

More Thoughts on Taxation of Commercial Litigation Income

To the Editor:

I am writing concerning the article by Nicolas H. Schmelzer, "Tax Treatment of Commercial Litigation Income," *Tax Notes*, Aug. 2, 1999, p. 733. I was delighted to see some aspect of the tax treatment of litigation awards discussed other than section 104. Many tax practitioners (including me) have to focus a good deal on section 104 and the treatment of individual recipients of litigation awards and settlements. There have, after all, been many changes over the past 10 years, both statutory and case law. The case law has been voluminous, including a number of Supreme Court decisions.

In contrast, as Mr. Schmelzer points out, the tax treatment of commercial litigation recoveries has been relatively quiet. Although commercial cases may not splash across the television much the way large sexual discrimination or wrongful termination recoveries do, in gross volume commercial litigation is many times the dollar amount and, arguably, many times the importance to the federal income tax system.

There is every reason that lawyers and litigants alike in commercial litigation should consider tax impacts and tax planning opportunities early on in the litigation (or at least early in the process of resolving it). Nevertheless, from what I can tell, perhaps because of the plethora of changes over the last 10 years affecting section 104, it is the personal injury, employment, and general practice lawyer who may be more savvy about such tax matters than the business litigator.

A good many of them should read Mr. Schmelzer's article. I, for one, think that some of the classic cases he cites, including *Sager Glove v. Commissioner*, 36 T.C. 1173 (1961), *aff'd* 311 F.2d 210 (7th Cir. 1962), and *Raytheon v. Commissioner*, 144 F.2d 110 (1st Cir. 1944), *cert. denied* 323 U.S. 779, are still good law. I will admit that it is a bit puzzling to look at some more recent cases Mr. Schmelzer cites, including *Nahey v. Commissioner*, 111 T.C. 256, *Doc 98-31324 (17 pages)*, *98 TNT 204-14* (1998).

I don't think that the somewhat confusing notion of a sale or exchange in the context of the settlement of a case has been fully explored. The courts are going to have to grapple with this issue further.

However, I don't think that the somewhat confusing notion of a sale or exchange in the context of the settlement of a case has been fully explored. I predict, and I believe Mr. Schmelzer's article is consistent with this notion, that the courts are going to have to grapple with this issue further.

But for now, let's see some more cases involving the tax treatment of business litigation, where the incentive is capital treatment, or even a nontaxable recovery of

basis. It would be a welcome break from all the authority about section 104!

Very truly yours,

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