McCue Bros. & Drummond, Inc. v. Commissioner of Internal Revenue, T.C. Memo. 1953-239

A statutory right to continue tenancy under emergency rent control laws constitutes a property right, and the compensation received for surrendering this right can be treated as capital gain, not ordinary income, for federal tax purposes.

Summary

McCue Bros. & Drummond, Inc. (Petitioner), a hat retailer, received $22,500 from Jamlee Hotel Corporation to vacate its store in New York City. Petitioner's lease had expired, but it remained in possession due to New York's emergency rent control laws. Petitioner argued that the $22,500 was a long-term capital gain from surrendering a property right. The Commissioner of Internal Revenue (Respondent) argued it was ordinary income. The Tax Court held that Petitioner's statutory tenancy was a property right, and its surrender was a sale or exchange of a capital asset, thus qualifying for capital gains treatment. This decision hinged on the court's interpretation of statutory tenancy under New York law as a valuable property right, despite not being a traditional leasehold interest.

Facts

Petitioner operated a retail hat store at 1294 Broadway, New York City, from 1928 to June 30, 1946.

Petitioner leased the store from New York Life Insurance Company under a lease expiring January 31, 1946.

Jamlee Hotel Corporation purchased the Hotel McAlpin, where the store was located, in June 1945 and planned renovations.

In February 1946, Jamlee negotiated with Petitioner to vacate the store to facilitate renovations.

On May 17, 1946, Petitioner and Jamlee agreed that Petitioner would vacate by June 30, 1946, in exchange for $22,500.

Petitioner vacated on June 28, 1946, and received $22,500, reporting it as long-term capital gain on its tax return.

New York's emergency rent control laws, enacted in 1945, protected business tenants from eviction and continued leases even after expiration, as long as rent was paid.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Petitioner's

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income and excess profits taxes, treating the $22,500 as ordinary income.

Petitioner appealed to the Tax Court to contest this determination.

The Tax Court reviewed the stipulated facts and relevant law to determine the tax treatment of the $22,500 payment.

Issue(s)

1. Whether Petitioner's statutory right to remain in possession of the store premises under New York emergency rent control laws constituted "property held by the taxpayer" within the meaning of Section 117(a)(1) of the Internal Revenue Code, thus qualifying as a capital asset.

2. Whether the transaction in which Petitioner surrendered its statutory right to possession for $22,500 constituted a "sale or exchange" of a capital asset under Section 117 of the Internal Revenue Code.

3. Whether Petitioner held the statutory tenancy right for more than 6 months to qualify for long-term capital gain treatment under Section 117(a)(4) of the Internal Revenue Code.

Holding

1. Yes, because Petitioner's statutory right to possession under the New York emergency rent control laws was a legally recognized and valuable property right, even though it arose from statute rather than contract.

2. Yes, because Petitioner's surrender of its statutory right to possession to Jamlee for $22,500 constituted a transfer of a property right for consideration, which is considered a sale or exchange.

3. Yes, because Petitioner's right to possession under the emergency rent control statute existed from January 24, 1945, which was more than six months before the surrender in June 1946, satisfying the holding period requirement.

Court's Reasoning

The court reasoned that while New York law (Wasservogel v. Meyerowitz, Stern v. Equitable Trust Co. of New York) stated that statutory tenants hold over not due to a property right from the lease, but because emergency laws prevent eviction, these laws nonetheless grant statutory tenants certain rights and privileges.

The court emphasized that these emergency laws were intended to curb exorbitant rents and evictions, and must be construed in light of these purposes. Referencing Stern, the court noted the emergency laws extended "against the will of the landlord, the right of the tenant to remain in possession of the leased premises so

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long as he paid a reasonable rental for their use and occupancy."

Drawing analogies to cases like Isadore Golonsky and Louis W. Ray, where payments for lease cancellations or relinquishing leasehold rights were treated as capital gains, the court concluded that the statutory right of possession was a similar property right.

The court stated, "In view of the numerous authorities examined, including the cases cited, we are convinced that the statutory right of possession, use, and occupancy which the petitioner had in the store premises under the emergency laws was a property right. We are also convinced that there was a transfer of this property right by petitioner to its landlord for $22,500, and that such transfer constituted a sale of a capital asset within the meaning of section 117."

Regarding the holding period, the court determined that the statutory right existed from the enactment of the rent control laws in January 1945, thus exceeding the six-month requirement for long-term capital gain treatment.

Practical Implications

This case clarifies that statutory rights, even if not rooted in traditional contract or property law, can be recognized as property for federal income tax purposes, specifically in the context of capital gains.

It provides a legal basis for tenants in rent-controlled environments to treat payments received for surrendering their statutory tenancies as capital gains, potentially resulting in lower tax liabilities compared to ordinary income.

The decision highlights that the definition of "property" in tax law is broad enough to encompass legally protected rights and privileges, not just tangible assets or contractual interests.

This case has influenced subsequent tax cases involving the characterization of income from the relinquishment of various statutory and regulatory rights, emphasizing a functional approach to defining property in tax law.

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