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Taxable Income—Retirement of Corporate Bonds at Discount (United States v. Kirby Lumber Company, 283 U.S. 814 (1931))

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and even the most ardent supporter of state's rights will admit that to have decided otherwise would have been to encourage the building up of a protective tariff wall between the states. It is a situation as presented by this case that the authors of our Constitution must have borne in mind when they wrote Article 1, Section 8, into that document.

PHILIP ADELMAN.

TAXABLE INCOME—RETIREMENT OF CORPORATE BONDS AT DISCOUNT.—During 1923, the respondent corporation purchased and retired for \$940,779, certain of its own bonds which it had previously issued at their par value of \$1,078,300. The Commissioner of Internal Revenue declared the difference of \$137,521 to be income and taxable as such. Upon a contrary ruling by the Board of Tax Appeals, the case was brought on behalf of the government to the Supreme Court. *Held*, that the repurchase of the bonds at a discount created taxable income. *United States v. Kirby Lumber Company*, 283 U. S. 814, 52 Sup. Ct. 4 (1931).

Taxable income has been judicially defined as the gain resulting from the employment of capital, labor or both combined,¹ provided that the profit gained through the sale or conversion of capital assets be included.² In the case of *Bowers v. Kerbaugh-Empire Company*,³ the Supreme Court held that, where the proceeds of a loan had been lost by the borrower, repayment of the debt in depreciated currency did not constitute taxable income. The Board of Tax Appeals, in a subsequent series of cases,⁴ relied upon a strained and rather illogical⁵ interpretation of the ruling in the *Bowers* case to declare

¹ *Towne v. Eisner*, 245 U. S. 418, 38 Sup. Ct. 158 (1918); *Peabody v. Eisner*, 247 U. S. 347, 38 Sup. Ct. 546 (1918); *Eisner v. Macomber*, 252 U. S. 189, 40 Sup. Ct. 189 (1920); *Walsh v. Brewster*, 255 U. S. 536, 41 Sup. Ct. 392 (1921).

² *Goodrich v. Edwards*, 255 U. S. 527, 41 Sup. Ct. 390 (1921); *Burnet v. John F. Campbell Co.*, 50 F. (2d) 487 (C. C. A. D. C. 1931).

³ 271 U. S. 170, 46 Sup. Ct. 449 (1926).

⁴ *Appeal of Independent Brewing Company of Pittsburgh*, 41 B. T. A. 870 (1926); *Appeal of New Orleans, Texas and Mexico Railway Co.*, 6 B. T. A. 436 (1927); *National Sugar Mfg. Co. v. Comm.*, 7 B. T. A. 577 (1927); *Douglas County Light and Water Co. v. Comm.*, 14 B. T. A. 1052 (1929); *Consolidated Gas Company of Pittsburgh v. Comm.*, 24 B. T. A. (1931).

⁵ KLEIN, *FEDERAL INCOME TAXATION* (1929) p. 1039: "In a recent decision, it (the Board of Tax Appeals) held flatly that no taxable income or deductible loss could be derived by a corporation from the retirement of its own bonds. The convincing dissent of Mr. Sternhagen from the decision implies that the majority relied on the holding of the Supreme Court in *Bowers v. Kerbaugh-Empire Company*. A careful reading of the *Kerbaugh* case furnishes no warrant for the Board's ruling which will probably be overruled by the courts."

that the retirement of corporate bonds at a discount does not create assessable gain. In the instant case, which is a reversal upon both logical and statutory⁶ grounds of the position taken by the Board, the Supreme Court has pointed out that its decision in the *Bowers* case was prompted by the equitable consideration that the transaction, as a whole, resulted in a loss to the debtor.⁷ Similar reasons of equity will undoubtedly influence the Supreme Court to uphold the Board in its contention, likewise founded upon the *Bowers* case, that the cancellation of the indebtedness of an insolvent firm by agreement of creditors does not make for taxable income.⁸ The significance of the present case lies rather in the indication of the applicability of equitable principles in determining taxable profits than in any explanation of the scope of a definition.

J. L.

INCOME TAX—SALE OF UNIDENTIFIED SECURITIES—DETERMINATION OF TAXABLE GAIN.—During 1924 and 1925, petitioner had been dealing on margin in the stock of the United Gas Improvement Company. In the latter year, his margin repeatedly fell below the agreed percentage and sales of the stock were thereupon made by his brokers. The petitioner, in his 1925 tax returns, set off these sales against his 1925 purchases, thereby showing a loss. The Commissioner of Internal Revenue, claiming that such sales should be set off against the earliest 1924 purchases, declared a taxable profit. Upon affirmance of the Commissioner's ruling by the Board of Tax Appeals, the case was brought by the taxpayer to the Circuit Court of Appeals. *Held*, that the amount of profit or loss resulting from the sale of unidentified securities is determined by charging such

⁶ U. S. Treas. Reg. 62, Art. 545 (1) (c) (applying to 1921 Rev. Act): "If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year." See Art. 544 (1) (c) of Reg. 45 (Revenue Act of 1918); Art. 545 (1) (c) of Reg. 65 (Revenue Act of 1924); Art. 545 (1) (c) of Reg. 69 (Revenue Act of 1926); Art. 68 (1) (c) of Reg. 74 (Revenue Act of 1928).

⁷ In his dissenting opinion in the National Sugar Mfg. Co. case, *supra* note 4 at p. 578, Mr. Sternhagen declared, "* * * but the court was undoubtedly influenced to a substantial extent by the equitable consideration that, at the time the tax was sought to be imposed, 'the result of the whole transaction was a loss, and the fact that the borrowed money was lost, and that the excess of such loss over income was more than the amount borrowed.' The opinion concludes with the statement that 'the mere diminution of loss is not gain, profit or income.' This is far from saying that the diminution of liability in a going business is not gain, and I can not believe that the Supreme Court intended to have its decision so understood."

⁸ *Simmons Gin Company v. Comm.*, 16 B. T. A. 793 (1929); *Progress Paper Co. v. Comm.*, 20 B. T. A. 234 (1930).