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## BUREAU OF LAW

## MEMORANDUM

*Income Tax Determination*  
*A-2*  
*Levi, Dino*

TO: The State Tax Commission

FROM: Solomon Sies, Hearing Officer

SUBJECT: DINO LEVI

*x - ref**(U. B. T. Determination)*

Assessment #B 659566 - 1956  
Articles 16 and 16-A

A hearing with reference to the above matter was held before me at 80 Centre Street, New York, New York, on November 13, 1964. The appearances and the evidence produced were as shown in the stenographic minutes and exhibits submitted herewith.

The issues involved herein are: (1) whether the gain realized by the taxpayer upon the surrender of the premises and cancellation of the lease of the premises used by him in his business constitutes a capital gain or ordinary income for purposes of taxation under Article 16 of the Tax Law; and (2) whether such gain is taxable under Article 16-A of the Tax Law.

On July 1, 1954, the taxpayer entered into a written agreement of lease, as tenant, with 2539 Corporation as landlord of two stores, a basement and sub-cellar at premises known as 13 E. 47th Street, New York City, for a period of 4 1/2 years to be occupied as executive offices and show rooms for the sale of retail and wholesale bric-a-brac, objects of art and home furnishings. The provisions in the rider attached to the lease gave either party the right to cancel the lease after December 31, 1956, upon 60 days written notice of election to do so.

On December 14, 1956, the taxpayer entered into an agreement with Webb & Knapp, as agents for Union Carbide and Carbon Corp., owner of the premises, to cancel the lease and vacate the premises. This agreement provided that the owner pay the taxpayer the sum of \$30,000.00 plus expenses of removal of furniture and fixtures and storage for a period of six months. The taxpayer surrendered the premises on December 26, 1956, and received the sum of \$41,000.00 from Webb & Knapp which he reported on his 1956 return as a capital gain. The Income Tax Bureau, however, issued an assessment of additional normal tax and additional unincorporated business tax holding that the profit realized on the sale of the lease was subject to normal tax rates rather than net capital gain tax rates, on the ground that the lease constituted a depreciable asset used in the taxpayer's trade or business so as to come within the exclusion of the definition of the words "capital assets" in accordance with subdivision 12, section 350 of the Tax Law and also held the gain realized therefrom to be subject to unincorporated business taxes.

Section 350, subdivision 13, of the Tax Law defines the words "capital gain" to mean "gain or profit from the sale or exchange

of capital assets". Consequently, the taxability of the gain realized upon surrender of the decedent's leasehold is dependent on whether or not the leasehold constituted a capital asset within the meaning of Article 16 of the Tax Law.

Section 350, subdivision 12 of the Tax Law defines the term "capital assets" to exclude, among other things, "property used in the trade or business of a character which is subject to the allowance for depreciation". The definition of "capital assets" as defined in section 350 is derived from Section 117(a) Internal Revenue Code 1939.

Section 117(a) of the 1939 Internal Revenue Code (now amended and renumbered as sections 1221 et seq. of the I. R. C. of 1954) broadly defines "capital assets" as contained in Section 206(a)(6) of the Revenue Act of 1921. It was amended in 1938 to exclude from the definition of capital assets property held in the taxpayer's trade or business subject to the allowance for depreciation. (Sec. 117(a) Rev. Act 1938).

The Commissioner conceded under the 1921 Act that gains derived from the sale of a leasehold interest were taxable as capital gains. (A.W. Hamm, 20 B.T.A. 1133-1930), but where the leasehold was deemed to have been held by the taxpayer in his trade or business, the exception introduced by the Revenue Act of 1938 was held applicable, and the gain taxed as ordinary income. (John D. Packler, 45 B.T.A. 708 1941 - aff'd. 133 F. 2d 509 - 6th Cir. 1943). The theory of the Board of Tax Appeals and the Circuit Court was that the exception set forth in section 117(a) (now I.R.C. 1954 - sect. 1221) related to property of a type on which depreciation would be allowable if a basis existed therefor. The fact that a particular taxpayer had no basis or a basis of zero and thus was actually unable to benefit from a depreciation deduction was considered irrelevant. (512 West 35th Street Corp. v. Commr., 151 F. 2d 942 - 2nd Cir. - 1942; Clare A. Perkins v. Commr., 195 F. 2d 699 - 6 Cir. 1943, cert. den. 322 U.S. 739 - 1944).

The taxpayer's representative relies on the decisions in the cases of Isidore Golonsky v. Commr., 16 T.C. 1450, aff'd. 200 F. (2d) 72, cert. den. 345 U.S. 939; Louis W. Ray, 18 T.C. 438, aff'd. 210 F. (2d) 390, cert. den. 348 U.S. 829; Moffat Bros. & Drummond, Inc., 19 T.C. 67, aff'd. 210 F. 2d 732, cert. den. 348 U.S. 829.

In Golonsky (supra) it was held that the gain realized by the lessee from the lessor for the cancellation of the unexpired term of the lease was subject to capital gain tax. In Moffat Bros. & Drummond, Inc. the gain realized by the lessee from the lessor for the surrender of possession of the premises as a statutory tenant was held to be subject to capital gain tax. The case of Louis W. Ray (supra) involved the relinquishment of a restrictive covenant in the lease which was preventing the owner from selling the reversion. The Court followed the Golonsky case and held that the amount received by the lessee was subject to capital gain tax. These cases

were decided on the basis of subsection (j) which was added to section 117 of I.R.C. by the Revenue Act of 1942 (now section 1231 I.R.C. 1954). Subsection (j) provides that gains resulting from the sale or exchange of depreciable property used in a trade or business are taxable as capital gains (provided the property is held for more than six months). No similar provision is contained in Article 16 of the Tax Law.

Section 386-d of the Tax Law defines gross income for unincorporated business tax purposes to include gains, profits or income derived by the business from the ownership or use of or interest in such business. Under the above definition, it appears that gains from dealings in both real and personal property including leaseholds used in the business, are subject to unincorporated business tax under Article 16-A of the Tax Law. In Matter of Xavier v. Chapman, 271 App. Div. 383, the Court had under consideration the provisions of section 351-f of the Tax Law, which provided that the emergency tax on personal income shall not apply to profits on the sale or exchange of real or personal property not connected with the taxpayer's business. In that case, it was held that a gain upon the sale of a taxpayer's newspaper publishing business was taxable as a gain from the sale of real or personal property connected with the taxpayer's trade or business, despite the contention that the entire business which was sold was a personal asset rather than an asset connected with the business.

Similar questions of fact and law were presented for consideration by Law Bureau in the Matter of Estate of Harry Kantrowitz. There, the decedent taxpayer was operating a retail food store in the Bronx, New York City under a lease which did not expire until October 31, 1947. On February 28, 1946, he entered into an agreement with the lessor for the cancellation of the lease and surrender of the premises on April 30, 1946 in consideration of the sum of \$18,500.00. The taxpayer reported said income as a capital gain and failed to include such gain for unincorporated business tax purposes under Article 16-A. It was held that the gain realized upon the surrender of the leasehold constituted ordinary income rather than capital gain under Article 16 of the Tax Law and that such gain was also subject to tax under Article 16-A of the Tax Law. (See Law Bureau Memorandum to Commissioner Best from Deputy Commissioner Kassell, Estate of Harry Kantrowitz, Deceased, dated May 11, 1935, copy attached.)

I am therefore of the opinion that the gain realized by the taxpayer from the owner of the premises for the cancellation of his leasehold interest and surrender of the premises constituted ordinary income rather than a capital gain for tax purposes under Article 16 of the Tax Law and that such gain was also subject to unincorporated business tax under Article 16-A of the Tax Law.

For the reasons stated above, I recommend that the determination of the Tax Commission in the above matter be substantially in the form submitted herewith.

SOLOMON SIES

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Hearing Officer

SS:lf  
Enc.

June 27, 1969

**STATE OF NEW YORK**

**STATE TAX COMMISSION**

**IN THE MATTER OF THE APPLICATION**

**OF**

**DINO LEVI**

**FOR REVISION OR REFUND OF PERSONAL  
INCOME TAXES UNDER ARTICLE 16, AND  
UNINCORPORATED BUSINESS TAXES UNDER  
ARTICLE 16-A OF THE TAX LAW FOR THE  
YEAR 1956.**

The taxpayer herein, having filed an application for revision or refund of personal income taxes under Article 16 and unincorporated business taxes under Article 16-A of the Tax Law for the year 1956 and a hearing having been held in connection therewith at the office of the State Tax Commission, 80 Centre Street, New York, New York, on November 13, 1964, before Solomon Siss, Hearing Officer of the Department of Taxation & Finance, at which hearing the taxpayer was represented by Louis Lieberman, C. F. A., and the matter having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That on July 1, 1954, the taxpayer, Dino Levi, entered into a written agreement of lease, as tenant, with 2639 Corporation, a New York corporation, as landlord of two stores, a basement and sub-cellar, of premises located at 33 East 47th Street, New York, New York, also known as 270 Park Avenue, New York City, for a period of 4 1/2 years commencing July 1, 1954 and terminating on December 31, 1958; that said premises were to be occupied by the taxpayer as executive offices and show rooms for the sale of bric-a-brac, objects of art and home furnishings at a rental of \$17,000.00 per annum; that the rider attached to the aforementioned lease provided that either party should have the right to cancel said lease after December 31, 1956, upon 60 days written notice of election to do so; that pursuant to the agreement of lease, the taxpayer occupied the aforementioned premises for the purposes

indicated therein and conducted business at said premises for the period from July 1, 1954 to about December 26, 1956.

(2) That on December 14, 1956, the taxpayer entered into an agreement with Webb & Knapp, as agents for Union Carbide and Carbon Corp., owner of the building known as 270 Park Avenue, to cancel the lease and vacate the premises occupied by him under the lease mentioned in Finding (1) above; that the aforementioned agreement provided that the owner pay the taxpayer lessee the sum of \$35,000.00 plus expenses of removal of furniture and fixtures and storage for a period of six months in consideration of the cancellation of said lease and the removal of the taxpayer from said premises; that in accordance with said agreement the taxpayer cancelled the lease and vacated the aforementioned premises on December 26, 1956; that in consideration of said surrender and cancellation the taxpayer received the sum of \$41,000.00 from Webb and Knapp on or about December 26, 1956.

(3) That the taxpayer filed personal and unincorporated business tax returns for the year 1956 and reported on his personal income tax return the sum of \$41,000.00 received from Webb and Knapp as a capital gain and, accordingly, paid the capital gain tax computed to be due but did not include such income on his unincorporated business tax return; that on September 9, 1959, the Department of Taxation and Finance made an additional assessment against the taxpayer (Assessment No. B-659966) for the year 1956 holding the gain realized on the cancellation of the lease subject to normal tax rates rather than capital gain tax rates and recomputed the normal additional tax due in the sum of \$1,652.84 and further recomputed additional unincorporated business tax due in the sum of \$1,542.50 upon the ground that such lease was a depreciable asset used by the taxpayer in his business excluded from the definition of a "capital asset" as defined in Article 16 of the Tax Law.

(4) That the taxpayer's leasehold interest used by him in his business constituted property used in the trade or business of a character subject to the allowance for depreciation.

(5) That the gain realized by the taxpayer on the sale of the leasehold interest used in his business represented income derived from a transaction connected with the carrying on of such business.

Based upon the foregoing findings and all of the evidence presented herein, the State Tax Commission hereby

**DETERMINES:**

(A) That the early cancellation of the lease and the surrender of possession of the premises by the taxpayer to the owner thereof did not constitute the transfer of a "capital asset" as defined in subdivision 12, section 350 of the Tax Law; that the amount received pursuant thereto was includible in gross income under Article 16 of the Tax Law for the year 1936 in accordance with the provisions of section 359, subdivision 1 of the Tax Law.

(B) That the aforementioned gain realized by the taxpayer for the surrender and cancellation of the lease used by him in his business was includible in gross income for unincorporated business tax purposes in accordance with the provisions of section 306-d, Article 16-A of the Tax Law.

(C) That, accordingly, the additional normal income tax assessed under Article 16 of the Tax Law in the sum of \$1,652.84 and the additional unincorporated business tax assessed under Article 16A of the Tax Law for the year 1936 (Assessment #B 659566) are correct and lawfully due and owing; that said assessment does not include any tax or other charge which could not have been lawfully demanded and that the taxpayer's application for



revision or refund filed with respect thereto be and the same  
is hereby denied.

DATED: Albany, New York on the 15th day of July, 1969.

**STATE TAX COMMISSION**

*Norman Gallman*

**PRESIDENT**

*Bruce Manley*

**COMMISSIONER**

*Milton Kerner*

**COMMISSIONER**