27 T.C. 892 (1957)

The cancellation of a contract right, as opposed to the sale or exchange of a property right, does not qualify for capital gains treatment under Section 117(j) of the Internal Revenue Code of 1939, even if consideration is received.

Summary

The United States Tax Court held in Leh v. Commissioner that a payment received by a partnership for the cancellation of a gasoline supply contract was taxable as ordinary income and not as capital gain. The court distinguished between the sale or exchange of a property right, which might qualify for capital gains treatment, and the termination of a contract, which does not. The court found that the partnership's right to purchase gasoline under the contract was extinguished rather than transferred, thus precluding capital gains treatment.

Facts

Progress Company, a partnership, had a contract with Olympic Refining Company to purchase gasoline. In 1950, when gasoline was in short supply, Olympic paid Progress $183,330.50 to cancel and terminate the contract. The partnership reported this amount as a long-term capital gain. The Commissioner of Internal Revenue determined that the gain was ordinary income.

Procedural History

The Commissioner of Internal Revenue determined tax deficiencies against the petitioners, Marc D. Leh, L. Waive Leh, David E. Brown, and Christabel H. Brown, for 1950, claiming that the gain received by the Progress partnership should be treated as ordinary income. The taxpayers challenged this determination in the United States Tax Court.

Issue(s)

1. Whether the amount received by Progress from Olympic for the termination of the gasoline contract was taxable as capital gain.

Holding

1. No, because the transaction was a cancellation and termination of a contract, not a sale or exchange of a property right.

Court's Reasoning

The court considered whether the transaction fell under Section 117(j) of the Internal Revenue Code of 1939, which provides for capital gains treatment for gains from the sale or exchange of certain property used in a trade or business. The court

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agreed that the contract right was property used in the trade or business.

The crucial issue was whether the termination of the contract constituted a “sale or exchange.” The court found that the contract was canceled and terminated. The court distinguished this from situations where a contractual right is transferred and thereby gives the other party expanded rights. In this case, the contract right simply ceased to exist. The court referenced *Commissioner v. Starr Brothers, Inc.*, where the court held that the mere release of a contractual right which

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