16 T.C. 1450 (1951)

Amounts received by a lessee from the owner for the accelerated cancellation of a lease are considered capital gains because valuable property rights (use and possession) are transferred from the lessee to the owner.

Summary

Isadore Golonsky and Frank Gold received payments from Sansom Realty Company for the early termination of a lease. The Commissioner of Internal Revenue determined that these payments should be taxed as ordinary income. Golonsky and Gold argued that the payments should be treated as long-term capital gains. The Tax Court held that the payments constituted capital gains because the lessees transferred their rights to use and possess the property back to the owner, which is a transfer of property.

Facts

Golonsky leased commercial property beginning October 1, 1938, with the lease automatically renewing annually unless terminated by written notice three months before the end of the year. Golonsky assigned the lease to himself and Gold in 1941 with the lessor's consent. Sansom Realty Company acquired the property on June 1, 1944, subject to the existing lease. Sansom Realty Co. contracted with Golonsky and Gold to vacate the premises and terminate the lease by June 30, 1944, in exchange for $7,500. Golonsky and Gold complied and received the $7,500 in 1944.

Procedural History

The Commissioner of Internal Revenue determined that the $3,750 received by each petitioner was taxable as ordinary income. Golonsky and Gold petitioned the Tax Court, arguing the payment was a long-term capital gain. The Tax Court reversed the Commissioner's determination, holding the payments qualified as capital gains.

Issue(s)

Whether the amount received by the lessees from the owner for accelerated cancellation of a lease constitutes ordinary income or a long-term capital gain?

Holding

Yes, the amount received constitutes a capital gain because the lessees transferred their right to use and possession of the property back to the owner, which is a transfer of property.

Court's Reasoning

The court reasoned that Golonsky and Gold, as lessees, possessed the right to use

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and possess the property for the months of July, August, and September 1944. Sansom Realty Company paid $7,500 to acquire this right, which it did not previously have. This constitutes a transfer of property, bringing the transaction under Section 117 of the Internal Revenue Code (regarding capital gains). The court distinguished this situation from the satisfaction of a debt or the surrender of an option, neither of which involves a transfer of property. The court also distinguished the case from *Hort v. Commissioner*, where a payment from the lessee to the lessor for cancellation of a lease was deemed a substitute for rent. In this case, the payment flowed from the lessor to the lessee. The court stated, "The use of the word 'cancellation' is not determinative where something is transferred."

Practical Implications

This case clarifies that payments from a landlord to a tenant for early lease termination are treated as capital gains, not ordinary income, because the tenant is transferring a valuable property right back to the landlord. The key is that the lessee is giving up something of value – the right to possess and use the property. This ruling impacts how such transactions are structured and taxed, providing a significant benefit to lessees. Subsequent cases have relied on *Golonsky* to determine the character of income received in similar lease termination scenarios. Attorneys advising clients in lease negotiations and terminations need to consider this precedent to optimize tax outcomes.

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