## *Goff v. Commissioner, 20 T.C. 567 (1953)*

A transaction qualifies as a sale or exchange for capital gains purposes when a party relinquishes a valuable contractual right, thereby transferring a new and distinct property right to the other party.

### Summary

The Tax Court addressed whether proceeds from terminating a contract granting exclusive production rights constituted ordinary income or capital gains. Saxon Hosiery Mills (Saxon) had an agreement with Artcraft Hosiery Company (Artcraft) that entitled Saxon to all hosiery production from specific machines. Saxon relinquished those rights to Artcraft in exchange for stock. The court held that Saxon's relinquishment constituted a sale or exchange of a capital asset, because Artcraft gained the unfettered right to use the machines as it pleased, which it did not previously possess. Thus, Saxon's gain was a long-term capital gain.

### Facts

Saxon acquired hosiery machines and installed them in Pickwick Hosiery Mills (Pickwick) under a lease agreement where Pickwick paid rent per dozen pairs of hose manufactured. Pickwick was obligated to deliver all hosiery produced on those machines to Saxon until December 15, 1946, with a minimum production quota. In 1944, Pickwick assigned its rights and obligations under the Saxon agreement to Artcraft. On June 30, 1946, Saxon and Artcraft entered into an "Agreement of Sale" where Saxon sold all its rights, title, and interest in the machines and the production agreement to Artcraft for stock. Saxon reported a long-term capital gain from this transaction, which the Commissioner challenged.

### Procedural History

The Commissioner determined deficiencies in the petitioners' income tax, arguing that the gain realized by Saxon from relinquishing its rights to Artcraft was ordinary income, not capital gain. The Tax Court considered the case after the petitioners contested the Commissioner's determination.

### Issue(s)

Whether Saxon's gain from relinquishing its rights to Artcraft under the production agreement constituted a "sale or exchange" of a capital asset, thus qualifying for capital gains treatment, or whether it represented ordinary income.

### Holding

Yes, because Artcraft acquired a valuable property right—the right to use the machines without the restrictions imposed by the original agreement—through the transaction. This constitutes a "sale or exchange" of a capital asset.

## Court’s Reasoning

The court reasoned that Saxon possessed a capital asset in the form of the contractual right to have the machines used exclusively for its benefit until December 15, 1951. The court emphasized that Artcraft’s acquisition of Saxon’s rights gave Artcraft the liberty to use the machines as it chose for the next 5 years and 5½ months. Before the agreement on June 30, 1946, Artcraft was bound to use the machines to produce hosiery for Saxon. The court cited several cases supporting the idea that relinquishing contract rights can constitute a sale or exchange, particularly when it transfers new property rights to the other party. For instance, the court referenced *Isadore Golonsky, 16 T. C. 1450*, which involved payments for terminating restrictive covenants.

## Practical Implications

This case clarifies that the termination of contractual rights can qualify as a “sale or exchange” for capital gains purposes if the other party acquires a new, distinct property right as a result. Attorneys should analyze the substance of the transaction, focusing on what rights were transferred and whether the other party’s freedom to act has increased. This ruling has implications for businesses negotiating the termination of contracts, licenses, and other agreements where valuable rights are involved. It’s important to structure these transactions to take advantage of capital gains treatment where applicable. Later cases may distinguish *Goff* if the rights relinquished are deemed minimal or do not substantially alter the other party’s existing property rights.