Mittleman v. Commissioner, 56 T. C. 171, 1971 U. S. Tax Ct. LEXIS 144 (1971)

Liquidated damages received from a terminated executory contract to sell stock are taxable as ordinary income, not capital gains.

Summary

In Mittleman v. Commissioner, the Tax Court ruled that the petitioner realized ordinary income from liquidated damages when a contract to sell stock was terminated. Meyer Mittleman entered into an agreement to purchase stock from Abe Gottlieb and subsequently arranged to sell a portion of that stock to Allan Glassman. When Glassman withdrew from the agreement, Mittleman retained a portion of Glassman's payments as liquidated damages. The court held that these damages were taxable as ordinary income because the sale to Glassman was still executory at the time of termination, and the retained payments were not from the sale or exchange of a capital asset.

Facts

In 1962, Meyer Mittleman agreed to purchase stock from Abe Gottlieb and entered into a separate agreement to sell a portion of that stock to Allan Glassman. Glassman was to make a downpayment and periodic payments, with the agreement stipulating that if Glassman did not complete the payments, he would receive back his downpayment and one-third of the periodic payments as liquidated damages. In 1963, Glassman voluntarily left his employment with the corporations involved and terminated the stock purchase agreement with Mittleman. Mittleman repurchased Glassman's interest for $40,783, retaining $19,817 as liquidated damages under the original agreement.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Mittleman's 1963 Federal income tax, asserting that the $19,817 retained from Glassman constituted taxable income. Mittleman petitioned the United States Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination, ruling that the amount retained was taxable as ordinary income.

Issue(s)

1. Whether Mittleman realized a gain as a result of the termination of the stock sale agreement with Glassman.
2. Whether the gain realized by Mittleman is taxable as ordinary income or capital gain.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because Mittleman retained $19,817 as liquidated damages when Glassman terminated the agreement, which constituted a gain to Mittleman.
2. Yes, because the gain was from liquidated damages under an executory contract, not from the sale or exchange of a capital asset.

Court’s Reasoning

The court found that the agreement between Mittleman and Glassman was executory, meaning the sale of stock was not complete until full payment was made. When Glassman terminated the agreement, Mittleman retained a portion of the payments as liquidated damages, which were not tied to the sale or exchange of a capital asset. The court applied the rule that liquidated damages from a terminated contract are taxable as ordinary income, citing cases such as *Schuster’s Express, Inc. v. Commissioner* and *Commissioner v. Ferrer*. The court also rejected Mittleman’s argument that the substance of the agreements differed from their form, finding no strong proof to support this claim. The court emphasized that the written agreements clearly established Mittleman as the primary purchaser from Gottlieb and the seller to Glassman, and that the termination of the executory agreement with Glassman resulted in ordinary income to Mittleman.

Practical Implications

This decision impacts how liquidated damages from terminated contracts are treated for tax purposes. Attorneys and tax professionals should advise clients that such damages are likely to be taxed as ordinary income, not capital gains, when the underlying contract remains executory. This ruling may influence the structuring of stock purchase agreements, particularly in terms of specifying conditions for termination and the treatment of payments upon such termination. Businesses should consider the tax implications when entering into agreements that could potentially lead to liquidated damages. Subsequent cases, such as *Commissioner v. National Alfalfa Dehydrating and Milling Co.* , have cited *Mittleman* to support the taxation of liquidated damages as ordinary income in similar contexts.

© 2025 SCOTUSreports.com. All rights reserved.