Ericka Williams
Acct 3113
Tax Research Cases

Issue: In Case 1, William owns a building that is leased to Lester's Machine Shop. Lester requests that William rewire the building for new equipment plans to purchase. The wiring would cost about $4,000, but would not increase the value of the building because its only use is in the connection with the specialized equipment. Rather than lose Lester as a lesee, William agrees to forgo one month's rent of $1,000 if Lester will pay for the wiring. Because Lester does not want to move, he agrees. What amount, if any, must William include in gross income?

Authorities:

- Sec. 109
- Reg. Sec. 1.109-1
- *CIR v. Grace H. Cunningham*, 2 AFTR 2d 5511, 58-2 USTC ¶ 9771 (9th Cir., 1958)

Conclusion: Whenever a lessor rents from a lessee there will sometimes be questions as to who includes certain improvements within gross income for tax purposes. According to this case involving William, the lessor, and Lester, the lessee needs to determine who includes the improvements on Lester's Machine Shop within gross income. According to Code Section 109, gross income does not include income, other than rent, derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee. Also Regulation Section 1.109-1 states that the exclusion applies only with respect to the income realized by the lessor, William, upon the termination of the lease and has no application to income, if any, in the form of rent, which may be derived by a lessor during the period of the lease and attributable to buildings erected or other improvements made by the lessee. Because rewiring needs to be done to benefit Lester's company, William suggest that he pay the $4,000 cost, and he will forgo $1,000 of one month's rent. Due to the facts given from Code Section 109 and Regulation Section 1.109-1 William will not have to include the cost of the improvements or the forgo of rent within his gross income, unless Lester decides to terminate his lease, in which he is not.

Issue: In Case 2 Jack, a tenured university professor, has been a malcontent for many years at Rockport University. The university has recently offered to pay $200,000 to Jack if he will relinquish his tenure position and resign. Jack is of the opinion that tenure is an intangible capital asset and the $200,000 received for release of the tenure should be a long-term capital gain. Explain why you agree or disagree.

Authorities:

- *Harry M. Flowers,* 61 T.C. 140 (1973)
- *Estelle Goldman,* 1975 PH T.C. Memo ¶ 75,138, 34 TCM 639

Ericka Williams
Acct 3113
Tax Research Cases

<u>Conclusion:</u> There has to be a distinguishing factor between intangible capital assets and a long term capital gains. In the case of Jack, a tenured professor, he is being offered $200,000 to renounce his tenure position. Jack feels that he should be able to report this amount as a long-term capital gain rather than an intangible capital asset. According to the cases of Harry M. Flower, 61 T.C. 140, and Estelle Goldman, 1975 PH T.C. Memo, Jack's assumption would be incorrect. Harry M. Flower states that payment to salesman's corporation under agreement ending personal service contract was ordinary income, and there was no capital gain allocation since no goodwill was transferred. Also, payments received by petitioner under an agreement terminating a contract under which petitioner had the right to perform personal services on a commission basis is taxable to petitioners as ordinary income rather than capital gain. This statement helps to provide reasoning as to why Jack cannot include the $200,000 pay as a long term capital gain because it is a substitute for his ordinary income. If Jack was to report his $200,000 as a long term capital gain he would be in the same situation that happened in the Estelle Goldman case. In this case the receiver reported their income as a capital gain which in turn caused their income to be more than it should have been in the preceding years. As a result of all of these facts Jack should not report his funds given to him, due to resigning from his tenure position, as a long term capital gain.