18 T.C. 438 (1952)

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A lessee’s relinquishment of a valuable right or benefit granted within a lease, such as a restrictive covenant, constitutes a sale of property, and any resulting gain is treated as a capital gain for tax purposes.

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Summary

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Louis W. Ray, a variety store owner, received $20,000 from his lessor, Republic National Life Insurance Company, in exchange for relinquishing a restrictive covenant in his lease that prevented the lessor from renting other space in the building to competing variety stores. The IRS determined this amount was ordinary income, but Ray argued it was a capital gain. The Tax Court held that the relinquishment of the leasehold benefit was a sale of property, specifically an intangible property right, and therefore qualified for capital gains treatment. The court emphasized that the restrictive covenant was a valuable right that ran with the land.

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Facts

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- Louis W. Ray operated a retail variety store in Dallas, Texas, leasing the space from Republic National Life Insurance Company under a 5-year lease.

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- The lease contained a clause (paragraph 15) restricting the lessor from renting space in the building to another variety store, protecting Ray from direct competition.

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- The lessor wanted to sell the building but the restrictive covenant in Ray's lease hindered the sale.

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- The lessor paid Ray $20,000 to relinquish his rights under paragraph 15 of the lease, allowing the sale of the building to proceed.

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- Ray reported the $20,000 as a capital gain on his tax return.

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Procedural History

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- The Commissioner of Internal Revenue determined a deficiency in Ray's income tax, arguing the $20,000 should be taxed as ordinary income.

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- Ray petitioned the Tax Court for a redetermination of the deficiency.

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Issue(s)

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1. Whether the $20,000 received by the petitioner for relinquishing a restrictive covenant in a lease constitutes ordinary income or gain from the sale of a capital asset.

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Holding

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1. Yes, the $20,000 received by the petitioner constitutes gain from the sale of a capital asset because the relinquishment of the restrictive covenant was a sale of a property right.

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Court’s Reasoning

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The court reasoned that the transaction constituted a

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