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Hort Vs. Commissioner

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Court : US Supreme Court

Decided On : Mar-31-1941

Appeal No. : 313 U.S. 28

Appellant : Hort

Respondent : Commissioner

Judgement :

Hort v. Commissioner - 313 U.S. 28 (1941)
U.S. Supreme Court Hort v. Commissioner, 313 U.S. 28 (1941)

Hort v. Commissioner

No. 517

Argued March 7, 1941

Decided March 31, 1941

313 U.S. 28

CERTIORARI TO THE CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

SYLLABUS

1. An amount received by a lessor in consideration of the cancellation of a lease of real estate is income taxable to him under 22(a) of the Revenue Act of 1932, and must be reported as gross income in its entirety. P. 313 U. S. 30 .

2. Although the amount so received be less than the difference between the present value of the unmatured rental payments and the fair rental value of the property for the unexpired period of the lease, there is no loss deductible under 23(e) of the Act. P. 313 U. S. 32 .

3. Even though the lease be regarded as "property," the consideration received for its cancellation is not, for the purposes of the Revenue Act of 1932, a return of capital. P. 313 U. S. 31 .

112 F.2d 167 affirmed.

Certiorari, 311 U.S. 641, to review the affirmance of a decision of the Board of Tax Appeals, 39 B.T.A. 922, sustaining the determination of a deficiency in income tax.

MR. JUSTICE MURPHY delivered the opinion of the Court.

We must determine whether the amount petitioner received as consideration for cancellation of a lease of realty in New York City was ordinary gross income as

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defined in 22(a) of the Revenue Act of 1932, 47 Stat. 169, 178, and whether, in any event, petitioner sustained a loss through cancellation of the lease which is recognized in 23(e) of the same Act, 47 Stat. 169, 180.

Petitioner acquired the property, a lot and ten-story office building, by devise from his father in 1928. At the time he became owner, the premises were leased to a firm which had sublet the main floor to the Irving Trust Co. In 1927, five years before the head lease expired, the Irving Trust Co. and petitioner's father executed a contract in which the latter agreed to lease the main floor and basement to the

former for a term of fifteen years at an annual rental of $25,000, the term to commence at the expiration of the head lease.

In 1933, the Irving Trust Co. found it unprofitable to maintain a branch in petitioner's building. After some negotiations, petitioner and the Trust Co. agreed to cancel the lease in consideration of a payment to petitioner of $140,000. Petitioner did not include this amount in gross income in his income tax return for 1933. On the contrary, he reported a loss of $21,494.75 on the theory that the amount he received as consideration for the cancellation was $21,494.75 less than the difference between the present value of the unmatured rental payments and the fair rental value of the main floor and basement for the unexpired term of the lease. He did not deduct this figure, however, because he reported other losses in excess of gross income.

The Commissioner included the entire $140,000 in gross income, disallowed the asserted loss, made certain other adjustments not material here, and assessed a deficiency. The Board of Tax Appeals affirmed. 39 B.T.A. 922. The Circuit Court of Appeals affirmed per curiam on the authority of *Warren Service Corp. v. Helvering,* 110 F.2d 723. 112 F.2d 167. Because of conflict with *Commissioner v. Langwell Real Estate Corp.,* 47 F.2d 841, we

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granted certiorari limited to the question whether,

"in computing net gain or loss for income tax purposes, a taxpayer [can] offset the value of the lease canceled against the consideration received by him for the cancellation."

311 U.S. 641.

Petitioner apparently contends that the amount received for cancellation of the lease was capital, rather than ordinary income, and that it was therefore subject to 101, 111-113, and 117, 47 Stat. 169, 191, 195-202, 207, which govern capital gains and losses. Further, he argues that, even if that amount must be reported as

ordinary gross income, he sustained a loss which $23(e) authorizes him to deduct. We cannot agree.

The amount received by petitioner for cancellation of the lease must be included in his gross income in its entirety. Section 22(a), copied in the margin, [Footnote 1] expressly defines gross income to include "gains, profits, and income derived from . . . rent, . . . or gains or profits and income from any source whatever." Plainly this definition reached the rent paid prior to cancellation, just as it would have embraced subsequent payments if the lease had never been canceled. It would have included a prepayment of the discounted value of unmatured rental payments whether received at the inception of the lease or at any time thereafter. Similarly, it would have extended to the proceeds of a suit to recover damages had the Irving Trust Co. breached the lease instead

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of concluding a settlement. *Compare United States v. Safety Car Heating Co.,* 297 U. S. 88 ; *Burnet v. Sanford & Brooks Co.,* 282 U. S. 359 . That the amount petitioner received resulted from negotiations ending in cancellation of the lease, rather than from a suit to enforce it, cannot alter the fact that basically the payment was merely a substitute for the rent reserved in the lease. So far as the application of $22(a) is concerned, it is immaterial that petitioner chose to accept an amount less than the strict present value of the unmatured rental payments, rather than to engage in litigation, possibly uncertain and expensive.

The consideration received for cancellation of the lease was not a return of capital. We assume that the lease was "property," whatever that signifies abstractly. Presumably the bond in *Helvering v. Horst,* 311 U. S. 112 , and the lease in *Helvering v. Bruun,* 309 U. S. 461 , were also "property," but the interest coupon in *Horst* and the building in *Bruun* nevertheless were held to constitute items of gross income. Simply because the lease was "property," the amount received for its cancellation was not a return of capital, quite apart from the fact that "property" and "capital" are not necessarily synonymous in the Revenue Act of 1932 or in common usage. Where, as in this case, the disputed amount was essentially a

substitute for rental payments which 22(a) expressly characterizes as gross income, it must be regarded as ordinary income, and it is immaterial that, for some purposes, the contract creating the right to such payments may be treated as "property" or "capital."

For the same reasons, that amount was not a return of capital because petitioner acquired the lease as an incident of the realty devised to him by his father. Theoretically, it might have been possible in such a case to value realty and lease separately, and to label each a capital asset. *Compare Maass v. Higgins,* 312 U. S. 443 ;

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Appeal of Farmer, 1 B.T.A. 711. But that would not have converted into capital the amount petitioner received from the Trust Co., since 22(b)(3) [Footnote 2] of the 1932 Act, 47 Stat. 169, 178, would have required him to include in gross income the rent derived from the property, and that section, like 22(a), does not distinguish rental payments and a payment which is clearly a substitute for rental payments.

We conclude that petitioner must report as gross income the entire amount received for cancellation of the lease, without regard to the claimed disparity between that amount and the difference between the present value of the unmatured rental payments and the fair rental value of the property for the unexpired period of the lease. The cancellation of the lease involved nothing more than relinquishment of the right to future rental payments in return for a present substitute payment and possession of the leased premises. Undoubtedly it diminished the amount of gross income petitioner expected to realize, but, to that extent, he was relieved of the duty to pay income tax. Nothing in 23(e) [Footnote 3] indicates that

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Congress intended to allow petitioner to reduce ordinary income actually received and reported by the amount of income he failed to realize. *See Warren Service Corp. v. Helvering, supra; Josey v. Commissioner,* 104 F.2d 453; *Tiscornia v.*

Commissioner, 95 F.2d 678; Farrelly Walsh, Inc. v. Commissioner, 13 B.T.A. 923; Georcke Co. v. Commissioner, 7 B.T.A. 860; Merckens v. Commissioner, 7 B.T.A. 32. *Compare United States v. Safety Car Heating Co., supra; Voliva v. Commissioner,* 36 F.2d 212; Appeal of Denholm & McKay Co., 2 B.T.A. 444. We may assume that petitioner was injured insofar as the cancellation of the lease affected the value of the realty. But that would become a deductible loss only when its extent had been fixed by a closed transaction. Regulations No. 77, Art. 171, p. 46; *United States v. White Dental Mfg. Co.,* 274 U. S. 398 .

The judgment of the Circuit Court of Appeals is affirmed.

[Footnote 1]

Sec. 22(a).

"'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

[Footnote 2]

Sec. 22(b).

"The following items shall not be included in gross income and shall be exempt from taxation under this title:"

" * * * *"

"(3) The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income)."

[Footnote 3]

Sec. 23(e).

"Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year, and not compensated for by insurance or otherwise [shall be deductible from gross income] --"

"(1) if incurred in trade or business; or"

"(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or"

"(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if, at the time of the filing of the return, such loss has been claimed as a deduction for estate tax purposes in the estate tax return."

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