

71 Ct. Cl. 290, \*, 44 F.2d 885, \*\*;  
1930 U.S. Ct. Cl. LEXIS 313, \*\*\*; 9 A.F.T.R. (P-H) 454

**KIRBY LUMBER CO. v. THE UNITED STATES n1**

**n1 Certiorari applied for.**

**No. L-52**

**UNITED STATES COURT OF CLAIMS**

**71 Ct. Cl. 290; 44 F.2d 885; 1930 U.S. Ct. Cl. LEXIS 313; 9 A.F.T.R. (P-H) 454**

**December 1, 1930, Decided**

**SYLLABUS:**

[\*\*\*1]

*On the Proofs*

*Income tax; gain through redemption of bonds. --*  
Where a taxpayer redeems his monetary obligations or bonds at less than their original amounts, the gain so realized is not taxable as income.

**COUNSEL:**

*Mr. Thomas J. Reilly, for the plaintiff. Mr. Robert Ash was on the briefs.*

*Mr. Assistant Attorney General Charles B. Rugg, for the defendant. Messrs. Fred K. Dyar and William E. Davis were on the brief.*

**JUDGES:**

Williams, *Judge*, delivered the opinion. Whaley, *Judge*; Littleton, *Judge*; Green, *Judge*; and Booth, *Chief Justice*, concur.

**OPINIONBY:**

WILLIAMS

**OPINION:**

[\*291] [\*\*886] *The Reporter's* statement of the case:

The plaintiff in this case during the taxable year 1923, issued its own bonds at par and subsequently within the year purchased and retired certain of the said bonds, so issued, at a price less than the issuing price.

The excess of the issuing price over the purchase price of the said bonds was the sum of \$ 137,521.30.

The issue in the case is whether or not this item, \$ 137,521.30, was taxable as income to the plaintiff for the year in question.

The court, having made the foregoing introductory statement, [\*\*\*2] entered special findings of fact as follows:

I. The plaintiff, the Kirby Lumber Company, is a corporation organized and existing under the laws of the State of Texas, with its principal office at 911-915 Main Street, Houston, Texas.

II. The plaintiff on or about March 13, 1924, filed with the collector of internal revenue at Austin, Texas, its income-tax return for the calendar year 1923 disclosing a tax liability of \$ 188,062.24, which was duly paid.

III. On February 16, 1928, the Commissioner of Internal Revenue made an additional assessment in the sum of \$ 8,047.05 for the year 1923, which was duly paid.

IV. On July 16, 1923, the Kirby Lumber Company made a deed of trust or mortgage of certain of its property to secure the payment of certain bonds, aggregating the total principal sum of \$ 14,000,000. Although the deed of trust authorized the issue of \$ 14,000,000 in bonds, only \$ 12,126,800 were actually issued and they were issued at par on July 16, 1923.

V. During the year 1923, the Kirby Lumber Company purchased \$ 1,078,300 par value of these bonds for \$ 940,778.70, [\*292] or \$ 137,521.30 less than the issuing price, and retired the said bonds so purchased.

VI. In [\*\*\*3] its return referred to in Finding II, the taxpayer included \$ 124,446.45 of the \$ 137,521.30, referred to in Finding V, as a portion of its income for the year 1923, and in the said additional assessment for the year 1923 the commissioner included as an additional amount of income, subject to tax for said year, an

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additional sum in the amount of \$ 13,074.85 on account of the purchase of bonds at less than the issuing price; so that there was included in plaintiff's taxable income for the year 1923 the said sum of \$ 137,521.30 referred to in Finding V.

VII. The bonds mentioned in Finding IV above were issued at par, the Kirby Lumber Company receiving the par value of the bonds issued, without incurring expense incident to the issue of the said bonds.

VIII. On or about January 24, 1928, the plaintiff filed with the collector of internal revenue at Austin, Texas, a claim for refund of \$ 17,188.99, or such greater amount as is legally refundable. The said claim for refund was based on the ground that the difference between the issuing price of the bonds retired and the price at which they were subsequently acquired by the plaintiff was not taxable gain to the plaintiff.

IX. On May [\*\*\*4] 8, 1928, the Deputy Commissioner of Internal Revenue wrote the plaintiff that, "The claim will, therefore, be rejected. The rejection of the claim will officially appear on the next schedule to be approved by the commissioner."

The court decided that plaintiff was entitled to recover, with interest.

The plaintiff brings this suit to recover \$ 17,188.99, income taxes which it claims were erroneously assessed against it for the calendar year 1923.

The plaintiff during the taxable year issued its own bonds at par, and later within the year purchased on the open market certain of these bonds at less than par, and retired [\*293] them. The difference between the par value of such bonds and the price at which they were purchased and retired was the sum of \$ 137,521.30.

The question before the court for determination is this, namely, is the \$ 137,521.30 the excess of the issuing price of the bonds over the purchase price a taxable gain or income to the plaintiff for the year 1923.

Article 545 of Treasury Regulations 62 provides:

"*Sale and retirement of corporate bonds.* -- (1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or [\*\*\*5] loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) 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."

In conformity with the regulations the Commissioner of Internal Revenue determined that the excess of the issuing price of the bonds over the purchase price represented taxable income to the plaintiff and assessed and collected the taxes in question.

The plaintiff contends that the item in controversy is not taxable as income because it was not gain derived from either capital or labor, or from both combined, or through a sale or conversion of capital, and cites in support of its contention a long line of decisions of the Board of Tax Appeals, which decisions are premised on *Bowers v. Kerbaugh-Empire Co.*, 271 U.S. 170-174.

In the *Kerbaugh-Empire* [\*\*\*6] case, *supra*, the defendant in error had before the World War borrowed money from a bank in Germany, repayable in marks or their equivalent in gold coin of the United States.

A subsidiary of the defendant in error, for whose use the money was borrowed, lost the money in business and claimed, and was allowed, a loss of such amounts in its income-tax returns for the years in which the losses occurred.

[\*294] In 1921 the defendant in error made payment of the balance due on its notes. Owing to the depreciated value, at that time, of the German mark there was, measured by United States gold coin, a difference between the value of the marks borrowed at the time the loans were made and the amount paid in liquidation of the unpaid balance the sum of \$ 684,456.18.

The Commissioner of Internal Revenue treated this sum of \$ 684,456.18 as income for the year 1921 and assessed taxes thereon. The Supreme Court held that it was not taxable as income. The court stated the issue to be:

"The question for decision is whether the difference between the value of marks measured by dollars at the time of payment to the custodian and the value when the loans were made was income."

The court [\*\*\*7] then said:

"The sixteenth amendment declares that Congress shall have power to levy and collect taxes on income, 'from whatever source derived,' without apportionment among the several States and without regard to any census or enumeration.

\*\*\*\*\* 'Income' has been taken to mean the same thing as used in the corporation excise tax act of 1909, in the sixteenth amendment and in the various revenue acts subsequently passed. *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335; *Merchants L. & T. Co. v. Smietanka*, 255 U.S. 509, 519. After full consideration, this court declared that income may be defined as gain derived from capital, from labor, or from both combined,

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including profit gained through sale or conversion of capital. *Stratton's Independence v. Howbert*, 231 U.S. 399, 415; *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179, 185; *Eisner v. Macomber*, 252 U.S. 189, 207. And that definition has been adhered to and applied repeatedly. See e. g. *Merchants L. & T. Co. v. Smietanka*, *supra*, 518; *Goodrich v. Edwards*, 255 U.S. 527, 535; **[\*\*887]** *United States v. Phellis*, 257 U.S. 156, 169; *Miles v. Safe Deposit [\*\*\*8] Co.*, 259 U.S. 247, 252, 253; *United States v. Supplee-Biddle Co.*, 265 U.S. 189, 194; *Irwin v. Gavit*, 268 U.S. 161, 167; *Edwards v. Cuba Railroad*, 268 U.S. 628, 633. In determining what constitutes income substance rather than form is to be given controlling weight. *Eisner v. Macomber*, *supra*, 206."

**[\*295]** Counsel for the Government contend that the decision in this case does not support the position of the plaintiff in the instant case. It is urged that the decision is "authority for the proposition that when A borrows money and loses, through business reverses, the entire amount of money borrowed, any subsequent settlement with the lender whereby A is enabled to liquidate his obligation for less than its face amount, the difference between the amount paid to liquidate the obligation and the face amount of the obligation is not income."

Counsel say:

"It is conceivable that had the Kirby Lumber Company been insolvent when it purchased the bonds in question at a discount on the issuing price, the decision of the Supreme Court in the *Kerbaugh-Empire Company case* might be authority to sustain its position that the

transaction resulted in no **[\*\*\*9]** taxable gain; but, so far as the record in this case discloses, such were not the facts."

We can not agree with the contentions of counsel for the defendant. It is obvious that where a person issues obligations and afterwards redeems such obligations at a price less than that of their issue, such person derives gain through the transaction. The question is whether such gain is taxable as income. In our opinion the question whether the person engaging in such transaction is solvent or insolvent, or whether he made a profit or suffered a loss through the use of the money for which the obligations were issued is wholly immaterial.

That this was the view of the Supreme Court in the *Kerbaugh-Empire case* is unmistakably shown in the court's precise and explicit statement of the issue. Had the factors urged by the defendant been considered material to the determination of the case they would undoubtedly have been included by the court in its statement of the issue.

We think the decision in the *Kerbaugh-Empire case* fully sustains the contentions of plaintiff in the instant case that the excess of the issuing price of its bonds over the purchasing price of such of its bonds as **[\*\*\*10]** it purchased subsequent to issue, is not taxable as income, and that the taxes herein were erroneously assessed and collected.

**[\*296]** Judgment is therefore awarded the plaintiff in the sum of \$ 17,188.99, with interest thereon as is by law provided. It is so ordered.