

# Taxation - Patent Infringement Damages as Taxable Income

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sin statutes<sup>11</sup> applicable to a judge's interest in local litigation were relied upon in reversing the trial court, the element of local prejudice was a factor in the case and is necessarily implied in the statutes relied upon in that decision.

The *Cyra* and *Belden* cases are the only decisions in Wisconsin where the Supreme Court has reversed for abuse of discretion in the matter of local prejudice. Such rarity of Wisconsin decisions indicates the reluctance of appellate courts to interfere with the trial court exercise of discretion.

To the writer this reluctance, as exemplified in the instant case, seems to be carried too far. Certainly no fault can be found where affidavits on the issue of local prejudice are mere recitals of opinions or conclusions. However, where there is a close question of fact to be determined by the trial court, as appears here, discretionary power as upheld by the appellate court is too broad. Surely a change of venue to a more remote and disinterested jurisdiction cannot be prejudicial to either party, whereas denial of change of venue where there is a close question of fact might be unduly prejudicial to the party seeking the change.

No doubt the practical answer is that excitement, sympathy and possible local prejudice evaporates with time, particularly where litigation is delayed, and that change of venue would be the vexatious rule instead of the infrequent exception in an urban community where much litigation occurs. However, practical considerations can not obscure the fact that local prejudice can be initially present, and may linger to the detriment of the party seeking the change of venue.

GILBERT A. SCHNEIDER

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**Taxation — Patent Infringement Damages as Taxable Income —** Plaintiff, a cash basis taxpayer, alleged in his complaint for patent infringement that he had been deprived of "large gains and profits" and prayed that the defendant be enjoined, that it be ordered to pay over both the profits derived from the infringement and the damages which the plaintiff had suffered therefrom. At the hearing before the master, the plaintiff abandoned his claim for profits, choosing only to press the claim for damages. In his report the master recommended that the award of the plaintiff be increased to make the taxpayer's recovery "more nearly adequate to compensate him for the damage to his business under his patent" and the court, following this recommendation, increased the award over forty-five thousand dollars. The judgment finally entered included damages for patent infringement, interest, the increase in the award, and the loss of profits on foreign sales. In his Federal income tax return for 1944, the plaintiff reported as taxable

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<sup>11</sup> WIS. STATS. 261.01, 261.06, 270.16 (1931).

income only the proceeds of the judgment which represented the lost profits. The Commissioner assessed a deficiency, seeking to tax the balance of the judgment after deducting litigation fees and expenses. *Held*: Entire net amount awarded plaintiff constituted taxable income. The plaintiff in his infringement suit failed to allege injury to capital, and the damages asked for were compensation for the profits he would have made absent the infringement complained of. The master did not take any evidence of damages to the plaintiff's capital and the award was made solely to compensate the plaintiff for his unrealized profits. *Mathey vs. Commissioner of Internal Revenue*, 177 F. (2d) 259 (1949).

In determining whether the proceeds of a patent infringement suit constitute a non-taxable return of capital or a taxable recovery of lost profits the courts generally have looked to the nature of the plaintiff's demand. In *U.S. v. Safety Car Heating and Lighting Co.*,<sup>1</sup> the plaintiff asked for an accounting of damages and profits, and then in his complaint waived any recovery for damages and confined his claim to profits received by the infringer. The court held the entire amount taxable income because plaintiff made an election to abandon its claim for damages and confined itself to profits realized by the infringement. It said further to determine what the plaintiff received the court will consider what he asked for, and not what he could have had if he had made another choice. In an equitable action for accounting of profits in a patent infringement action,<sup>2</sup> the Board of Tax Appeals held that even though there was some evidence of injury to capital the sole issue was the amount of profits, and consequently, the entire judgment represented taxable income. In *Commissioner of Internal Revenue v. S. A. Woods Machinery Co.*,<sup>3</sup> cited in the instant case, where plaintiff received its own capital stock in settlement of a patent infringement suit, the court held the receipt of the stock equivalent to the payment of the debt in cash and therefore taxable income although the decree was in the usual order of reference to ascertain damages and profits. It must be observed that the court was preoccupied with the question whether gain or loss could arise out of a transaction in its own capital stock, ignoring the basic issue of taxable income.<sup>4</sup> A more recent decision<sup>5</sup> has held without more that payment of damages on account of infringement is taxable income and not a return of capital. The court therein based its decision on the *U.S. v. Safety Car Heating and Lighting Co.*,<sup>6</sup> and *Commissioner v. S. A. Woods Machinery Co.*<sup>7</sup> cases.

<sup>1</sup> *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88 (1936).

<sup>2</sup> *W. W. Sly Manufacturing Co. v. Commissioner*, 24 B.T.A. 65 (1931).

<sup>3</sup> *Commissioner v. S. A. Woods Machinery Co.*, 57 F. (2d) 635 (C.C.A.1st 1932).

<sup>4</sup> *Commissioner v. S. A. Woods Machinery Co.*, 21 B.T.A. 818, 820 (1930).

<sup>5</sup> *Triplex Safety Glass Co. of N. A. v. Latchum*, 44 F.Supp. 436 (1942).

<sup>6</sup> Note 1, *Supra*.

<sup>7</sup> Note 3, *Supra*.

In spite of this apparent judicial predisposition that an award of damages in patent litigation is an award of compensation for gains or profits to the patent owner, the court in the instant case suggests two avenues of hope for the taxpayer. First, the taxpayer in his complaint in the patent infringement action should allege specifically "loss or damage to capital" and not merely ask for "damages." The second test suggested is that the master in making the award should take evidence of damage to the plaintiff's capital and make the award to compensate the taxpayer for such loss. However, in view of the Act of Congress of 1946<sup>8</sup> making the basis of recovery in patent infringement actions general damages, abolishing sessions before Masters, the two tests presented seem to have practical significance only in patent infringement suits commenced prior to 1946.

PATRICIA MAHONEY

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Torts — Remedies Available for Continuing Trespass — Agents of the defendant, city of New York, had placed refuse on Plaintiff's land over a substantial period of time and failed to remove it. Plaintiff commenced action within six months of the last dumping but failed to allege whether he was suing in trespass or for nuisance. The New York Code contained a statute of limitation which provided for recovery against the city only if the action were commenced within six months of the alleged offense. Plaintiff was desirous of recovery for all the damage done by the numerous disposals, but the city contended that plaintiff could recover only for the last trespass. *Held*: The claim here was for non-feasance and the plaintiff did not claim damages for the overt act. This was a continuing trespass against which the statute of limitations will not run. *Bompton Realty Company v. City of New York*, 91 N.Y.S. (2d) 780, (1949).

This case is a typical example of the tendency of the courts to make no distinction between a problem involving a continuing trespass and one involving a private nuisance. Originally the courts held to the hard fast rule that when a plaintiff who had a cause of action at law sought an injunction, the question must be decided in a court of law prior to resort to equity.<sup>1</sup> The reason was given that if the plaintiff had an

<sup>8</sup> Act of Congress, 1946, amending Revised Statutes 4921 (U.S.C.A. title 35, Patents, Sec. 70) "The several courts vested with jurisdiction of cases arising under the patent laws shall have power to grant injunctions according to the course and principles of courts of equity, to prevent the violation of any right secured by patent, on such terms as the court may deem reasonable; and upon a judgment being rendered in any case for an infringement the complainant shall be entitled to recover general damages which shall be due compensation for making, using or selling the invention, not less than a reasonable royalty therefor, together with such costs, and interest as may be fixed by the court . . . See Senate Committee on Patents, Senate Report No. 1503, June 14, 1946. See Biesterfeld, Chester, *Patent Law*, Ch. XVI, pp. 166-169.

<sup>1</sup> *Zander v. Valentine Blatz Brewing Company*, 95 Wis. 162, 70 N.W. 164 (1897); *Mercantile Library Co. v. University of Pennsylvania*, 220 Pa. 328, 69 Atl. 861