Catholic University Law Review

Volume 17 | Issue 1 Article 5

1967

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Catholic University Law Review

Recommended Citation
Catholic University Law Review, *Treble Damages – Tax Treatment and Antitrust Policy*, 17 Cath. U. L. Rev. 102 (1968).
Available at: https://scholarship.law.edu/lawreview/vol17/iss1/5

COMMENT / Treble Damages—Tax Treatment and Antitrust Policy*

The tax lawyer is presented with numerous problems as a result of the provisions of the antitrust laws. These problems include the deductibility of legal fees,[1] fines and penalties,[2] the tax consequences of divestiture orders,[3] and the tax treatment of treble damages in private actions.

This comment will be limited to tax controversies arising out of private enforcement of the antitrust laws as provided in Section 4 of the Clayton Act.[4] In turn, this provision for treble damages gives rise to two basic questions. On the one hand, what would be the tax consequences to the unsuccessful defendant who pays treble damages? On the other hand, what should be the consequences to the successful plaintiff who recovers treble damages?

The wisdom of the present law will extensively be examined, but before proceeding to that question, it may be helpful to state the current law. Stated simply, the amount which the defendant pays is an "ordinary and necessary" business expense deductible under Section 162(a) of the Internal Revenue Code.[5] The amount which the plaintiff receives is includable in gross income under Section 61.[6]

Thus, if a defendant is found guilty of price fixing which results in $100,000 damages to the plaintiff, the defendant will pay a $300,000 judg-

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* Written by Kevin E. Booth, a 1967 graduate from Catholic University of America School of Law.

1. Commissioner v. Tellier, 383 U.S. 687 (1966).

2. Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958); Hoover Motor Express Co. v. United States, 356 U.S. 38 (1958); Dixie Mach. Welding & Metal Works, Inc. v. United States, 315 F.2d 439 (5th Cir. 1963).

3. *See* Noall & Troxell, *Tax Aspects of Antitrust Proceedings*, 18 TAX L. REV. 213 (1963).

4. 38 Stat. 731 (1914), 15 U.S.C. § 15 (1964).

5. INT. REV. CODE OF 1954, § 162(a) as interpreted by Rev. Rul. 64-224, 1964-2 CUM. BULL. 52.

6. INT. REV. CODE OF 1954, § 61, *formerly* § 22, as interpreted by the Court in Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955), and later defined by the Service in Treas. Reg. § 1.61e-14(a) (1958).

ment. He will then take a $300,000 tax deduction. Presuming that the defendant is a corporation, it will pay approximately a 50 percent income tax;[7] as a result of its price fixing activities, the corporation will be out-of-pocket $150,000. If the defendant were not a corporation, his tax rate would vary from 14 percent of the first $500 to a maximum of 70 percent on income over $100,000,[8] but the effect would be the same.

On the income side, the problem is more complicated. The $300,000 which the plaintiff received would be includable in gross income. If this money were taxed at the ordinary corporate rate, the plaintiff would pay $150,000 in taxes. If the plaintiff were not a corporation, he would have a tax rate between 14 and 70 percent. Due to the defendant's activity however, the plaintiff probably lost money over several years, and it seems singularly unjust to make him pay at an extremely high rate because he recovers many years' lost profits in one year. Between 1958 and 1964, the plaintiff would have been allowed to spread his income over as many years as he sustained antitrust injuries.[9] In 1964, however, the special code provision allowing this treatment was repealed and Congress substituted the general income-averaging provision.[10]

One further point remains concerning the tax treatment of the plaintiff. In the prior discussion it was assumed that his $300,000 recovery was ordinary income. It is possible, however, that the plaintiff might succeed in having at least one-third of his recovery taxed at the 25 percent capital gains rate. The tax treatment of recoveries in civil litigation depends on the nature of the action upon which the recovery is based.[11] *Commissioner v. Glenshaw Glass Co.*[12] makes it clear that two-thirds of the award will be taxed at the ordinary rate; plaintiffs have been successful, however, in having the one-third actual damages taxed as capital gains.[13]

This possibility of capital gain should be kept in mind by the lawyer drafting the antitrust complaint. If loss of good will (a capital asset) is emphasized, the result may well be a 25 percent tax, rather than the 48 percent rate which would apply if the emphasis is placed on the lost profits. While it is suggested that *Glenshaw Glass* might mean that the additional two-thirds of the award constitutes ordinary income only when the one-third is ordinary

7. *See* INT. REV. CODE OF 1954, § 11 for corporate tax rate.

8. INT. REV. CODE OF 1954, § 1 (a).

9. INT. REV. CODE OF 1954, § 1306, *repealed by* tit. II, § 232 (a), 78 Stat. 105 (1964).

10. INT. REV. CODE OF 1954, § 1301, tit. II, § 232 (a), 78 Stat. 106 (1964).

11. *See generally* Cutler, *Taxation of the Proceeds of Litigation*, 57 COLUM. L. REV. 470 (1957); Castigan, *Income Taxes on Recoveries for Civil Litigation*, U. SO. CAL. 1954 TAX INST. 559.

12. *Supra* note 6.

13. Durkee v. Commissioner, 162 F.2d 184 (6th Cir. 1947); Raytheon Prod. Corp. v. Commissioner, 144 F.2d 110 (1st Cir. 1944).

income,[14] subsequent Tax Court decisions indicate that the punitive portion is always taxable at ordinary rates.[15]

I. The Deduction Question—Revenue Ruling 64-224

Revenue Ruling 64-224[16] has made it clear that a deduction will be allowed for the amount paid in satisfaction of a treble damages judgment. There has been considerable controversy about this ruling ever since it was issued. Representative Emanuel Celler has publicly stated that:

> ... to work such a *de facto* amendment of the antitrust laws by an administrative ruling, not subject to judicial review, in the teeth of the clearly expressed intent of Congress, and in face of a long line of judicial decisions to the contrary, is bad law, bad public policy, and bad public administration.[17]

In a joint press release, Senator Hart and Representative Celler, the chairmen of the Senate and House Antitrust Subcommittees, respectively, stated their opinion that "... the new ruling appears flatly contrary to the existing law as declared by the Supreme Court and the lower federal courts. Accordingly, this ruling seems most unfortunate both as a matter of law and from the viewpoint of tax and antitrust policy."[18]

While the critics of Revenue Ruling 64-224 have been loud and numerous, the ruling has not been without impressive supporters. On October 5, 1965, the Board of Governors of the American Bar Association adopted the following resolution on the recommendation of the sections of antitrust law and taxation: "Resolved, that the American Bar Association approves and endorses in principle the ruling of the Internal Revenue Service, Ruling 64-224. . . ."[19]

The first charge leveled against 64-224 is that it is bad law. What this means is not entirely clear. There is no doubt, however, that it *is* the law, and since the ruling favors the taxpayer, it is unlikely that it will be challenged in court. Consequently, it will remain the law unless the Service changes its position or Congress amends either the Internal Revenue Code or the Clayton Act.

14. Koenig, *Federal Taxation of Private Antitrust Recovery*, 13 STAN. L. REV. 264, 279 (1961).

15. Ralph Freeman, 33 T.C. 323 (1959); Chalmers Cullins, 24 T.C. 322 (1955); *cf.* Rev. Rul. 58-418, 1958-2 CUM. BULL. 52.

16. Rev. Rul. 64-224, 1964-2 CUM. BULL. 52.

17. STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, STUDY OF INCOME TAX TREATMENT OF TREBLE DAMAGE PAYMENTS UNDER THE ANTITRUST LAWS 59 (1965) [hereinafter cited as STAFF STUDY].

18. *Id.* at 44.

19. *Hearings on S. 2479 Before the Subcom. on Antitrust and Monopoloy of the Senate Comm. on the Judiciary*, 89th Cong., 2d Sess. 36 (1966) [hereinafter cited as *Hearings on S. 2479*].

Apparently, the critics believe that an objective analysis of the judicial precedents and legislative history should have led the Service to rule against deductibility. However, an examination of the precedents and legislative history simply fails either to support or discredit Ruling 64-224.

Profitable examination of the Revenue Ruling may begin by looking to the opinion of the tax bar prior to the promulgation of this rule. After an extensive review of the pertinent cases,[20] commentators stated:

> Since there is no authority disallowing deductions for payments made to private litigants, a deduction for the entire amount of the treble damages, plus reasonable attorneys' fees allowed by section 7 of the Sherman Act and section 4 of the Clayton Act, should be allowed.[21]

Thus, it is to be noted that a year before the Service issued its ruling, tax lawyers apparently regarded these expenses deductible.

A. Arguments Against the Deduction

The expense of illegal business activities is not deductible.[22] The test for denial of the deduction is clearly set out in *Tank Truck Rentals, Inc. v. Commissioner,* where the Court said:

> Although each case must turn on its own facts, Jerry Rossman v. Commissioner (CA2) 175 F.2d 711, 713, the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction. The flexibility of such a standard is necessary if we are to accomodate both the congressional intent to tax only net income, and the presumption against congressional intent to encourage violation of declared public policy.[23]

Moreover, the legislative history of Section 7 of the Sherman Act, which preceded Section 4 of the Clayton Act, shows that the section is essentially penal. At one point in the debate on the original Section 7, a controversy arose as to whether jurisdiction to enforce the Act should be given to state courts. Senator Hoar expressed the view of the majority of the Senate that passed the Act: "... but we can not say that a State court shall be clothed with the jurisdiction to enforce a claim for threefold the damages suffered which is purely penal and punitive."[24]

The error of Revenue Ruling 64-224 is demonstrated by the difference between the flagrant criminal antitrust conspiracy from which it comes[25] and

20. Noall & Troxell, *supra* note 3, at 235-37.

21. *Id.* at 237.

22. United States v. Sullivan, 274 U.S. 259, 264 (1927); Tank Truck Rentals, Inc. v. Commissioner, *supra* note 2; Hoover Motor Express Co. v. United States, *supra* note 2.

23. Tank Truck Rentals, Inc. v. Commissioner, *supra* note 2, at 35.

24. 41 CONG. REC. 9164 (1913).

25. It is presumed that the reader is familiar with the background of Rev. Rul. 64-224, but perhaps that background should be briefly summarized. The ruling appears to have

the leading cases allowing the expense deduction. For example, in *Jerry Rossman Corp.*[26] the offense was inadvertent; there was no criminal conviction; the violator voluntarily disclosed the offense and did his best to make restitution.

Finally, there is no evidence of a congressional intent to reduce the "sting" of treble damage payments by allowing a deduction.

B. Arguments in Favor of the Deduction

The deduction should be allowed because actions under Section 4 of the Clayton Act are remedial in nature. Even though the law gives a plaintiff enhanced damages, those damages are remedial when they are "recoverable to his own use and in form and substance the suit calls for indemnity."[27] The Supreme Court has held a treble damage suit is not a suit for a penalty.[28] Likewise, the double damage provision of Section 16 (b) of the Fair Labor Standards Act has been held remedial rather than penal by the Supreme Court.[29]

Since the overriding purpose of our income tax is to tax net, rather than gross income, the denial of deductions on policy grounds should be narrowly construed.[30] The cases which have denied the deduction seem to fall into six categories. These are: (1) a fine or penalty paid directly to the state or local government; (2) expenses to influence legislation; (3) legal fees in connection with unsuccessful defenses of criminal actions;[31] (4) payments to private persons when the payment itself is illegal, for example, bribes and kickbacks; (5) cost of liquor for entertainment in "dry" states; and (6) business entertainment of public officials. Since antitrust treble damage payments to pri-

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been issued on the initiative of the Service, but undoubtedly as the result of the *Philadelphia Electric* cases. This was a case of "hard core" price fixing. Seven executives went to prison; 23 other officers were given suspended jail sentences and five years probation, and the companies paid $2 million in fines.

As a result, 1,800 civil suits have been brought for treble damages. General Electric, the largest of the offenders, has already paid $190 million in settlements. Estimates of the industry-wide settlement figure for civil suits range as high as $400 million. Thus it should be noted that not only are we talking about a "hard core" criminal conspiracy, but we are talking about $200 million in lost taxes.

26. Jerry Rossman Corp. v. Commissioner, 175 F.2d 711 (2d Cir. 1949). The defendant corporation had inadvertently charged in excess of OPA ceiling and the payments involved were voluntary payments made to the Administrator because the parties affected by overcharges could not be located.

27. Reed v. Northfield, 30 Mass. (13 Pick.) 94, 101 (1832); Huntington v. Attrill, 146 U.S. 657, 668 (1892).

28. Chattanooga Foundry & Pipe Works v. Atlanta, 203 U.S. 390 (1906) (dictum). The penal or remedial question arose in the context of deciding whether the state or federal statute of limitations should be applied.

29. Overnight Motor Transp. Co. v. Missel, 316 U.S. 572, 583 (1942).

30. Tank Truck Rentals, Inc. v. Commissioner, *supra* note 2.

31. Cases denying deductions for this reason have probably been overturned by the recent Supreme Court decision in Commissioner v. Tellier, *supra* note 1.

vate persons do not fall into any of the situations where the deduction has commonly been disallowed, the Internal Revenue Service was correct in allowing the deduction, and if the result was bad antitrust policy, Congress should legislatively disallow the deduction.

C. *Revenue Ruling 64-224 Was Not Unreasonable*

The conclusion is that the Internal Revenue Service, looking at the precedent and legislative history which existed at the time it issued 64-224, could either have allowed or disallowed the deduction. Its interpretation was not unreasonable. This sentiment was expressed by William Orrick, former head of the Antitrust Division:

> The Antitrust Division does not consider metaphysical speculation on whether 15 U.S.C. § 15 is "penal" or "remedial" to be fruitful; the Congress which passed the Sherman Act couldn't even decide that question. Compare the position of Senator Hoar in 21 Cong. Rec. 3146 (1890) with that of Senator Reagan in 21 Cong. Rec. 3146 (1890).[32]

Faced with the necessity of deciding the question because of the tremendous treble damage payments growing out of the *Philadelphia Electric* cases,[33] the Commissioner decided to allow the deduction. Viewed in the context of the Commissioner's inability to amend the Internal Revenue Code and his responsibility for its objective interpretation, it is difficult to view Ruling 64-224 as an incorrect application of existing law.

Support for the Commissioner's position is found in a recent article:

> ... no matter what one might conclude as a matter of first impression, it appears too late to argue today that an expense cannot under *any* circumstances be "ordinary and necessary" in the generally accepted sense simply for the reason that it is improper in itself or is incurred in connection with illegal or improper activity. The clear weight of judicial opinion has not supported this line of thinking.[34]

It must be remembered that the Internal Revenue Service is bound to interpret the Code in a judicial manner, "in a fair and impartial manner, from neither a government nor a taxpayer point of view."[35]

Finally, Commissioner Cohen's opinion that the subsequent *Tellier* case[36] supports Revenue Ruling 64-224 is valid.[37] It is reasonable to view the unani-

32. STAFF STUDY, *supra* note 17, at 105-06. The statement was made in a letter from Mr. Orrick to Mr. Mortimer M. Caplin, Commissioner of the Internal Revenue Service, Sept. 13, 1963.

33. *See* note 25 *supra*.

34. Lamont, *Controversial Aspects of Ordinary and Necessary Business Expense*, 42 TAXES 808, 817 (1964).

35. REV. PROC. 64-22, 1964-1 CUM. BULL. 689.

36. Commissioner v. Tellier, *supra* note 1.

37. STAFF STUDY, *supra* note 17, at 87.

mous Court in *Tellier* as giving notice to the Service that the public policy exception to the general rule of deductibility is a very limited one.[38]

D. Antitrust Policy—Congress Should Reverse Revenue Ruling 64-224

Legislation should be enacted reversing Ruling 64-224, not because the Service was in error or because the rule is bad tax law, but because it fails adequately to reconcile conflicting policies of tax and antitrust law.

The most serious objection to Congressional reversal of 64-224 is the type of argument made by the A.B.A. Section on Taxation. "[T]he Section does not believe it is wise tax policy to attempt to achieve social goals in other areas by manipulation of tax provisions."[39] This argument has much to recommend it; perhaps the tax laws should be morally neutral and the tax horizon should not be clouded by other social policies. There is much in the legislative history of The 1913 Income Tax Act[40] which supports the A.B.A. position. During the debates on the bill, an attempt was made to amend the words "ordinary and necessary" in the deduction section, so that a deduction would be allowed for "[l]osses incurred by the taxpayer in the pursuit of any ordinary and legitimate trade or business."[41] This amendment was defeated, the reason for which was clearly expressed by the bill's sponsor, Sen. John Sharp Williams:

> ... the object of this bill is to tax a man's net income; that is to say, what he has at the end of the year [after deductions of his losses].... It is not to reform men's moral characters; that is not the object at all.... [You cannot] count the man as having money which he has not got, because he lost it in a way that you do not approve of.[42]

The response has been made that we are continually using tax law to implement social policy. Frequently cited examples are percentage depletion allowances for minerals,[43] the investment credit provision,[44] accelerated depreciation,[45] and capital gain advantages to patent transfers.[46] However, it is seldom pointed out that on most, if not all, of the occasions when Congress has chosen to implement social policy by means of revenue laws, it has done so by giving the taxpayer an advantage. Frequently, the taxpayer is rewarded by paying less than the fair taxes on his income. Congressional re-

38. While the author agrees with those who view *Tellier* as intended to limit the policy exception to deductibility, the case may have been viewed from another perspective. Since the case allowed legal fees in a criminal action, it is at least plausible that it was aimed at increasing the right to counsel.

39. A.B.A. BULL., SEC. TAX., April 1966, p. 32.

40. The 1913 Income Tax Acts, § II of the Tariff Act of 1913, 38 Stat. 166.

41. 50 CONG. REC. 3850 (1913).

42. 50 CONG. REC. 3849-50 (1913).

43. INT. REV. CODE OF 1954, § 613 (to stimulate exploration for minerals).

44. INT. REV. CODE OF 1954, § 38 (to stimulate business expansion).

45. INT. REV. CODE OF 1954, § 167 (to stimulate increase in depreciable assets).

46. INT. REV. CODE OF 1954, § 1235 (to stimulate invention).

versal of Revenue Ruling 64-224 would not reward any taxpayer; rather, it would be a special provision giving a disadvantage. It is certainly arguable that the violator of the antitrust laws would be taxed to some extent on his gross rather than his net income. Although the issue has not been resolved, there is some authority for the proposition that the term "income," as used in the sixteenth amendment, means "net income," and not "gross income" or "gross receipts."[47] This raises the possibility that disallowing the deduction—whether that result be achieved administratively, judicially, or legislatively—would be unconstitutional.

While the constitutional argument holds some theoretical promise, for several reasons it is extremely doubtful that it would succeed. Perhaps the most important is the reluctance of courts to treat tax questions in constitutional terms,[48] but frequently there is language in tax cases indicating that deductions are a matter of "legislative grace." Finally, there is the long history of judicial denial of deductions on public policy grounds.[49]

The A.B.A.'s objection to using tax provisions to foster social policy goals, however, is answered by the fact that courts have been denying deductions on policy grounds for years. If courts can and do deny deductions on policy grounds, then Congress can and should enumerate those policies, frustration of which will result in a denial of deductions. The question is not whether Congress should use the tax system to achieve social goals in other areas; it is "whether or not it is possible to achieve that goal more efficiently, directly, and fairly through other measures which lie outside of the tax system."[50]

Here it would appear that an efficient, fair, and direct way to put a "sting" into the antitrust laws and discourage businessmen from frustrating a national policy is to deny deductions for the payment of treble damages, at least in certain circumstances. This presents a major question. If Ruling 64-224 is to be reversed by Congress, what result should the new legislation achieve? Two bills have been introduced. On August 30, 1965, Sen. Philip Hart introduced a bill[51] to amend Section 4 of the Clayton Act. On July 25, 1966, Sen. Russel Long introduced legislation[52] to amend Section 162 (a) of the Internal Reve-

47. Commissioner v. Weisman, 197 F.2d 221 (1st Cir. 1952); Hofferbert v. Anderson Oldsmobile, Inc., 197 F.2d 504 (4th Cir. 1952).

48. For example, a similar argument was recently made in the Tax Court in Hagan Advertising Displays, Inc. v. Commissioner, 47 T.C. No. 13 (Nov. 18, 1966), but the court brushed aside the constitutional argument and decided on the basis of INT. REV. CODE OF 1954, § 446 (b).

49. *See, e.g.*, Tank Truck Rentals, Inc. v. Commissioner, *supra* note 2.

50. Remarks by the Honorable Stanley S. Surrey, Assistant Secretary of the Treasury before the Tax Executives Institute, March 7, 1966, cited in Wright, *A Tax Formula to Restore the Historical Effects of the Antitrust Treble Damage Provision*, 65 MICH. L. REV. 245 (1966).

51. S. 2479, 89th Cong., 1st Sess. (1965).

52. S. 3650, 89th Cong., 2d Sess. (1966).

nue Code. Both bills died in committee, Senator Hart's in the Committee on the Judiciary and Senator Long's bill in the Committee on Finance.[53]

Senator Hart's bill would have amended Section 4 of the Clayton Act by providing "any judgment entered" and "any payment made by a defendant in settlement... shall be treated as a penalty imposed on such defendant by the United States for such violation."[54]

Senator Long's bill was less sweeping. First, it would have denied a deduction for only two-thirds punitive damages; in no event would it have taxed the one-third actual damages. Second, even the two-thirds deduction would have been disallowed only when the defendant had been subject to a prior criminal proceeding, as long as there had been a prior criminal proceeding which established the antitrust violation as "hard core." Here, the two-thirds disallowance would have applied to either judgment or settlement.

These proposed amendments must be examined in light of the assertion that allowing the antitrust defendant to pass 50 percent of his treble damage judgment on to the Treasury is emphasizing tax policy at the expense of antitrust policy.

Senator Hart's bill said only that the award would be a "penalty." He would have depended on case law, such as *Tank Truck Rentals,*[55] to produce a deduction exclusion. In the light of the bill's legislative history, it seems reasonable that the bill would have had the intended effect, but "penalty" is a word of many legal meanings.[56] Reliance on that word to automatically exclude the deduction is risky business at best. Assistant Attorney General Donald Turner testified that "[b]ecause of the reasoning of the Supreme Court in its recent decision in *Commissioner v. Tellier,* there is an element of uncertainty as to the precise tax consequences which S. 2479 would have."[57]

Mr. Turner also pointed out that under 15 U.S.C. § 32, a natural person giving testimony in any antitrust proceeding is immune from prosecution or penalty concerning any transaction about which he has testified.[58] Since treble damages become a penalty under the Hart bill, the proposed legislation might have immunized persons who testified in earlier suits from later

53. The reason that two bills, which were to do substantially the same thing, went to different committees should be explained. Senator Hart's Subcommittee on Antitrust and Monopoly is part of the Judiciary Committee and supervises the antitrust laws. The Finance Committee, of which Senator Long is Chairman, is responsible for the Internal Revenue Code.

54. S. 2479, 89th Cong., 1st Sess. (1965).

55. Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958).

56. Professor Vold has suggested ten shades of meaning. Vold, *Constitutionality of Statutory Double or Treble Damages Provisions in Nebraska,* 19 NEB. L. REV. 63, 65-66 (1940). Moreover, penalty used in the sense S. 2479 uses it probably is not its normal meaning; *cf.* Huntington v. Attrill, 146 U.S. 657 (1892).

57. *Hearings on S. 2479, supra* note 19, at 26.

58. *Hearings on S. 2479, supra* note 19, at 27.

treble damage actions, possibly leaving the wronged party with no action. Finally, the extent to which the bill might have been given retroactive effect is unclear, and it would appear that the bill's purpose might have been frustrated by settlement prior to the formal commencement of a treble damage action.

Senator Long's bill appeared to be the better drafted proposal. One reason is that it would have amended the Internal Revenue Code, and this is perhaps the more reasonable approach to the problem. While either proposal was motivated by a concern for antitrust policy, tax law is the subject in question, and that is the law which should be amended. No hearings were held on the Long bill. Perhaps defects in the drafting would come to light if the bill had been subjected to public hearings. However, at this time, objections to the proposal would seem to be more a question of the policy decisions which went into its drafting than of technical deficiencies.

While it is not important in which volume of the United States Code the new legislation appears, it nevertheless seems preferable that the Internal Revenue Code, rather than the Clayton Act, be amended. In any event, the legislation should be definite, as was the proposed revenue amendment, and should not depend on the courts' interpretation of an ambiguous word like "penalty."

Since the purpose of each bill was to put more "sting" into the antitrust laws, there should be little relevance to the fact that the defendant might already have paid taxes on the amount of the actual damages,[59] for the question is not whether the defendant has already paid taxes; it is how large an additional burden should be imposed on the violator. If the desire is to produce the maximum deterrent effect, Senator Hart's denial of the entire deduction appears more appropriate than Senator Long's denial of two-thirds.

Senator Long's distinction between denial, when there has been prior criminal action, and allowance, when there has not been, is probably sound. An antitrust offense can occur when the defendant is in good faith. In this situation, treble damages may be useful in compensating the victim, but there is no reason to increase the penalty on the offender.[60] Since the Antitrust Division should bring a criminal action whenever there is a "hard core" offense, the distinction would apply the increased penalty where it would do the most good.

Finally, it should be noted that both proposals would have applied to both

59. The probable reason that the one-third, two-thirds distinction was placed in S. 3650 is the feeling that normally the taxpayer would have already paid taxes on the one-third; thus, if the defendant is guilty of price fixing so that the plaintiff has been injured to the extent of $100,000, defendant has had $100,000 added income and he has already paid taxes on it.

60. *See* Statement of William Simon for the A.B.A., STAFF STUDY, *supra* note 17, at 35, 40-42.

settlements and judgments. Increasing the "stakes" for the defendant without a corresponding increase for the plaintiff will make the defendant all the more willing to delay and less willing to settle. In addition, settlements might be expected to be lower when the defendant can no longer pass half the cost to the Government. If the deduction is denied only in "hard core" cases, perhaps the failure to distinguish between settlements and judgments makes sense in not allowing the criminal offender to lighten his penalty; but if the denial is going to apply to all offenses, it is suggested that settlements should be stimulated by allowing the deduction when the defendant settles a claim arising out of a noncriminal action.

E. Conclusion

There is nothing sacred about taxation which would leave the area free from all other policy considerations. Revenue Ruling 64-224 has significantly blunted the deterrent effect of a major means of enforcing the antitrust policy, by allowing the defendant to pass one-half of the monetary burden imposed for violation of the antitrust law to the Government by way of a deduction. The present state of the law does not do justice to our national antitrust policy. As a result, regardless of whether the Service's decision was correct or incorrect under existing law, Congress should amend Section 162 (a) of the Internal Revenue Code to deny an "ordinary and necessary" business expense deduction for "hard core" antitrust violations.

II. The Income Question—Commissioner v. Glenshaw Glass Co.[61]

One of the unfortunate side effects of Ruling 64-224 is that it has resulted in considerable interest in the deduction side of the tax-treble damage controversy, while the equally important question of the income side has been almost totally ignored.[62] Since the Supreme Court's opinion in *Commissioner v. Glenshaw Glass Co.*,[63] the plaintiff who recovers a treble damage award under Section 4 of the Clayton Act has income, although the determination whether that income is ordinary or capital gain appears to depend on the individual facts. When *Glenshaw Glass* was decided, its significance was not lost on the legal community.[64] However, in 1957 two bills[65] were introduced

61. 348 U.S. 426 (1955).

62. There appear to be only these recent references to the question of the income status of treble damage payments. *See* Wright, *supra* note 50; the Statement of Professor Wright, *Hearing on S. 2479, supra* note 19, at 3-11; question by Senator Hart to Donald Turner, *Hearing on S. 2479, supra* note 19, at 35.

63. *Supra* note 61.

64. 8 ALA. L. REV. 419 (1956); 9 ARK. L. REV. 462 (1955); 22 BROOKLYN L. REV. 154 (1956); 24 FORDHAM L. REV. 469 (1955); 43 GEO. L.J. 691 (1955); 69 HARV. L. REV. 195 (1955); 54 MICH. L. REV. 151 (1955); 21 MO. L. REV. 187 (1956); 31 NOTRE DAME LAW. 104 (1955); 29 SO. CAL. L. REV. 375 (1956); 2 U.C.L.A.L. REV. 587 (1955); 25 U. CIN. L. REV. 372 (1956); 1 WAYNE L. REV. 233 (1955).

65. H.R. 494, 85th Cong., 1st Sess. (1957) would have exempted private antitrust recoveries

in the House to reverse *Glenshaw Glass*. Neither appears to have received significant support, and Congress contented itself with the various averaging devices previously noted.[66]

Two reasons make it imperative that Congress reconsider the income consequences of treble damages while considering the deduction side. First, private action for treble damages has been described as "the strongest pillar of antitrust."[67] A primary purpose of enacting the treble damage provision was to aid the limited resources of the Justice Department in enforcing the antitrust laws.[68] When the individual victim's incentive to sue is decreased to the point where he will not bring a suit, the "strongest pillar" has collapsed, and any interest in putting the sting in antitrust law by reversing Ruling 64-224 would be wasted effort.

Secondly, it appears to have been assumed that the plaintiff has adequate incentive to sue when success means treble damages. The question is—for the moment ignoring tax consequences—does any plaintiff ever recover treble damages? It is doubtful that he will be able to prove satisfactorily the full extent of his actual damages. Further, the gradual loss of profits over a long period may have effects on a business that cannot be estimated. There will be substantial litigation expenses which cannot be recovered. The amount of time that a plaintiff takes away from his business will never be considered. "When all of these factors are taken into account, it would be a rare and fortunate plaintiff who came out of an antitrust suit with a net recovery amounting to full compensation for his actual damages."[69]

Thus, if treble damages are the "strongest pillar," and the incentive to bring these suits has grown less as a result of *Glenshaw Glass* and high tax rates, Congress should certainly consider modifying *Glenshaw Glass*. But the income question has not only general but also specific relevance at a time when Congress is considering increasing the stakes for the defendant. If the defendant is no longer allowed a tax deduction, at least where he settles, he has more reason to resist private enforcement; plaintiff's job becomes more difficult and his incentive is correspondingly decreased.

In *Glenshaw Glass*, the plaintiff had recovered $800,000 from Hartford-

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from income. H.R. 4566, 85th Cong., 1st Sess. (1957) would have exempted the two-third punitive portion from income.

66. *See* text at notes 9, 10 *supra*.

67. Loevinger, *Private Action—The Strongest Pillar of Antitrust*, 3 ANTITRUST BULL. 167, 172 (1958).

68. *See* Wright, *supra* note 50, at 247 n. 14. Among others, Professor Wright quotes former Attorney General Katzenbach as follows:

> In addition, a great number of cases make it clear that the primary purpose of Congress in providing a private treble damage remedy was to harness private interest as an aid to the Government in antitrust law enforcement and thus to further the public interest in deterring antitrust violations

69. Loevinger, *supra* note 67, at 173.

Empire. It reported only as much of the award as represented actual damages. The Tax Court[70] and the Third Circuit[71] agreed with the taxpayer that the punitive portion of the award was not income. The Supreme Court, with only Justice Douglas dissenting, reversed. Briefly, the Court concluded that the recovery of actual damages was taxable, a fact which the taxpayer necessarily admitted. The Court reasoned that "[i]t 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 . . . ."[72]

It is important that the Court's opinion in that case be viewed in its proper perspective. In the Third Circuit, *Glenshaw* had been consolidated with *Commissioner v. William Goldman Theatres, Inc.*[73] The common question was whether money received as exemplary damages for fraud or as punitive damages for antitrust was includable in gross income. The Court was concerned with whether so-called "windfall" profits were income within the meaning given to the term in *Eisner v. Macomber.*[74] The *Glenshaw* decision was strictly a technical tax decision and no thought appears to have been given to its possible adverse effects on antitrust policy.

Since there is little doubt that *Glenshaw Glass* was correctly decided, there are perhaps only two reasonable paths open for Congressional action. Either Congress could reverse *Glenshaw Glass* and make the two-thirds punitive portion of the award tax free, or they could give capital gains treatment to two-thirds of the recovery.[75] In either event, the one-third actual damages should receive no special tax treatment.

Of the two alternatives, the capital gain treatment is more appealing. First, all money which the plaintiff receives is clearly income to him. It is a rather serious bending of our revenue system to claim that any income is entirely tax free. Although there is no way of knowing exactly how much increased incentive is needed, perhaps 25 percent would be enough, and the proposal would result in a minimum revenue loss. Preferential capital gain treatment is an established tax practice,[76] and income lost as a result of extending such

70. Glenshaw Glass Co. v. Commissioner, 18 T.C. 860 (1952).

71. Commissioner v. Glenshaw Glass Co., 211 F.2d 928 (3rd Cir. 1954), *rev'd,* 348 U.S. 426 (1955).

72. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). *Glenshaw* was decided under § 22 (a) of the INT. REV. CODE OF 1939, but there is absolutely no question that the same result would be reached under § 61 (a) of the present Code.

73. Commissioner v. Glenshaw Glass Co., *supra* note 71.

74. 252 U.S. 189, 207 (1919). The *Eisner* opinion defines income as "'gain derived from capital, from labor, or from both combined . . . .'"

75. *See* Wright, *supra* note 50. Professor Wright would give two-thirds capital gain or one-third tax free. He would give only one-third tax free because he is attempting to restore the "historical effect" to antitrust. While his historical effect analysis is interesting, it does not seem particularly relevant, and to me it makes a lot more sense to give the tax preference to the entire punitive portion of the recovery, *i.e.,* two-thirds.

76. *E.g., see* INT. REV. CODE OF 1954, § 1235.

treatment to treble damages should be recouped if defendants are no longer allowed to take deductions.

Conclusion

There is no question that *Glenshaw Glass* was correctly decided on technical tax principles. Yet, if the desire is to make private antitrust enforcement really effective, the incentive to the plaintiff is at least as important as the deterrent to the defendant. At a time when Congress is considering increasing the stakes for the defendant by changing the tax consequences on the deduction side of treble damages, thereby making the plaintiff's job more difficult and probable settlement offers lower, they should likewise consider increasing the incentive for the plaintiff.

Effective private enforcement of the antitrust laws demands not only that offenders be adequately punished, but also that suits be brought against most offenders. Tax laws should be used to stimulate plaintiffs to bring suits as well as to deter defendants from antitrust violations. It is argued that this added stimulation through capital gain treatment of two-thirds of the recovery should be seriously considered, particularly with regard to plaintiffs who must commence an action without the help of a prior government suit.