***22 T.C. 630 (1954)***

Payments received on a judgment, where the judgment itself represents the return of capital rather than compensation for lost profits, are not taxable as ordinary income.

**Summary**

Nevada Oil Co. (petitioner) received payments on a judgment stemming from a lawsuit by minority stockholders against a corporation for mismanagement. The Tax Court held that these payments were not taxable as ordinary income. The court reasoned that the judgment represented a return of capital to the minority shareholders who had exchanged their stock for the judgment and oil leases. Because the petitioner acquired the judgment in a transaction that was, in effect, a settlement for the surrender of stock, the payments it received were treated as a return of capital, not ordinary income derived from profits.

**Facts**

Prior to October 6, 1943, the W. C. Turnbow Petroleum Corporation (Corporation) and W. C. Turnbow were involved in litigation with minority stockholders. The stockholders sued for mismanagement, and a judgment was entered in their favor against Turnbow. The minority stockholders formed Nevada Oil Co. (petitioner) to take over their interests and were substituted for them in the amended judgment. The final amended judgment ordered that the Corporation and W. C. Turnbow pay $150,000 with interest to the petitioner. The judgment was to be paid in installments. The petitioner received payments on the judgment in 1947 and 1948, which it did not report as income. The IRS determined deficiencies, claiming the payments were ordinary income.

**Procedural History**

Minority stockholders sued the Corporation and Turnbow. The District Court entered an initial judgment and then, after a motion for rehearing, a final amended judgment. The petitioner was created and substituted as the plaintiff in the case after the initial judgment. The IRS assessed income tax deficiencies against the petitioner. The petitioner challenged the deficiencies in the U.S. Tax Court.

**Issue(s)**

Whether the amounts received by the petitioner as payments on the judgment were taxable as ordinary income.

**Holding**

No, because the judgment payments represented a return of capital, not ordinary income.

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## Court’s Reasoning

The court considered the nature of the judgment and the circumstances under which it was obtained. The court found the judgment was, in essence, a settlement that allowed minority shareholders to exchange their stock for assets. The judgment itself and the subsequent installment payments did not represent compensation for lost profits or income derived from the business. The court distinguished the case from precedents where payments received as a result of litigation were considered taxable income because they compensated for lost profits. Here, the payments were a return of capital. The court also noted the original judgment indicated the payment was to be in the nature of a dividend, which further supported the conclusion that it was a return of capital and not ordinary income.

## Practical Implications

This case is significant because it clarifies that the tax treatment of payments received as a result of a legal judgment depends on the nature of the underlying asset or claim. If the judgment represents a recovery of capital, such as the value of a surrendered stock, then the payments received are generally treated as a return of capital, not ordinary income. This principle has implications for structuring settlements and for how taxpayers account for proceeds from litigation. When litigating cases, attorneys must consider the nature of damages or recovery requested to determine proper tax treatment. This also affects how businesses will choose to structure settlements or buyouts.

## Meta Description

The case establishes that payments from a judgment are not taxable as ordinary income if they represent a return of capital rather than compensation for lost profits or revenue.

## Tags

Nevada Oil Co., Tax Court, 1954, Income Tax, Return of Capital, Judgment, Stockholder Dispute

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