Washington Law Review

Volume 28 | Number 2

5-1-1953

Taxation—Prizes for Artistic or Scholastic Accomplishments—Gifts or Income?

Newman L. Dotson

RCW 28.24.060 [REM. SUPP. 1945 § 4719-1] which permitted all students of public or private schools to use the ". . . transportation facilities provided by the school district in which they reside." Although the U.S. Supreme Court had already found such statutes not violative of the Federal Constitution, *Everson v. Board of Education,* 330 U.S. 1 (1947), Justice Steinert, speaking for the majority and denying the writ, noted that the Washington Constitution is stricter than the Federal Constitution, and that Art. I § 11 and Art. IX § 4 of the Washington Constitution presented a "clear denial of the rights asserted." A determination of the constitutionality of released time plans in Washington schools would require separate consideration of precisely what constitutes "sectarian influence" within the prohibition of Art. IX § 4. The *Visser* opinion dealt with the question of what constitutes support of an admittedly sectarian school, and therefore offers no help here.

However, Art. IX § 2 (". . . But the entire revenue derived from the common school fund and the state tax for common schools shall be exclusively applied to the support of the common schools") has provided additional support for the decisions denying transportation rights to students of religious schools, but would have no application to a provision like the one in the *Zorach* case involving only the question of released time.

In any event, the rule thus far is merely that the *Zorach* type program does not violate the Federal Constitution. The Washington Constitution could present another hurdle for the local advocates of this type of religious training.

RAYMOND H. SIDERIUS

Taxation—Prizes for Artistic or Scholastic Accomplishments—Gifts or Income? *P* won $25,000 for the best symphony entered in a contest sponsored by a philanthropist. *P* composed his symphony during a three year period, 1936 to 1939, entered the contest and won the prize in 1947. The sponsor of the award derived no profit from the contest nor from *P's* participation in it. The Commissioner of Internal Revenue ruled that the entire award was taxable as income and under I.R.C. § 107(b), to be computed as though the award had been ratably received over the three year period ending with 1947. *P* filed a claim for refund on the ground that the prize constituted a gift under I.R.C. § 22(b)(3) which excludes gift from gross income as defined under I.R.C. § 22(a). The district court held that it was a gift. *Robertson v .U.S.,* 93 F. Supp. 660 (D. Utah 1950). The Court of Appeals reversed, holding that the award was taxable as income. *U.S. v. Robertson,* 190 F. 2d 680 (C.A. 10th 1951). Certiorari granted because of a conflict between this case and *McDermott v. Commissioner,* 150 F. 2d 585 (App. D.C. 1945). *Held:* Affirmed. Acceptance by contestants of the offer tendered by the sponsor of a prize contest creates an enforceable contract. Payment of the prize offered to the winner of the contest is the discharge of a contractual obligation and therefore not excludable from gross income as property received as a gift. *Robertson v. U.S.,* 343 U.S. 711 (1952).

The taxability of a prize is determined by Sections 22(a) and 22(b)(3) of the Internal Revenue Code. Section 22(a) provides, "Gross income includes gains, profits and income derived from salaries, wages or compensation for personal service . . . of whatever kind and in whatever form paid. . . ." Section 22(b) provides, "The following items shall not be included in gross income and shall be exempt from taxation under this chapter: . . . (3) . . . The value of property acquired by gift. . . ." If the award is compensation for personal services, it is taxable; if it is a gift, it is exempt.

This is the first ruling of the Supreme Court in this area. The broad doctrine

announced by this decision, while adequate for the disposition of the case presented to the court, does not greatly clarify the confusion which has existed in this narrow field. The reason for this confusion is more easily understood when it is noted that in this class of cases, from the viewpoint of the sponsor, who receives no legal benefit, the money is a gift, made with full donative intent. However, the winner has actually received something of value as the result of the performance of personal services: the writing of the essay or the composition of the symphony for the prize. Thus it seems that the prize money may be held taxable or non-taxable, depending upon whether it is viewed from the standpoint of the donor or from that of the recipient.

In *McDermott v. Commissioner, supra,* the petitioner was awarded $3000 for the best essay submitted in a contest annually sponsored by the American Bar Association. The Court of Appeals held the prize money to be a gift and non-taxable. The court strongly emphasized the sponsor's donative intention and the recipient's non-pecuniary motivation as being the most important if not the controlling factors in reaching its decision. At least one subsequent case has followed this holding. *Amirikian v. U.S.,* 100 F. Supp. 263 (D. Md. 1951).

On the other hand, the Tax Court has been placing less emphasis on these factors, but rather, expressing the view that the controlling issue is whether as to the recipient, this award was gain or compensation from labor or work at a business or profession, i.e. an exchange of services or its product for money. *Herbert Stein,* 14 T.C. 494 (1950). The Tax Court has adhered to the view expressed by the Bureau of Internal Revenue. The Bureau has declared that the winners of the Ross Essay Prize for 1949 and future years will be held to have received taxable income. I.T. 3960, 1949-2 CUM. BULL. 13; I.T. 3987, 1950-1 CUM. BULL. 9.

The dotrcine enunciated in the principal case is more in keeping with the policy of the Tax Court decisions and an implied repudiation of the rationale of the *McDermott* case. The Supreme Court expressly declares that ". . . where a payment is in return for services rendered, its character as taxable income is unaffected by the fact that the person making it derives no economic benefit therefrom."

The decision in the principal case would not seem to alter the law with respect to scholarship grants or awards such as Nobel Prizes and Rhodes Scholarships which have long been held not taxable, though necessarily made on a competitive basis. G.C.M. 5881, VIII-1 CUM. BULL. 68 (1929). The Supreme Court in the instant case clearly points out that the case would be different if this were an award made in recognition of past achievements or present abilities, or out of affection, respect, admiration, charity or similar impulses. An element common to the principal case and the above situations is that the composition of the symphony was accomplished long before the recipient had knowledge that such award would be made. However, in the *Robertson* case the recipient exchanged the product of his services for the prize, which would seem to distinguish it from the scholarship cases in which the donee performs no services, but is given the grant in recognition of past or present abilities.

The majority of the prize cases are to be found in situations involving radio quiz shows, newspaper and puzzle contests, and lotteries. In these cases the recipient has performed services or given consideration. The winnings have consistently been held to be taxable income. *Droge v. Commissioner,* 35 B.T.A. 829 (1937) (Irish Sweepstakes); I.T. 1651, II-1 CUM. BULL. 54 (1923); I.T. 1667, II-1 CUM. BULL. 83 (1923). There can be little doubt as to the existence of a contract in such a situation.

An analogous though distinguishable fact pattern was presented in *Pauline C. Washburn,* 5 T.C. 1333 (1945). The Tax Court there held that $900 received by the petitioner from the Pot O' Gold Radio Program was not taxable income. The money was paid for merely answering the telephone, the number being selected by chance.

It does not seem that the rationale of this decision conflicts with the holding in the principal case. It would require a very definite extension of orthodox contract principles in order to find a contract under such circumstances. Perhaps it could be said that picking up the telephone and answering it would be sufficient consideration to support the sponsor's offer to pay a given amount to the person who so answers, but a bar to the formation of a contract would be the fundamental principle of contract law that an act done without knowledge of an offer cannot be an acceptance thereof. RESTATEMENT, CONTRACTS § 53 (1932).

In the *Robertson* case the court was not faced with the issue and therefore, unfortunately, did not provide any clearly defined guide as to the answer when the payment of the award is not the discharge of a contractual obligation. It is submitted that, although the Supreme Court in its summary disposition of the factual situation presented by the principal case has provided a guide to some of the more troublesome situations upon which the Bureau and the lower courts have been in general disagreement, an equal number of problems remain open for further judicial determination, with the *Robertson* opinion giving little or no aid to the Supreme Court should it be called upon to settle future controversies in this narrow but confusing area of the law.

NEWMAN L. DOTSON

Corporations—Right of Director to Inspect Corporate Books. *P*, as a director and stockholder of a corporation, sought a writ of mandamus to compel the corporation's officers to make available for inspection by *P* certain corporate books and records. The court found that *P*'s purposes in seeking inspection of the records were hostile to the corporation and if consummated would be inimical to the best interests of the corporation. The trial court dismissed *P*'s petition. *Held:* Affirmed. *State* ex rel. *Paschall v. Scott,* 141 Wash. Dec. 62, 247 P.2d 543 (1952).

This case is the first Washington ruling upon the question of whether the right of a director of a corporation to inspect and examine the corporate books and records is absolute, or whether it is qualified and may be denied upon proof of a purpose which is hostile and adverse to the best interests of the corporation. Washington adopts the view that the director's right of inspection is qalified rather than absolute, a minority position.

Two statutes have a bearing on this question: first, "The business of every corporation shall be managed by a board of at least three directors. . . ." RCW 23.36.010 [REM. SUPP. 1943 § 3803-31]; second, "Officers and directors stand in a fiduciary relation to the corporation, and must discharge the duties of their respective positions *in good faith*. . . ." RCW 23.36.080 [RRS § 3803-33] (italics added). It is axiomatic that if the directors are to manage the affairs of a corporation they must have access to the corporate records to carry out that function. However, the statute commands that the director must discharge the duties of his position in good faith. Thus, the court reasoned that the director's right of inspection is an incident of the duties imposed by statute, discharge of which must be in good faith. When the director's good faith disappears he can no longer assert that he is carrying out his duties, hence the right of inspection can no longer be claimed.

The majority rule, clearly rejected by the Washington court, confers upon the director an absolute right of inspection. The right will not be denied, even upon the showing of motives adverse to the interests of the corporation. The following cases are in accord with the majority view: *Lavin v. J. C. Lavin Co., Inc.,* 264 App. Div. 205, 34 N.Y.S.