Taxation - Contest Awards, Compensation or Gift

John J. Wittak
Taxation — Contest Awards, Compensation or Gift — The plaintiff, a professor of music, completed a musical composition in 1939 as a contribution to the field of music. Six years later the plaintiff was persuaded to enter the score in the Reichhold Music Award Contest. Mr. Henry Reichhold, industrialist and philanthropist, had announced the contest for "... the furtherance of a spirit of understanding and unity among Nations; and also to be helpful in bringing to the public the most important new music written in the Americas." The plaintiff’s score was selected as the best submitted and in 1947 he received the highest award of $25,000. The composition remained the property of the plaintiff and neither Mr. Reichhold nor the Award Committee derived any profit from the contest or from the plaintiff’s participation in it. The plaintiff included the award as income for the year 1947 and then instituted a refund action in 1949 on the theory that the money was received as a gift. Held: The award constitutes a "gift" and is excluded from the plaintiff’s income under Section 22 (b) (3) of the Internal Revenue Code. Robertson v. United States, 93 F. Supp. 660 (U.S. Dist. Ct., Utah, 1950).

The courts and the Commissioner of Internal Revenue are in serious disagreement, as is readily perceptible from court decisions and Commissioner's rulings, whether to consider awards as "income derived from any source whatever" or being excluded therefrom by reason of the statutory exemption for a "gift." It is best to distinguish because of the fine line of demarcation between them, prizes won as a result of commercial contests and awards received as a result of scholarly work.

Generally the courts and the Commissioner will view prizes achieved in commercial contests as income. An award attained by a contestant in a newspaper contest promulgated as an advertising stunt was considered taxable income; and an automobile won as a result of a contest conducted by a restaurant was considered income at its fair market value. However the Tax Court has held that money received in a contest in which the recipient performed no services before or after the award, was to be considered a "gift." The Commissioner in his rulings has specified that when determining whether an award

1 IRC Sec. 22 (a) "General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, ... or from professions, vocations, trades, business, commerce, ... or gains or profits and income derived from any source whatever. . . ."
2 IRC Sec. 22 (b) "Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter: (3) Gifts, bequests, devises, and inheritances. — The value of the property acquired by gift, bequest, devise, or inheritance. . . ."
3 I.T. 1651, CB II-1, 54 (1923).
4 I.T. 1667, CB II-1, 83 (1923).
5 Pauline C. Washburn v. Comm. of Int. Rev., 5 T.C. 1333 (1945)
is income or excluded as a gift, emphasis should be given to the fact that the individual takes part in the contest and performs the conditions. The determining element deduced from court decisions and the Commissioner's rulings seems to be that if the contestant has performed any conditions in order to win the award, he derives taxable income therefrom.

In regard to awards received for scholarly work the courts and the Commissioner are violently split. The Commissioner in 1929 considered an award received by a professional economist as a "gift" since it was in "... recognition of the taxpayer's achievements in science and his services in promoting the public welfare." The Commissioner, however, since that time has changed his position and now generally considers awards as income to the contest winner. The courts have followed the Commissioner in his present stand; the case of McDermott vs. Commissioner of Internal Revenue being a typical example. This case involved an essay written by a law professor for the Ross Essay Contest for which he received an award. The Court of Appeals for the District of Columbia concluded that the award was a gift, viewing it with reference to the Nobel Prizes, Guggenheim Fellowships and the Rhodes Scholarships. To consider otherwise, the court deduced, would disrupt the settled policy of encouraging scholarly work. The Commissioner is vehemently opposed to this decision and has declared that further awards of the Ross Essay Contest would be considered taxable income. The Tax Court has held upon a similar fact situation that the award was income although in that instance the donor did not view the award as a gift, but treated it as an expense and used it as an advertising medium.

The McDermott case considered certain elements which, in determining the taxability of an award are important to weigh:

1. The intent of the donor: is his purpose to give and incite or to employ and buy?
2. Are the services that are performed rendered to the person making the award?
3. Did the promulgators of the contest derive profit from it or from the plaintiff's participation in it?
4. What is the contestant's motive in entering the contest?

When applying these elements to the instant case no other conclusion can be drawn than the award was a "gift" regardless of the

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7 G.C.M. 5581, VIII-1 CB 68 (1929).
10 Herbert Stein v. Comm. of Int. Rev., 14 T.C. 494 (1950). The court in dictum believed the decision in the McDermott case placed undue emphasis upon the fact that the award was in the field of learning and education.
11 Supra, note 8.
Commissioner’s rulings. The expressed intent of the donor was to make a gift and not to buy the composition. The plaintiff rendered no services to the donor since the time and effort incidental to a composition of this type were expended before the contest was ever promulgated. The donor received no financial remuneration from the contest; title to the composition remained in the plaintiff and the donor received no pecuniary benefits from it. The plaintiff’s expressed motive for entering the contest was to make a contribution to the field of music and coupled with that fact is the added factor that the composition was completed six years before the announcement of the contest. No other conclusion can be drawn except that the plaintiff entered the contest for his expressly stated purpose.

Although it is doubtful the Commissioner will accede to the decision in the instant case, yet to do otherwise would only serve to further widen the gap between the courts and the Commissioner of Internal Revenue.

JOHN J. WITTAK

Workmen’s Compensation—Effect Upon Prior Release of Employer’s Election to Subscribe to Act—Claimant, an employee of The Pocahontas Corporation, contracted silicosis in the second stage several years before the employer elected to subscribe to the West Virginia Workmen’s Compensation Act. On October 6, 1940, claimant and his employer entered into a compromise settlement by which the claimant received $1,000, the amount then fixed by the act for that disability, and the employer obtained a written release from the claimant for “all manner of . . . claims . . . for . . . injuries . . . .” Claimant continued in the employ of The Pocahontas Corporation. On June 15, 1943, the employer elected to subscribe to the act. Claimant then submitted a claim to the compensation commissioner for the same disability mentioned above and was awarded $1,600, the amount then allowed under the act. The Pocahontas Corporation set up the release as satisfaction and discharge of the claim. The Workmen’s Compensation Appeal Board, in December, 1949, reversed the order of the commissioner, and claimant appealed. Held: Commissioner’s order reinstated.

Under the Workmen’s Compensation Act, any contract or agreement which exempts an employer or employee from the burden or waives the benefit of the Act, is pro tanto void. Upon election to subscribe, the employer elected to accept the obligations and burdens of the Act as well as the benefits and protection thereof. It, in effect, waived any defense created by the release or settlement insofar as it affected any claim made under the Act. Vernon v. State Compensation Commissioner et al., 61 S.E. (2) 243 (W.Va., 1950).