Roemer v. Commissioner, 79 T. C. 398 (1982)

Compensatory and punitive damages for defamation are taxable as ordinary income when primarily related to business reputation, not personal injuries.

Summary

Paul Roemer, an insurance broker, sued Retail Credit Co. for libel and received $40,000 in compensatory damages and $250,000 in punitive damages. The Tax Court held that neither the compensatory nor punitive damages were excludable from Roemer's gross income under IRC section 104(a)(2), as they were awarded primarily for damage to his business reputation, not personal injuries. The court further ruled that the damages were taxable as ordinary income, not capital gain, and deemed the issue of costs moot. Dissenting opinions argued that the damages were for injury to personal reputation and thus should be excludable.

Facts

Paul Roemer, an insurance broker, was defamed by Retail Credit Co. in a report that led to the denial of his agency license applications and damaged his business. He sued for libel and was awarded $40,000 in compensatory damages and $250,000 in punitive damages. The trial focused on the impact of the defamation on Roemer's business opportunities and reputation within the insurance industry. Roemer reported part of the damages as income on his 1975 tax return, but the Commissioner of Internal Revenue determined that the entire award should be included in his gross income.

Procedural History

Roemer filed a petition in the U. S. Tax Court challenging the Commissioner's determination that the damages he received were taxable income. The Tax Court upheld the Commissioner's position, ruling that the compensatory and punitive damages were taxable as ordinary income. The court's decision was split, with dissenting opinions arguing for the exclusion of the damages from income under IRC section 104(a)(2).

Issue(s)

1. Whether compensatory damages of $40,000 received by Roemer for defamation are excludable from gross income under IRC section 104(a)(2) as damages received on account of personal injuries.
2. Whether punitive damages of $250,000 received by Roemer in the same defamation suit are excludable from gross income under IRC section 104(a)(2).
3. If the compensatory and punitive damages are includable in Roemer's gross income, whether they should be treated as ordinary income or capital gain.
4. Whether costs of $7,751 are includable in Roemer's gross income and, if so, whether they are deductible under section 212.

Holding

1. No, because the compensatory damages were awarded primarily for damage to Roemer's business and professional reputation, not for personal injuries.
2. No, because the punitive damages were not awarded on account of personal injuries but rather for the defendant's conduct.
3. The damages are taxable as ordinary income because they represent compensation for lost profits and business opportunities, not a return of capital.
4. The issue of costs is moot, as the result would be the same under either the Commissioner's or Roemer's rationale.

Court's Reasoning

The court distinguished between damages for injury to personal reputation and those for injury to business reputation, holding that only the former are excludable under IRC section 104(a)(2). The court examined the nature of Roemer's claims and the evidence presented at the libel trial, concluding that the damages were awarded primarily for harm to his business reputation. The court relied on the principle that the tax consequences of damages depend on the nature of the litigation and the origin of the claims. It rejected Roemer's argument that the damages should be treated as capital gain, finding no evidence that the jury awarded any portion for loss of goodwill. Dissenting opinions argued that the damages were for injury to personal reputation and should be excludable, emphasizing the intertwined nature of Roemer's personal and professional reputation. The court also followed the Supreme Court's ruling in Commissioner v. Glenshaw Glass Co. that punitive damages are taxable as ordinary income.

Practical Implications

This decision clarifies that damages for defamation are taxable as ordinary income when they primarily relate to business reputation, even if personal reputation is also affected. Attorneys should carefully analyze the nature of the claims in defamation suits to determine the tax treatment of any damages awarded. The ruling may affect how plaintiffs structure their claims and arguments in defamation cases to potentially benefit from tax exclusions. Businesses and professionals should be aware that damages received for harm to their professional reputation will generally be taxable. Subsequent cases have followed this reasoning, further solidifying the principle that damages related to business reputation are not excludable under IRC section 104(a)(2).

