpayer received $2500 from a movie company in connection with the filming of a movie which appeared to depict the plaintiff as manager of a baseball team. The taxpayer sought refund of this money, claiming it “was paid in settlement of injuries to his personal reputation and for invasion . . . of privacy.” *Id.* at 921. The court held that the plaintiff was not damaged, but the court noted that, had an actual invasion of privacy been followed by compensation, then the award would be completely non-taxable. *Id.* at 923-24. The court cited both *Hawkins* and *Ehrlich* in reaching its conclusion. In *Ehrlich v. Higgins*, 52 F. Supp. 805 (S.D.N.Y. 1943), the taxpayer received $42,500 in consideration for consent to use her name and specific personal correspondence with respect to a proposed film biography of her late husband. The court rejected the plaintiff’s claim that the payments were actually received for violation of her right of privacy and thus non-taxable, because the evidence presented in court did not disclose that any wrong had been perpetrated. *Id.* at 808. The court did express the view that it would distinguish between a case where damage occurs followed by payment and where a legal right was surrendered for consideration. *Id.*; see generally *Fouts, supra* note 9, at 559-60 (analysis of non-taxable status of an award for invasion of privacy).


109. *Id.*

110. *See* Harnett, *supra* note 25, at 627. Professor Bertram Harnett was the first to suggest the notion of a Suffered-Enough Concept. Harnett contends that the personal injury exemption stems, in part, from the feeling “that the taxation of recoveries carved from pain and suffering is offensive, and the victim is more to be pitied rather than taxed.” *Id.*
tarian benefit on the victim. This comment posits that this concept addresses the unique characteristics of the personality of a human being and stresses that the law governing man should be attuned to those qualities. The personality of a human being can be described as having two essential qualities: a logical thought process and an emotional responsive process. As a result of an interplay between these two processes, an individual is able to communicate with society.

The American legal system was established to "insure domestic tranquility, provide for the common defence [and] promote the general welfare." Recognizing the enormously strong emotional desires of mankind, the founding fathers incorporated a system of checks and balances to safeguard against the abuse of power. The judicial and legislative systems today have also been responsive to the emotional component of an individual and have manifested this humanitarian understanding by adopting the Suffered-Enough Concept.

1. Judicial Recognition of the Suffered-Enough Concept.—In 1975, the New Jersey District Court decided Huddell v. Levin, determining that the provisions for the personal injury exemption in the IRS Code were "intended to relieve a taxpayer who has the misfortune to become ill or injured" of the need to pay income tax. Therefore, if the award received was taxable, then the congressional

111. For an interesting discussion of the interests represented in a personality, see Pound, Interests of Personality, 28 Harv. L. Rev. 445 (1915).

112. "A personality is a dynamic whole that is defined by the distinctive structural attributes of the self." H. SMITH, PERSONALITY DEVELOPMENT 8 (2d ed. 1974). See generally id. at 93-118 (analysis of the emotional composition of an individual); J. COLEMAN, CONTEMPORARY PSYCHOLOGY AND EFFECTIVE BEHAVIOR, 375-95 (4th ed. 1979) (analysis of emotions). It has also been said that every waking hour is filled with one's own thoughts and with emotions that only he can experience first hand. Id. at 48.

113. See generally H. SMITH, supra note 112; J. COLEMAN, supra note 112.

114. U.S. Const. preamble.


116. See infra notes 117-44 and accompanying text.

117. 395 F. Supp. 64 (D. N.J. 1975), vacated on other grounds, 537 F.2d 726 (3d Cir. 1976).

118. "The provisions of Section 22(b)(5) undoubtedly were intended to relieve a taxpayer who has the misfortune to become ill or injured, of the necessity of paying income tax upon insurance benefits received to combat the ravages of disease or accident," was cited with approval in Haynes v. United States, 353 U.S. 81, 84 n.3 (1957). See also Norfolk & W. Ry. v. Liepelt, 444 U.S. 490, 501 (1980) (Blackmun, J., dissenting).
The intent of section 104(a)(2) and its predecessors to extend a tax benefit to an injured party would be nullified. Furthermore, the Hudzell court concluded that

[it] can devise no societal purpose that would be furthered by awarding wrong-doing defendants with the benefit of this Congressional largesse. A societal purpose would be served by benefiting innocent victims of tortious conduct. . . . This court therefore concludes that Congress, as with all exemptions under Section 104, "... intended to relieve a taxpayer who has the misfortune to become ill or injured . . . ."120

In Norfolk & Western Railway v. Liepelt,121 a wrongful death action brought pursuant to the Federal Employees' Liability Act ("FELA"), the United States Supreme Court held that evidence was admissible to show the effect of income taxes on the victim's estimated future earnings. In addition, it held that a jury instruction explaining that taxes should not be considered in determining the amount of the award was proper.122 Although this suit did not require an analysis of the justification for IRC section 104(a)(2),123 the dissent argued that by mandating a reduction of a damage award "for federal income taxes that would have been paid by the

120. Id. at 87 (quoting Epemier v. United States, 199 F.2d 508, 511 (7th Cir. 1952), quoted in Haynes v. United States, 353 U.S. 81, 84 (1957)). The Hudzell court continued its analysis and determined that "the New Jersey Supreme Court would recognize the intended benefit of the Congressional exemption, under the 'Collateral source' doctrine." Id. at 88. This doctrine provides that benefits received by the victim due to a "contract, employment, or other relation cannot operate to reduce the damages recoverable against a tortfeasor." Id. Even a commentator who is generally critical of the "Collateral source" doctrine has recognized the special applicability of the doctrine to benefits created by legislation: "Whatever the logical difficulties of denying mitigation for collateral benefits in a system of damages which is primarily compensatory, Congress and the state legislatures may make a considered decision that particular benefits are to be additional to an injured party's other remedies. Where such legislative intent is ascertainable, mitigation is, of course, [im]proper. Since 1939, the Internal Revenue Code may have reflected such a policy choice, damages recoverable for loss of earnings being expressly excluded from gross income."

Id. at 88 n.33 (quoting Note, Unreason in the Law of Damages - the Collateral Source Rule, 77 HARV. L. REV. 741, 752 (1964)).

If the tax savings were deducted, then Congress' intent to confer a benefit upon the plaintiff would be nullified by shifting it to the defendant. Dixie Feed & Seed Co v. Byrd, 52 Tenn. App. 619, 627-28, 376 S.W.2d 745, 749 (1963) (citation omitted). See Recent Cases, 69 HARV. L. REV. 1495, 1497 (1956); Hudzell, 395 F. Supp. at 88.
121. 444 U.S. 490 (1980).
122. Id.
123. The issue did not center around the taxability of the award.
decedent on his earnings, the Court appropriates for the tortfeasor a benefit intended to be conferred on the victim or his survivors.” 124 Furthermore, the dissent quoted from the aforementioned passage in *Huddell*, 128 as a possible explanation for Congress’ decision in section 104(a)(2) to express its humane desire not to burden the already injured. 128

The majority in *Norfolk* took note of the dissent’s position and explained that they “see nothing in the language and are aware of nothing in the legislative history of § 104(a)(2) to suggest that it has any impact whatsoever on the proper measure of damages in a wrongful-death action.” 127 The majority opinion is correct in its analysis because neither the language in section 104(a)(2) nor its legislative history necessarily indicates any justification for the Code section. 128 Nevertheless, if the court had focused its attention on the established case law under section 104(a)(2)—involving both physical and nonphysical personal injury awards coupled with the widespread use of the Suffered-Enough Concept in the Code—then it might have reached the same conclusion about section 104(a)(2) as the dissent. Moreover, “given the [long history] of Congressional inaction in the face of clarifying opinions throughout the nation,” 129 “the ‘continued presence of the exemption in the tax code appears to indicate that Congress intended to benefit injured persons by relieving them of the necessity of paying a tax.’ ” 130

In applying the Suffered-Enough Concept, the circuit court in *Roemer* 131 determined that the injured party should not be burdened with having to sort out the taxable and non-taxable components of a lump sum award. 129 The court’s view represents a narrow interpretation of the Suffered-Enough Concept. It is possible that in applying the court’s interpretation to a situation where the award is allocated into its various components, the court would conclude that part of the award is taxable, since no additional administrative burden

125. 395 F. Supp. at 87; *see supra* text accompanying note 110.
127. *Id.* at 496 n.10.
128. *See supra* notes 71-72 and accompanying text.
131. 716 F.2d 693 (9th Cir. 1983).
132. *Id.* at 696 (citation omitted).
would be placed on the petitioner. Therefore, the Suffered-Enough Concept should instead be understood as a blanket policy explanation, substantiating the fact that for humanitarian purposes the injured party will receive a tax-free award.

2. Other IRC Sections Have Adopted the Suffered-Enough Concept.—The IRC has promulgated other sections creating special exceptions for taxpayers in difficult or special circumstances. For example, according to section 1033(a)(1), “[i]f property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted . . . . [i]nto property similar . . . no gain shall be recognized.” Generally, proceeds of life insurance contracts payable by reason of death are not taxable. Individuals who have obtained the age of 65 can often take a fifteen percent credit against their regular tax liability. In addition, amounts received under accident and health plans are generally excludable from gross income. These situations should represent taxable income under the IRC. Congress, however, has found it desirable “to temper the general policy[139] and allow an exception for a taxpayer victimized by illness or injury,” uncontrollable circumstance, or merely old age. Despite the broad exercise of its income taxing power, Congress has shown great solicitude for the protection of the human body and its attributes and has attempted to mitigate the hardship caused by death or injury.

In view of the judicially interpreted Congressional intent for section 104(a)(2), it is not surprising that the Ninth Circuit in Roemer—despite its reliance on state law—held that the entire award received by the petitioner was excludable from gross in-

133. Contrast this potential situation with Rev. Rul. 75-45, 1975-1 C.B. 47 which alleviates the problems of allocating a general award into the categories of lost profit and pain and suffering, by concluding that a personal injury award is entirely non-taxable. Furthermore, according to Professor Yorio, the exemption for § 104(a)(2) “cannot be justified solely on the grounds of administrative convenience.” Yorio, supra note 87, at 709.

134. For a list of additional exemptions, see Phillips, supra note 3, at 925-26.
139. See supra note 2 and accompanying text.
140. Phillips, supra note 3, at 926.
141. See Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429 (citations omitted) (The Supreme Court stated that Congress exerted the “full measure of its taxing power” in enacting the statutory definition for “gross income”).
142. See supra notes 117-33 and accompanying text.
come.\textsuperscript{143} This treatment is consistent with, and furthers an already established and prevalent policy, that "the victim is more to be pitied rather than taxed."\textsuperscript{144}

### C. Defamation Awards

The primary interest at issue in all defamation suits is admittedly the reputation of the defamed plaintiff.\textsuperscript{145} The case law in this area is designed "to protect [a person's] reputation rather than [his] dignity, self-esteem [character,] or mental equanimity."\textsuperscript{146}

In its vital aspect, the right to [a] reputation is not concerned with fame or distinction. It has regard, not to intellectual or other special acquirements, but [concerns] that repute which is slowly built up by integrity, honorable conduct, and right living. One's good name is therefore as truly the product of one's efforts as any physical possession; indeed, it alone gives to material possessions their value as sources of happiness.\textsuperscript{147}

Reputation is thus what a person appears to be.\textsuperscript{148} It results from observations of an individual's conduct—"the character imputed to him by others."\textsuperscript{149} Furthermore, it is something which is intrinsic as well as intangible and yet is a very valuable personal asset.\textsuperscript{150} It has been said, that "[a] good name is rather to be chosen than great riches [and a] good reputation, when based on sound character, is a man's most precious possession."\textsuperscript{151} Moreover, since credit is an integral facet of contemporary society, the confidence that one has in his fellowmen as manifested through an individual's reputation is invaluable.\textsuperscript{152}

Thus, the idea that a man may defame a business associate and

\begin{itemize}
  \item \textsuperscript{143} Roemer, 716 F.2d at 700.
  \item \textsuperscript{144} Harnett, supra note 25, at 627.
  \item \textsuperscript{145} Grant v. Readers Digest Ass'n, 151 F.2d 733, 734 (2d Cir.) (Hand, J.), cert. denied, 326 U.S. 797 (1945).
  \item \textsuperscript{146} Wade, Tort Liability for Abusive and Insulting Language, 4 VAND. L. REV. 63, 79 (1950).
  \item \textsuperscript{147} Van Vechter Veeder, The History and Theory of the Law of Defamation. II, 4 COLUM. L. REV. 33, 33 (1904).
  \item \textsuperscript{148} Id.
  \item \textsuperscript{149} Id.
  \item \textsuperscript{150} See L. Eldredge, supra note 14, at 2.
  \item \textsuperscript{151} Roth v. Greensboro News Co., 217 N.C. 13, 20, 6 S.E.2d 882, 887 (1940); accord Sweet v. Post Publishing Co., 215 Mass. 450, 455, 102 N.E. 660, 662 (1913) ("But the right of the private citizen to be secure in his reputation always must remain one of the most sacred of rights").
  \item \textsuperscript{152} See L. Eldredge, supra note 14, at 10-11.
\end{itemize}
restrict the false charge to that individual's professional reputation is delusive. As a result, the Roemer Tax Court's attempt to distinguish, for tax purposes, between an individual's personal reputation and professional reputation was premised on fallacious reasoning. The difference becomes meaningless when one focuses on the irreparable nature of a reputation, the anguish suffered by the victim, and the policy underlying section 104(a)(2)—it is better to pity the victim than to tax him.\footnote{156}

III. The Roemer Tax Court Misinterpreted Prior Case Law

This section focuses on an historic analysis of the tax treatment of defamation awards. The comment then applies these results to the Roemer Tax Court case and concludes, as the Ninth Circuit held,\footnote{154} that the entire award is excludable from gross income. This analysis is necessary because of the narrow grounds upon which the Ninth Circuit decided the case. The circuit court held that Roemer's award was excludable from gross income under section 104(a)(2) by analyzing whether he suffered a personal injury as determined under California state law.\footnote{155} The court explained that historically California has considered defamation law as an infringement of "a general personal right."\footnote{157} It is therefore distinguishable from trade libel or disparagement which consist of an attack on an individual's product or services.\footnote{158} The court concluded that the defamation of an individ-

\footnote{153} Harnett, supra note 25, at 627.
\footnote{154} Roemer, 716 F.2d 693.
\footnote{155} Id. at 700.
\footnote{156} Id. at 699. California defamation statutes appear in the Civil Code Section of the Statutory Code under the heading of Personal Rights. CAL. CIVIL CODE §§ 44-48.5 (West 1982).
\footnote{157} 716 F.2d at 699. The Ninth Circuit, relying on California law, easily distinguished the tax consequences of defamation to an individual and trade libel. Id. The former concerns the person of the plaintiff, while the latter involves only the plaintiff's goods. Id. Therefore, defamation is a personal injury and the award received is non-taxable, whereas an award for trade libel would be taxable.

The court's approach is problematic for two reasons: (1) It does not indicate how a court should deal with a situation where a lump sum award is received for both defamation and trade libel and (2) in some jurisdictions, like the State of Washington, clear distinctions are not made in the statutory application of the defamation and trade libel torts. It is possible that both causes of action can be brought pursuant to the Washington Statute. "Every malicious publication . . . which shall tend . . . to injure any person, corporation or association of persons in his or their business or occupation, shall be libel." WASH. REV. CODE ANN. §9.58.010(3) (1977). Cf. Waechter v. Carnation Co., 5 Wash. App. 121, 126-27, 485 P.2d 1000, 1004 (1971) (an action can be brought for defamation and trade libel, however, the latter is only recoverable if special damages are proven). Therefore, judicial determination of
ual's personal and professional reputations are equivalent for tax purposes because "all of the harm that is done flows from the same personal attack on the defamed individual."\textsuperscript{158}

In \textit{Lyeth v. Hoey},\textsuperscript{159} however, the United States Supreme Court held that

\begin{quote}
[when] dealing with the meaning and application of an act of Congress . . . to tax income and to grant exemptions from that tax, it is the will of Congress which controls, and the expression of its will, in the absence of language evidencing a different purpose, should be interpreted "so as to give a uniform application to a nationwide scheme of taxation." Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law.\textsuperscript{160}
\end{quote}

Furthermore, the Supreme Court determined in \textit{Morgan v. Commissioner},\textsuperscript{161} that although state law creates legal rights and interests, it is the federal revenue acts that designate which will be taxable and non-taxable.\textsuperscript{162} Once this classification has been made, "the federal law must prevail no matter what name is given to the interest or right by state law."\textsuperscript{163} Therefore, the Ninth Circuit should have incorporated an analysis of the relevant federal tax decisions involving defamation awards. Such a discussion would have set forth the federal Tax Court's position on defamation awards and would have helped to prevent future courts from making the same mistakes the Roemer Tax Court committed in interpreting the federal case law in this area.

\section*{A. The 1922 IRS Opinion and Its Progeny}

The IRS determined in 1922 that damages awarded for the li-

\begin{thebibliography}{99}
\bibitem{158} 716 F.2d 700.
\bibitem{159} 305 U.S. 188 (1938).
\bibitem{160} \textit{Id.} at 194 (citation omitted).
\bibitem{161} 309 U.S. 78 (1939).
\bibitem{162} \textit{Id.} at 80-81.
\bibitem{163} \textit{Id.} at 81. \textit{See} Estate of Sovenson v. Commissioner, 72 T.C. 1180 (1979) (citing \textit{Morgan}, 309 U.S. 78 (1939)); \textit{see also} Estate of Burgess v. Commissioner, 622 F.2d 700, 703 (4th Cir. 1980) (applying federal law in determining a federal tax question, although redistribution of decedent's property was directed by a state court presumably following state law); \textit{cf.} Estate of Borax v. Commissioner, 349 F.2d 666, 670 (2d Cir. 1965) (where the court determined that certainty and uniformity are important goals of the federal tax scheme. Therefore, the court validated the couple's divorce and concluded that the prior payments of the husband to his spouse were property deductible as alimony).
\end{thebibliography}
bel or slander of an individual were non-taxable. The IRS stated that one of its earlier opinions, published before the Supreme Court's landmark decision in *Eisner v. Macomber*, "may have been correct in holding that damages received by a lawyer for libel of his professional reputation constitute income. Business libel may be distinguished from ordinary defamation of character and is not here under consideration." The opinion reiterated that "[s]lander or libel affecting business reputation or property rights, however, are not considered in this opinion." The IRS thus chose to narrow the scope of its decision by leaving unanswered the question concerning the tax consequences of an award resulting from defamation to an individual's professional reputation.

In *Hawkins v. Commissioner*, the Board of Tax Appeals held that compensatory damages received in a settlement for libel and slander to an individual's reputation and health are not income. The *Hawkins* court did not distinguish for tax purposes between an individual's personal and business reputation. No suggestion was made that special, exemplary, or punitive damages were paid to the plaintiff; as the court noted, "we need not consider the law as to them."

*Farmers' & Merchants' Bank v. Commissioner* involved the Federal Reserve Bank of Cleveland's unfair business practices which impaired the reputation of the Farmers' & Merchants' Bank ("Bank"). The Bank consequently suffered a loss of depositors and income and initiated a suit which resulted in a favorable settlement. The Bank's award was considered to be non-taxable since

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165. 252 U.S. 189, 207 (1920) (where the Court defined income as "the gain derived from capital, from labor, or from both combined").
167. Id. at 94.
168. 6 B.T.A. 1023 (1927), acq. 8-1 C.B. 14 (1928).
169. Id. at 1024-25. For an analysis of the court's rationale, see supra text accompanying notes 83-88. The court did state that "[i]f compensation for the loss of a life is not taxable as income unless expressly provided, [then] compensation for the injury to personal reputation should similarly require an express provision." *Hawkins*, 6 B.T.A. at 1025.
170. The court explained that the compensation paid was the only remedy permitted by law for an injury "wholly personal and nonpecuniary" in its nature. *Hawkins*, 6 B.T.A. at 1024; see Plumb, *Income Tax on Gains and Losses in Litigation*, 25 CORNELL L. Q. 221, 234 n.80; Yorio, *supra* note 87, at 707 n.47.
172. 59 F.2d 912 (6th Cir. 1932).
173. Id. at 913. The Reserve Bank paid the plaintiff $18,750, however, the expense of the suit was subsequently deducted. Id.
the court resolved that it could "see no legal distinction between compensation for destruction of or damage to incorporeal or intangible property, such as good will, and similar compensation for damage to tangible property." Therefore, the payment was a return of capital and did not constitute income.

This represented the first time the courts grappled with a problem involving an injury to a business reputation and held the award to be non-taxable. The Farmers' court, however, did not have to address the question of whether a distinction existed or could be made between a personal and business reputation because a bank can only have the latter, since it is not a human being.

In 1955, the United States Supreme Court declared, in the landmark case of Commissioner v. Glenshaw Glass Co., that punitive damages were includable in gross income. Glenshaw Glass Company ("Glenshaw"), a Pennsylvania manufacturer of glass bottles and containers was engaged in lengthy litigation with the Hartford-Empire Company ("Hartford"). Glenshaw claimed, inter alia, "exemplary damages for fraud and treble damages for injury to its business by reason of Hartford's violation of the federal antitrust laws." The plaintiff received a settlement of approximately $800,000. The Commissioner filed a deficiency notice for the entire sum less deductible legal fees.

174. Id. at 913.
176. For an interesting analysis of this case, see Harnett, supra note 25, at 629-30.
177. See Knickerbocker, supra note 175, at 434.
180. Id. at 428.
181. Id. at 427.
182. Id. at 427-28.
183. Id. at 428.
184. Id.
that the award was taxable stated:

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. Respondents concede, as they must, that the recoveries are taxable to the extent that they compensate for damages actually incurred. It would be an anomaly that could not be justified in the absence of clear congressional intent to say that a recovery for actual damages is taxable but not the additional amount extracted as punishment for the same conduct which caused the injury. And we find no such evidence of intent to exempt these payments.\textsuperscript{185}

The Supreme Court did take note of the inapplicability of its holding to personal injury cases. In a footnote the Supreme Court declared:

The long history of departmental rulings holding personal injury recoveries non-taxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property. Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes.\textsuperscript{186}

Subsequently, in 1958, the IRS ruled in the settlement of a libel suit for injury to personal reputation, that only the compensatory award was non-taxable and that the punitive award was includable in the plaintiff's gross income.\textsuperscript{187} The IRS relied on Hawkins\textsuperscript{188} for excluding the compensatory award\textsuperscript{189} and interestingly cited Glenshaw Glass as support for taxing the punitive award.\textsuperscript{190} The IRS

\begin{footnotes}
\item[185] Id. at 431.
\item[186] Id. at 432 n.8 (emphasis added) (citations omitted).
\item[187] Rev. Rul. 58-418, 1958-2 C.B. 18. This ruling, which relied on the 1922 IRS Opinion, see supra notes 164, 166-67 and accompanying text, declared that if the defamatory statements injured the petitioner's business or professional reputation, a taxable award would result to the extent that his income was affected by those statements. Rev. Rul. 58-418, 1958-2 C.B. at 19.
\item[188] 6 B.T.A. 1023.
\item[190] Id.
\end{footnotes}
extracted from *Glenshaw Glass* the principle that an award "received [for] exemplary and punitive damages from wrongdoers as punishment for their unlawful conduct did not detract from their character as income to the recipients."\textsuperscript{101}

The IRS' interpretation of the Supreme Court's analysis of punitive damages received for a personal injury in *Glenshaw Glass* is, however, questionable. This writer believes that a proper interpretation of *Glenshaw Glass* encompasses the following: (1) the Supreme Court only determined that compensatory awards received for personal injury were non-taxable and (2) punitive damages awarded for injury to property were taxable. The Court did not determine the taxable status of punitive damages received for a personal injury. The justification for this position is based upon an analysis of the aforementioned footnote in *Glenshaw Glass*,\textsuperscript{9} the IRS opinion in 1958,\textsuperscript{11} and its subsequent reversal in 1975.\textsuperscript{14}

In 1955, the *Glenshaw Glass* Court was under the assumption that a return of capital theory proffered in departmental rulings regarding personal injury awards could not "support exemption of punitive damages following injury to property."\textsuperscript{9} The Supreme Court apparently did not address the treatment of punitive damages in the personal injury context. The Court continued to explain that, by definition, personal injury damages are compensatory.\textsuperscript{9} In basing its decision on a return of capital theory, the Supreme Court was compelled to hold that personal injury awards are only compensatory, because otherwise, there would be no explanation for the award's non-taxable status.

In concluding that "[p]unitive damages . . . cannot be considered a restoration of capital for taxation purposes,"\textsuperscript{107} the Supreme Court was arguably addressing the personal injury situation. Therefore, although it describes a personal injury award as being compensatory, it did not exclude the possibility that a punitive award for personal injury would also be non-taxable. Thus, the purpose of the footnote—although admittedly ambiguous—was to distinguish between awards received for personal injury and for property damages.

\textsuperscript{191} \textit{Id.}
\textsuperscript{192} 348 U.S. at 432 n.8; see supra text accompanying note 186.
\textsuperscript{194} Rev. Rul. 75-45, 1975-1 C.B. 47.
\textsuperscript{195} 348 U.S. at 432 n.8 (citations omitted).
\textsuperscript{196} \textit{Id.}
\textsuperscript{197} \textit{Id.}
In 1958,\textsuperscript{198} when the IRS ruled that punitive damages awarded for personal injury were taxable,\textsuperscript{199} it apparently applied the return of capital theory as set forth in the Supreme Court's decision in \textit{Glenshaw Glass}.\textsuperscript{200} Consequently, since punitive damages do not make the plaintiff/petitioner whole, they are taxable. In 1975, however, the IRS—contrary to its 1958 ruling—determined that punitive damages were also non-taxable when received for personal injury.\textsuperscript{201} Arguably, in so doing the IRS was willing to concede that the exclusion contained in section 104(a)(2) could not be explained through the use of ordinary logical principles. Thus, the only justification for this Code section is a humane desire not to burden those already injured.\textsuperscript{202} "Therefore, . . . any damages, whether compensatory or punitive, received on account of personal injuries or sickness are excludable from gross income."\textsuperscript{203} This ruling is consistent with the foregoing interpretation of the Supreme Court's view as expressed in \textit{Glenshaw Glass} as it bifurcates the tax treatment of punitive awards for personal and property damages.

With this explanation for the development of the non-taxable status of punitive damages explicated, this comment now focuses its attention on a series of three cases—\textit{Agar v. Commissioner},\textsuperscript{204} \textit{Knuckles v. Commissioner},\textsuperscript{205} and \textit{Draper v. Commissioner}\textsuperscript{206}—which the \textit{Roemer} Tax Court erroneously relied upon.

In \textit{Agar}, the plaintiff entered into a five-year employment contract as treasurer of the Daniger Corporation.\textsuperscript{207} The corporation had previously retained Agar's services as an accountant for many years.\textsuperscript{208} His contract provided for "a fixed annual salary of $35,000, payable in equal weekly installments,"\textsuperscript{209} and included a special "percentage compensation" profit-sharing plan.\textsuperscript{210} The contract fur-

\begin{itemize}
  \item \textsuperscript{198} Rev. Rul. 58-418, 1958-2 C.B. 18.
  \item \textsuperscript{199} \textit{Id.} at 19.
  \item \textsuperscript{200} \textit{See id.}
  \item \textsuperscript{201} Rev. Rul. 75-45, 1975-1 C.B. 47.
  \item \textsuperscript{202} \textit{See supra} notes 110-44 and accompanying text.
  \item \textsuperscript{203} Rev. Rul. 75-45, 1975-1 C.B. 47. This ruling has not been subsequently questioned.
  \item \textsuperscript{205} 23 T.C.M. (CCH) 182 (1964), \textit{aff'd}, 349 F.2d 610 (10th Cir. 1965). For an analysis of the \textit{Knuckles} decision, see Comment, \textit{supra} note 204, at 1248-49.
  \item \textsuperscript{206} 26 T.C. 201 (1956).
  \item \textsuperscript{207} \textit{Agar}, 19 T.C.M. (CCH) at 117.
  \item \textsuperscript{208} \textit{Id.} at 116.
  \item \textsuperscript{209} \textit{Id.} at 117.
  \item \textsuperscript{210} \textit{Id.}
\end{itemize}
ther provided that if Agar was removed for cause, he would not be entitled to receive any "unpaid 'fixed' or 'percentage' compensation." After commencement of his duties as treasurer, the plaintiff realized that the company had lost confidence in him. His health subsequently deteriorated because of the loss of respect as well as the hurried pace of his office. After a little more than a year, Agar resigned. Agar informed the company that he was going to sue for injuries resulting from the mistreatment by company personnel and, consequently, a $45,000 settlement was negotiated. 

Agar claimed that, according to Hawkins v. Commissioner, and the 1922 IRS opinion, these payments constituted compensatory damages for injury to his personal reputation and health, and as a result were non-taxable. On appeal, the Second Circuit stated:

The commissioner's rejection of this position was upheld by the Tax Court on two grounds: first, that the payments were in the nature of severance pay or extra compensation and not in settlement of a possible tort action; second, that even if in settlement of a tort claim the gravamen of that claim was an injury to business reputation and thus the taxpayer could not rely on the statutory exemption of payments on account of 'personal injuries.' Since we affirm upon the first ground, we do not have to decide whether whatever tort claim Agar may have asserted was based upon damage to his personal as well as his business reputation, assuming that the dichotomy is realistic, and whether all payments or a portion of them would therefore be tax exempt.

It should be noted that the Agar court adopted the same narrow approach used by the IRS in 1922. Neither authority stated that a discernible distinction could be made between an individual's personal and professional reputation nor addressed the issue of whether an award for the latter would be taxable.

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211. Id.
212. Id.
213. Id.
214. Id.
215. Id. at 118. The amount was to be paid in three equal payments. Id.
216. 6 B.T.A. 1023 (1927), acq. 7-1 C.B. 14 (1928).
218. 19 T.C.M. (CCH) at 119.
219. The court of appeals labeled Agar's claim as one for slander. 290 F.2d at 284 n.1.
220. Id. at 284 (emphasis added) (citation omitted).
222. Perhaps Agar might have been more successful had he used Farmers' Merchants' Bank v. Commissioner, 59 F.2d 912 (6th Cir. 1932), as support. See supra text accompanying
Four years later, in Knuckles, the Tenth Circuit similarly upheld a Tax Court opinion that an award to the petitioner was taxable because it was not made in settlement of his personal injury claim, but rather, represented compensation due him under his employment contract.223 The court accepted the Tax Court’s finding that the tort claim was not part of the settlement negotiations, since the claim was merely an afterthought brought into being by the possible tax advantage that might ensue.224 The court focused on the “intent of the payor” to establish the purpose of the payment.225

The Tax Court in Knuckles,226 explained that although there was proof that the petitioner’s “business reputation had suffered because of his experience with [his employer,] Perpetual [Life Insurance Company,] that fact militate[d] against him.”227 The Tax Court cited Draper and Hawkins v. Commissioner228 as support for its position.229 It is interesting to note that Hawkins, as has been previously discussed,230 did not address the question of whether an award for injury to an individual’s professional reputation was taxable. Furthermore, in Draper the sole issue was whether the petitioner’s expenditure for counsel fees in a libel action for damage to his professional reputation was deductible for tax purposes.231 Although the libel suit was tried, the jury failed to reach a final verdict. Due to a lack of funds, the petitioner was unable to retry the case.232 The Tax Court did hold, however, that the legal fees were deductible since they represented an ordinary and necessary business expense.233

The Draper court’s decision regarding the deductibility aspect of the legal expenses incurred does not represent a conclusive statement that an award received for defamation of an individual’s pro-

notes 172-76.
223. 349 F.2d at 612. The Tax Court also found that part of the settlement was for damage to Knuckles’ business reputation. Id.
224. Id. at 613.
225. Id.
226. 23 T.C.M. (CCH) 182 (1964).
227. Id. at 185.
228. 6 B.T.A. 1023 (1927), acq. 7-1 C.B. 14 (1928).
229. Knuckles, 23 T.C.M. (CCH) at 185.
230. See supra text accompanying notes 96-102.
231. 26 T.C. at 204. Cf. Kleinschmidt v. Commissioner, 12 T.C. 921, 921 (1949) (legal fees to prosecute a libel suit to recoup damages for injury to “personal reputation and good name ‘as a citizen, lawyer, banker, and a churchman’” did not constitute deductible ordinary and necessary expenses of carrying on his trade or business).
233. Id. at 204.
fessional reputation is taxable. The *Draper* court did not specifically rule on the tax consequences of a defamation award since the petitioner did not receive one. Thus, it would be questionable logic for a court to cite to the *Draper* decision in support of the proposition that an award for the defamation of an individual's professional reputation is taxable. Moreover, it is quite possible that the *Draper* court misinterpreted the underlying source of the expenses involved.

Draper, a professional dancer, was accused of being a Communist. In 1948, within the historical framework of the Cold War, the false accusation would obviously have represented a severe stigma to an individual. Therefore, although the record is devoid of any specific information, it is possible that Draper adopted a trial strategy focusing on damage to his professional reputation although in reality the nature of the claim was to his personal reputation. This tactic would have directed the jurors' attention to his loss of profits as opposed to his loss of self-esteem. Therefore, in reality, the legal expenses incurred would have constituted personal expenditures and should not have been deductible.

**B. Recent Cases**

In *Seay v. Commissioner*, the petitioner threatened to initiate a counter-suit against Froedtert Malt Corporation for causing him embarrassment which damaged his personal reputation. The suit never came to fruition since a settlement was reached in which Seay received $105,000. Of this amount, the petitioner reported $60,000 as ordinary income (representing one year's salary) and the remaining $45,000 as non-taxable. The company agreed that the $45,000 paid to Seay, as well as additional sums to other individuals, were paid "as compensation for such personal embarrassment,

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234. *Id.* at 202.
235. For a general discussion of the Cold War see W. LIPPMANN, THE COLD WAR: A STUDY IN U.S. FOREIGN POLICY. *See* Church v. Commissioner, *Tax Ct. Rep.* (CCH) Dec. No. 40,216 (June 20, 1983) (former Arizona attorney general's political career was ruined when he was falsely accused of being a communist).
237. The company terminated the plaintiff's employment as president and when he refused to vacate the premises, sought an injunction to keep him from managing the company or occupying the premises. The filing of the complaint was printed in newspapers including the *Wall Street Journal*. 58 T.C. at 33-34.
238. *Id.* at 35.
239. *Id.* Seay deducted his legal fees from that amount.
240. *Id.* at 36.
ment and physical strain and injury to health and personal reputation in the community' as the members of the Seay group had suffered.\textsuperscript{241} The Commissioner, however, levied a deficiency on Seay for the $45,000, claiming that this sum also represented income.\textsuperscript{242} The Tax Court held that the additional $45,000 was excludable from gross income since it was covered by section 104(a)(2).\textsuperscript{243} Furthermore, the court stated an essential principle: it is "the nature of the claim settled and not the validity of the claim"\textsuperscript{244} which is decisive in determining if section 104(a)(2) applies.\textsuperscript{245} Consequently, since the company agreed that the $45,000 was paid as compensation for damage to Seay's personal reputation, there was a personal injury award as encompassed in section 104(a)(2).\textsuperscript{246}

Six years later, the Tax Court decided \textit{Wolfson v. Commissioner}.\textsuperscript{247} The petitioner in \textit{Wolfson} instituted suit against his former employer originally seeking $144,000 for lost income and damages to his professional reputation as well as reinstatement to his former position at Wayne State University.\textsuperscript{248} The petitioner received a verdict for $175,000 but was not reinstated.\textsuperscript{249} He appealed, but before the case was heard, the parties reached a settlement in which the petitioner received $105,000 and his employer agreed to correct his record to reflect the fact that the petitioner was a member of the faculty of the school of medicine during the disputed period.\textsuperscript{250}

The Tax Court, affirmed on appeal,\textsuperscript{251} noted that Wolfson did not address the issue of whether damages to a professional reputation should be considered taxable.\textsuperscript{252} Although Wolfson originally alleged damage to his professional reputation in the state court proceeding,\textsuperscript{253} in the Tax Court he "rel[ied] solely upon his [revised] contention that the damages were [in reality] for libel to his personal

\begin{itemize}
\item \textsuperscript{241} \textit{Id.} at 35 (citation omitted).
\item \textsuperscript{242} \textit{Id.}
\item \textsuperscript{243} \textit{Id.} at 37.
\item \textsuperscript{244} \textit{Id.}
\item \textsuperscript{245} \textit{Id.}
\item \textsuperscript{246} \textit{Id.} at 37-38
\item \textsuperscript{247} \textit{47 T.C.M. (P-H) 1} 78, 445, 1852 (1978), \textit{aff'd and remanded}, 651 F.2d 1228 (6th Cir. 1981).
\item \textsuperscript{248} \textit{Id.} at 1856.
\item \textsuperscript{249} \textit{Id.} at 1857.
\item \textsuperscript{250} \textit{Id.} Wayne State University also agreed to forward this information to any individual who might inquire as to the plaintiff's relationship with the school.
\item \textsuperscript{251} 652 F.2d 1228 (6th Cir. 1981).
\item \textsuperscript{252} \textit{Wolfson}, \textit{47 T.C.M.} at 1859 n.9.
\item \textsuperscript{253} \textit{Id.} at 1859-60.
\end{itemize}
reputation; accordingly, petitioner did not adopt an alternative position in the event we found that damages were to his business reputation.\textsuperscript{254} The Tax Court concluded that the $105,000 payment was made on account of damages to the petitioner’s professional reputation.\textsuperscript{285} The Tax Court held that since the “petitioner [did] not address the issue of whether damages to an employee’s professional reputation are excludable from income, apparently conceding the validity of Rev. Rul. 58-418. . . . We hold the amounts are includable in income.”\textsuperscript{256} The court further concluded this issue with the following statement:

We expressly leave open the questions, however, of whether there is a valid distinction between damage to one’s personal reputation and damage to an employee’s professional reputation for purposes of section 104(a)(2), and, assuming there is a valid distinction, whether an award for damages to an employee’s professional reputation nonetheless represents a nontaxable return of capital.\textsuperscript{267}

In retrospect, had the petitioner’s attorney argued that, for tax purposes, there is no reason to differentiate between the two types of reputations, the award received might have been excludable from gross income. In his presentation to the court, the attorney should have focused the court’s attention on the policy behind section 104(a)(2),\textsuperscript{266} prior case law,\textsuperscript{268} and the personal nature of the petitioner’s injury.\textsuperscript{269}

Three years later, the Tax Court in \textit{Glynn v. Commissioner,}\textsuperscript{261} stated in dictum that:

[P]ayments for injury to professional reputation are not excludable from gross income, since any damages alleged to have been paid as a result of such injury would not fall within the exclusion 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 might have been or might be lost, and thus,

\begin{itemize}
  \item 254. \textit{Id.} at 1859 n.9.
  \item 255. \textit{Id.} at 1859.
  \item 256. \textit{Id.} at 1860.
  \item 257. \textit{Id.} (citations omitted).
  \item 258. \textit{See supra} notes 110-53 and accompanying text.
  \item 259. \textit{See supra} notes 164-257 and accompanying text; \textit{see also infra} notes 261-87 and accompanying text.
  \item 260. \textit{See supra} notes 145-63 and accompanying text.
  \item 261. \textit{Glynn v. Commissioner,} 76 T.C. 116 (1981), \textit{aff’d mem.}, 676 F.2d 682 (1st Cir. 1982).
\end{itemize}
being compensatory by nature, would be taxable as ordinary income.\textsuperscript{262}

This dicta represents a questionable position for the court to have taken in light of prior case law and the cases cited in support of its position. Specifically, the \textit{Glynn} court cites to \textit{Hawkins}\textsuperscript{263} and \textit{Agar}\textsuperscript{264} for analogous support of its proposition. As previously explained,\textsuperscript{265} however, neither \textit{Hawkins} nor \textit{Agar} could be said to provide this court with the logical foundation to reach its conclusion.\textsuperscript{266} The \textit{Hawkins} court never addressed the tax consequences of an award for libel to a professional reputation and the \textit{Agar} court was uncertain whether a reputation could be realistically bifurcated and consequently, whether an award for professional reputation would be taxable.\textsuperscript{267} Furthermore, \textit{Wolfson},\textsuperscript{268} a recent case decided before \textit{Glynn}, expressly left open the questions of whether a valid distinction exists between the two types of reputations and assuming such a distinction existed, whether an award for damage to a professional reputation would be taxable.\textsuperscript{269}

Thus, despite the fact that the \textit{Roemer} Tax Court misinterpreted these cases in determining that defamation to an individual's professional reputation is taxable, the Ninth Circuit had the opportunity to not only correct its result—which it did—but also to rectify its interpretation of the foregoing decisions. Unfortunately, the circuit court chose to disregard an analysis of these relevant cases and narrowly decided the case on state law grounds.\textsuperscript{270}

C. \textit{Why Rely on Glynn as opposed to Evans, Anderson and Gunderson?}

If one merely focuses on the dicta contained in the \textit{Glynn} court

\begin{footnotesize}
\begin{enumerate}[\textsuperscript{262}]
\item \textit{Id.} at 120 (emphasis in original) (citations omitted). The court never had to address the taxability question of an award for defamation of professional reputation because the court held that the settlement was essentially severance pay and did not arise from tort-like injuries to the petitioner's person as required under § 104(a)(2). \textit{Id.}
\item Hawkins v. Commissioner, 6 B.T.A. 1023 (1927), \textit{acq.} 7-1 C.B. 14 (1928).
\item Agar v. Commissioner, 290 F.2d 283 (2d Cir. 1961), \textit{aff'd} 19 T.C.M. (CCH) 116 (1960).
\item \textit{See supra} notes 96-102, 204, 207-22 and accompanying text.
\item The \textit{Glynn} court could have used Rev. Rul. 58-418, 1958-2 C.B. 18 as better support for its dictum statement. \textit{See supra} notes 187-91 and accompanying text.
\item \textit{See supra} text accompanying note 220.
\item \textit{Wolfson} v. Commissioner, 47 T.C.M. (P-H) 78, 445 (1978), \textit{aff'd and remanded}, 651 F.2d 1228 (6th Cir. 1981); \textit{see supra} notes 247-57 and accompanying text.
\item \textit{See supra} text accompanying note 257.
\item Roemer, 716 F.2d at 697.
\end{enumerate}
\end{footnotesize}
opinion, then the Roemer Tax Court's decision is not necessarily wrong; the soundness of this dicta, however, is questionable. In Evans v. Commissioner,271 the Tax Court held that in the absence of an allocation among several claims of the $25,000 received by the petitioner upon termination of his services at Southern Illinois University at Carbondale ("SIUC"), the entire settlement must be included in the petitioner's gross income.272 The petitioner alleged that the amount received was solely to compromise his claim of professional defamation, and an allocation was unnecessary.273 The court determined, however, that the "intent of SIUC was to settle all disputed claims, whether in tort or contract, arising out of termination of [petitioner's] employment . . . ."274 Thus, the nature of the claim was contractual. In support of its position, the court focused on the release signed by the petitioner which stated that the release was in "'settlement of any and all claims arising out of the employment or the lack thereof of [the petitioner].' "275 In addition, the release included "an express denial of liability" by his employer.276 In the absence of a portion of the lump sum payment allocated to a tort claim, the court had no choice but to include the money received in the petitioner's gross income.277 It is interesting to note the extent to which the court analyzed the evidence and determined that the nature of the claim was not solely defamation to the petitioner's professional reputation.278

The court, following the Glynn approach, could have rejected the petitioner's claim and still have reached the same outcome because recoveries for defamation of professional reputations are taxable. The court, however, chose not to employ this approach. Therefore, it can be reasonably inferred from the court's analysis that damages for defamation to an individual's professional reputation would be treated as a tort claim under section 104(a)(2) and consequently, excludable from gross income. It should, nevertheless, be

271. 40 T.C.M. (CCH) 260 (1980).
272. Id. at 263 (citation omitted).
273. Id. at 262. Plaintiff had earlier demanded that the release state that it was for, but "not limited to lack of due process, professional defamation, and damage to professional reputation." Id.
274. Id. at 263. The court found the intent of the payor was to settle "claims based on petitioner's employment contract as well as upon petitioner's claim of professional defamation." Id.
275. Id. at 262 (citation omitted).
276. Id.
277. Id.
278. See id. at 262-63.
noted that the court does state in a footnote that "[w]e do not reach
the issue of whether, as petitioner argues, a meaningful distinction
does not exist between professional defamation and personal defama-
tion." Yet, when one focuses on the language used at the end of
the court's opinion, a different conclusion could be reached. The
court states that "[i]n the absence of an allocation of the settlement
among the various claims, all of the payment must be included in
petitioner's gross income." Thus, if an allocation had been made
to the claim for defamation to the petitioner's professional reputa-
tion, then that portion of the award would be non-taxable.

Furthermore, this same conclusion could be reached from the
cases of Anderson v. Commissioner281 and Gunderson v. Commiss-
ioner.282 In both of these cases, a professor executed a release either
tsimilar to or identical to the one executed by the petitioner in Ev-
ans.283 The petitioners, however, did not assert a claim for profes-
sional defamation in their negotiations with the university.284 There
was no allocation of the settlement and the intent of the university
was to make a lump sum settlement on a contractual claim so that
the entire amount would be includable in the petitioner's gross in-
come.285 This did not, however, prevent these courts from making
extensive analyses to determine whether, in fact, the petitioners
presented a tort-type claim involving damage to their professional
reputations.286 If awards for defamation to an individual's profes-
sional reputation were taxable, then arguably these courts would not
have bothered with their analyses.

Therefore, applying the courts' rationale in Evans, Anderson
and Gunderson, if Roemer's award was granted for defamation to
his professional reputation—a tort-type action287—then the entire

279. Id. at 263 n.4 (citations omitted).
280. Id. at 263 (citation and footnote omitted).
281. 38 T.C.M. (CCH) 1206 (1979).
283. These cases are discussed in Evans, 40 T.C.M. (CCH) at 263 n.5. All three were
released from employment surrounding the same state budget cut.
284. Anderson, 38 T.C.M. (CCH) at 1208; Gunderson, 38 T.C.M. (CCH) at 465.
285. Anderson, 38 T.C.M. (CCH) at 1208-09; Gunderson, 38 T.C.M. (CCH) at 465.
286. Anderson, 38 T.C.M. (CCH) at 1208-09; Gunderson, 38 T.C.M. (CCH) at 465.
Anderson also noted that the court was "not called upon to decide whether damages received
for 'professional defamation, and damage to professional reputation' qualify[ed] as damages
received 'on account of personal injuries' within the meaning of sec. 104(a)(2)." 38 T.C.M.
(CCH) at 1208 n.5 (citations omitted).
287. Defamation is a tort. Consequently, irrespective of what aspect of an individual is
defamed, it still remains a tort.
award should be non-taxable. It is unclear why the Roemer Tax Court cited Glynn and did not apply the cases of Evans, Anderson, and Gunderson in determining the taxability of Roemer's damage award. Moreover, had the Ninth Circuit in Roemer been willing to focus its analysis on these relevant federal Tax Court decisions, it could have easily circumvented any future misplaced reliance on Glynn.

D. Why Must a Distinction Be Made?

The Roemer Tax Court held that "a distinction must be made"288 between an individual's personal and professional reputation. The crucial question which then arises is: Why must such a distinction be made? "[T]he law recognizes in every man a right to have the estimation in which he stands in the opinion of others unaffected by false statements to his discredit . . . ."289 In addition, society retains a strong commitment in preventing attacks upon reputation.290 The individual's right to the protection of his own good name "reflects no more than our basic concept of the essential dignity and worth of every human being—a concept at the root of any decent system of ordered liberty."291

In determining whether a settlement was intended as compensation for personal injuries the validity of the claim is irrelevant. Petitioner must show the nature of the claim which was the basis of settlement. To determine the nature of the claim settled, the focal point is the intention of the payor.292

In a defamation suit, the payor-defendant is required to pay for the actual harm inflicted by his defamatory falsehood including "impairment of reputation and standing in the community, personal humiliation and mental anguish and suffering."293 The defendant is paying for the personal injury inflicted, which is, therefore, a tort-type action. In Roemer, the petitioner presented a personal injury claim to the Tax Court. At trial, the value of his lost profits was stressed to assist the jury in estimating his damages.294 These lost profits, how-

291. Id. at 92 (Stewart, J., concurring).
292. Evans, 40 T.C.M. (CCH) at 262 (citations omitted).
294. Roemer, 79 T.C. at 413 (Forrester, J., dissenting); see supra text accompanying
ever, were in no way determinative of the essential nature of his claim.

Thus, when an individual's professional reputation is defamed, his personal reputation suffers as well, since the former is merely a manifestation of the latter. Roemer claimed that, prior to the time Retail Credit published its report, he enjoyed a good name and a fine reputation with respect to high standards of business, service rendered to clients, credit standing, honesty, integrity, and financial responsibility.295 As a result of these attributes, Roemer enjoyed the continued patronage of his clients and employers.296 Moreover, the success of the petitioner's insurance business depended on these personal characteristics as well as on his quality of service and high standards of business practice.297 Thus, Roemer's professional reputation for being an honest and sincere businessman was simply a manifestation of the qualities which comprised his personal nature. Therefore, the Roemer case exemplifies the notion that defamation suits represent tort-type claims encompassed under section 104(a)(2) because the nature of the claim is of a personal injury type. Consequently, the entire award in such litigation should be considered non-taxable. In addition, it is unnecessary to distinguish, as did the Roemer Tax Court, between an individual's occupation and reputation,298 since once a defamation suit is involved, any award is inherently personal for tax purposes and no further analysis should be required.

The Ninth Circuit astutely observed that such an artificial bifurcation of personal and professional reputation is illogical. Furthermore, although it correctly determined that the proper focus should be on the personal-nonpersonal distinction for section 104(a)(2) purposes, ascertaining whether the underlying award is, in fact, personal may still be problematic since one is relegated to the applicable state law.

296. Id.
297. Id.
298. Id. at 405-06; see supra notes 42-44 and accompanying text.
IV. CONCLUSION

"An action for defamation has been traditionally regarded as that part of tort law which protects the interest of a person in his reputation . . . .” 299 A reputation, unlike material things in life, is practically impossible to regain once it has been defamed. 300 According to the Tax Court in Roemer, defamation to an individual’s professional reputation is not a personal injury for purposes of determining the taxability of defamation awards under section 104(a)(2). 301

The IRC is devoid of any justification for section 104(a)(2). The Ninth Circuit, in reversing the Tax Court’s decision, has established that the relevant distinction for this exclusion is between personal and nonpersonal injury as opposed to physical and nonphysical injury. 302 Therefore, the ruined career and shattered dreams of Roemer constituted a personal injury and the award received was non-taxable. The Ninth Circuit emphasized that under California state law the tort of defamation is a personal injury. 303 Furthermore, it determined that there is no reason to differentiate for tax purposes between defamation to an individual’s personal and professional reputations; recoveries in both situations are non-taxable. Although the Ninth Circuit appears to have incorporated a Suffered-Enough Concept into its analysis of section 104(a)(2), 304 as a result of its narrow construction of the applicability of this concept, the potential still exists for a taxable award in this area.

The Ninth Circuit should have established a broader interpretation of the Suffered-Enough Concept, as the relevant policy reason behind section 104(a)(2). This would guarantee judicial recognition of Congress’ intent to confer a humanitarian benefit on the victim. Furthermore, the Ninth Circuit should have correlated the Suffered-Enough Concept with the established federal tax law in order to insure a uniform nationwide application of section 104(a)(2) where an individual’s reputation has been defamed.

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299. See L. Eldredge, supra note 14, at 2.
300. Id.
301. Id. at 10-11.
302. Roemer, 716 F.2d at 697.
303. Id. at 700.
304. Id. at 696.