1959

The Separate Tax Treatment of Import Transactions and Related Foreign Exchange Fluctuations: The Case for Integration

Follow this and additional works at: https://digitalcommons.law.yale.edu/ylj

Recommended Citation

Available at: https://digitalcommons.law.yale.edu/ylj/vol68/iss3/5

This Article is brought to you for free and open access by Yale Law School Legal Scholarship Repository. It has been accepted for inclusion in Yale Law Journal by an authorized editor of Yale Law School Legal Scholarship Repository. For more information, please contact julian.aiken@yale.edu.
NOTES AND COMMENTS

THE SEPARATE TAX TREATMENT OF IMPORT TRANSACTIONS AND RELATED FOREIGN-EXCHANGE FLUCTUATIONS: THE CASE FOR INTEGRATION

Fluctuations in foreign-exchange rates\(^1\) may have tax consequences for importers contracting on a nondollar basis,\(^2\) because their taxable income must

1. For a sampling of exchange movements over the past decade in principal foreign currencies vis-à-vis the United States dollar, see Pick, CURRENCY YEARBOOK 137 (France), 141 (Germany), 178 (India), 208 (Japan), 338 (United Kingdom) (1958). For the level of imports during this period, see U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES 1958, at 879.

Generally, "fluctuations" are regarded as the product of free-market pressures, e.g., Church's English Shoes, Ltd., 24 T.C. 56, 57 (1955) (price of pound dropped from $4.86 to $4.03), while "devaluation" connotes deliberate action by governmental fiscal or monetary authority, e.g., Willard Helburn, Inc., 20 T.C. 740, 741 (1953) (pound devalued from $4.04 to $2.81). Apparently, the courts have not distinguished between the two. But see note 11 infra.

Foreign-exchange rates and the level of imports interact. See KIEKHOFFER, ECONOMIC PRINCIPLES, PROBLEMS, AND POLICIES 317-20 (3d ed. 1946) [hereinafter cited as KIEKHOFFER].

Money values change in two ways—intrinsic and relatively. Intrinsic purchasing power of a currency is reflected in the amount of goods each unit will buy at one time as compared to another. This raises entirely distinct problems of inflation and deflation accounting not restricted to the foreign-exchange field. See generally HEPWORTH, REPORTING FOREIGN OPERATIONS 64-66 (1956); Paton, Measuring Profits Under Inflation Conditions: A Serious Problem for Accountants, 89 J. ACCOUNTANCY 16, 26 (1950). On the other hand, the relative changes reflected in the exchange rates do not necessarily affect internal prices but do affect the volume of overseas trade. MINTS, MONETARY POLICY FOR A COMPETITIVE SOCIETY 96 (1950). Thus, when the British government devalued the pound, an American purchasing in England could acquire more goods for his dollar, as the price in pounds remained the same. Aside from long-run inflationary pressures, to a British subject the devaluation was meaningless, since his pound bought as many goods in the local market after the devaluation as it did before.

2. The importer is not in a position to protect himself against the effects of a fluctuation in the value of foreign exchange. Nations often restrict the convertibility of their money into foreign currency. FINNEY & MILLER, PRINCIPLES OF ACCOUNTING—ADVANCED 586 (4th ed. 1952). Even absent these limitations, the foreign supplier is entitled to payment in his local currency unless he has specifically agreed to the contrary. See KIEKHOFFER 329.

Assume, however, that the importer can obtain a dollar contract to avoid tax problems: he nevertheless takes a serious competitive risk. If the foreign currency depreciates, competitors purchasing either subsequent to the exchange devaluation or in terms of the foreign currency can charge lower prices, as they can now buy more goods per dollar. Conversely, in the event of an appreciation of the foreign money, his costs would be lower than those of his later-buying competitors. No matter how he deals, then, he is forced to gamble
be computed in dollars. Specifically, when a contract to buy goods overseas is expressed in foreign monetary units and is subsequently liquidated for a dollar amount either greater or less than that obtaining at the time of purchase, this difference must be accounted for. Whether it represents a taxable gain (or deductible loss) is repeatedly litigated. The courts have generally concluded that it is reportable, the taxable occasion being the discharge of liability under the contract of purchase.

The usual judicial rationale for finding a taxable event is that the taxpayer has engaged in two separate transactions: an acquisition of goods at the date-of-purchase price, and a speculation in foreign exchange between purchase

in the sense that he must be able to predict the direction of future exchange fluctuations. Compare Kades, *Devaluation Revalued*, 28 TAXES 365, 372 & n.41 (1950).

Even by hedging, the importer can secure only the protection of a stabilized cost. If he contracts on a foreign money basis, he can purchase exchange futures to solidify the dollar price of the goods as of a given date. See Nussbaum, *Money In The Law* 122-23 (1939) [hereinafter cited as Nussbaum]; Keckhofer 395-97. But the effect of a hedging operation would be the same as initially contracting on a dollar basis. Again, he would be at either a competitive advantage or disadvantage, depending on which way the market moves. If he initially deals in dollars, he can sell foreign exchange at the prevailing rate to be delivered in the future so that any gain or loss in terms of market position would be counterbalanced by a gain or loss on the currency transaction. Nussbaum 122-23. Here, however, he faces a deleterious tax effect. The gain or loss on the hedging transaction would be immediately taxable, see Corn Products Ref. Co. v. Commissioner, 350 U.S. 46, 53 n.8 (1955) (collecting authorities), while the offsetting gain or loss in his market position would not be realized until the goods were resold, see note 36 infra and accompanying text.

3. For tax purposes, all import transactions handled on a foreign-currency basis must be translated into domestic currency at the rate prevailing at the time of the transaction. O.D. 590, 3 Cum. Bull. 75 (1920), see INDEX CCH 1958 Stand. Fed. Tax Rep. 72104.

4. See cases cited note 30 infra.


6. See America-Southeast Asia Co., Inc., 26 T.C. 198 (1956); Bevmore Corp., 15 CCH Tax Ct. Mem. 513 (1956); O.D. 489, 2 Cum. Bull. 60 (1920); cases cited note 5 supra. If the taxpayer merely holds foreign currency which has depreciated in value, no gain or loss is recognized. Hugo F. Urbauer, 7 B.T.A. 846 (1927); Theodore Tiedemann & Sons, Inc., 1 B.T.A. 1077 (1925); O.D. 940, 4 Cum. Bull. 64 (1921). The only exceptions to this rule are found in cases in which the foreign exchange had become substantially worthless, e.g., Louis Stern, 5 B.T.A. 870 (1926), or in cases in which the taxpayer was a dealer in foreign exchange, see O.D. 834, 4 Cum. Bull. 61 (1921). See also Stuetzer, *Tax Problems Raised by Foreign Currency Devaluation and Blocked Foreign Income*, 6 Tax L. Rev. 255, 257 (1951); G.C.M. 4954, VII-2 Cum. Bull. 293 (1928).

For a discussion of whether capital or ordinary income treatment should be accorded foreign-exchange gains and losses, see notes 50-62 infra and accompanying text.
FOREIGN-EXCHANGE FLUCTUATIONS

and payment. This reasoning does not comport with commercial realities. True, when the foreign currency used depreciates in terms of dollars between purchase and payment, the importer realizes a "bargain"; if it appreciates, he pays more than anticipated. Nonetheless, he has simply effected a purchase economically indistinguishable from an acquisition of identical merchandise in the domestic market. Although, in the latter case, no tax could be levied until the goods are resold, payment in depreciated (or appreciated) foreign monetary units is deemed to engender a taxable event. The unreality and latent inequity of this separate-transactions approach become clear if it is assumed that all the foreign-bought goods remain unsold at the end of the tax period during which the taxpayer's purchase liability was discharged. A depreciation of the foreign exchange between purchase and payment would then produce taxable "gain" although the importer has not received any actual revenue and, conceivably, may never be able to sell the goods in question. Even if the importer experiences a normal turnover of merchandise, the separate-transactions theory distorts taxable income by telescoping the entire foreign-exchange gain or loss into the year in which the importer pays for the merchandise.

As the fluctuation's effect is not set off against recorded date-of-purchase cost, his previously determined cost of goods sold is either under- or over-stated. Furthermore, to the extent that the merchandise remains unsold, the initially misstated cost will be carried forward as a misstated inventory valuation.

Suppose, for example, that an importer contracts to purchase goods for

7. "There were two transactions, for accounting and tax purposes, one involving the purchase and sale of shoes, the other a 'speculation' in foreign exchange." Church's English Shoes, Ltd., 24 T.C. 56, 59 (1955); see Joyce-Koebel Co., 6 B.T.A. 403, 406 (1927); Bernuth Lembcke Co., 1 B.T.A. 1051, 1054 (1925). No tax has been levied, however, when a foreign-exchange gain has been accompanied by a larger loss on the underlying transaction. See cases cited notes 27, 63 infra.

8. See Eisner v. Macomber, 252 U.S. 189 (1920) (requirement of a "realization"). In addition to a sale, a gain from exchanges of property may constitute a realization for tax purposes. See INT. RX CODE OF 1954, § 1031.

9. See Nusbaum 132.
200,000 pesos and takes delivery at a time when the pesos would cost $100,000; and that, during the succeeding tax period, a devaluation prior to payment enables him to acquire for $40,000 the exchange needed to discharge his debt. If, in the year of delivery, he resells half the goods for $75,000 and, in the year of payment, he sells the other half at the same price, his profit should be $110,000 ($150,000 less $40,000 actual cost of goods sold) divided equally between the two years. In contrast, under the separate-transactions theory, the merchandise is inventoried at date-of-purchase price—$100,000—rather than at actual dollar cost. The goods resold in the first period would therefore have an artificial $50,000 basis and would produce only a $25,000 profit. But since the entire $60,000 gain on foreign exchange must also be reported in that year, taxable income would be $85,000. When the remaining merchandise is resold in the subsequent period, the $25,000 profit for that year is reportable. This unequal apportionment of the $110,000 overall income combines with progressive tax rates to increase the total tax burden beyond what it would be were $55,000 taxed each year. The courts, however, have persisted in their application of the separate-transactions formula.

10. Under Treasury and accounting standards, the exchange rate to be used is the free-market rate—the price for which the currency can be obtained at a bank. O.D. 489, 2 Cum. Bull. 60, 61 (1920) ("foreign currency should be appraised in dollars (whether actually converted or not) . . . at the current or market rate of exchange, if any, then prevailing"); Finney & Miller, Principles of Accounting—Advanced 612 (4th ed. 1952). In some instances, the Treasury has issued bulletins stating what rates are to be considered for tax purposes as the prevailing free-market rate at given dates. See 1 CCH 1958 Stand. Fed. Tax Rep. § 635.45 (collecting citations). The method of payment—check, time draft, or cable transfer—may have an effect on the exchange rate, but an extremely minor one. Finney & Miller, Principles of Accounting—Advanced 589 (4th ed. 1952).

11. In this hypothetical, the exchange rate is shifted from 2-1 to 5-1. A drop of this magnitude would be unusual and might well be the result of planned governmental action. In situations involving a permanent devaluation, other methods of accounting and tax reporting might be used. See id. at 611.

12. The $60,000 exchange gain is arrived at by subtracting the actual cost of goods sold—$40,000—from the price the importer would have paid for the same number of pesos at the exchange rate prevailing at the date of purchase—in this case $100,000.

13. If no other income or expenses were involved in the hypothetical situation, individual and corporate importers would pay taxes as follows.

<table>
<thead>
<tr>
<th></th>
<th>Commercial Reporting</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1—Reportable Income</td>
<td>$55,000</td>
<td>$30,570</td>
</tr>
<tr>
<td>Year 2—Reportable Income</td>
<td>$55,000</td>
<td>$30,570</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$61,140</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Separate-Transactions Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1—Reportable Income</td>
<td>$85,000</td>
</tr>
<tr>
<td>Year 2—Reportable Income</td>
<td>$25,000</td>
</tr>
</tbody>
</table>

| Difference            | $3,430               |

More important than the $3,430 tax differential is the fact that during the first year the taxpayer's total cash receipts were only $75,000 and that, since he has remitted $40,000...
FOREIGN-EXCHANGE FLUCTUATIONS

Moreover, judicial usage of "date of purchase" and "date of payment" may have produced tax consequences at variance with those which would result from precise terminological analysis. "Date of purchase" has apparently been interpreted to mean either the time the contract is entered into or the date title in the goods passes to the importer. The latter alone properly establishes for the goods on hand, the imposition of a $54,420 tax would result in a cash deficit of $19,420. If the importer has the additional funds available to meet his obligation, the penalty imposed by this system is the loss of opportunity to use his capital to make further profits. If his credit is good, he may be able to borrow the money but he will then incur significant interest costs. And if neither alternative is available, it is conceivable that the taxpayer would be forced to incur heavy losses in attempting to raise the necessary cash and might even be bankrupted despite business earnings at 275% of invested capital. Thus, the difference in the tax burden during the first year—$23,850—may prove crucial to some taxpayers, and imposes a burden on all.


<table>
<thead>
<tr>
<th>Commercial Reporting</th>
<th>Total Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1—Reportable Income $55,000</td>
<td></td>
</tr>
<tr>
<td>Normal Tax</td>
<td>$16,500</td>
</tr>
<tr>
<td>Surtax</td>
<td>6,600</td>
</tr>
<tr>
<td></td>
<td>$23,100</td>
</tr>
<tr>
<td>Year 2—Reportable Income $55,000</td>
<td></td>
</tr>
<tr>
<td>Normal Tax</td>
<td>$16,500</td>
</tr>
<tr>
<td>Surtax</td>
<td>6,600</td>
</tr>
<tr>
<td></td>
<td>$23,100</td>
</tr>
</tbody>
</table>

Separate-Transactions Reporting

| Year 1—Reportable Income $85,000 |          |
| Normal Tax            | $25,500  |
| Surtax                | 13,200   |
|                      | $38,700  |
| Year 2—Reportable Income $25,000 |          |
| Normal Tax            | 7,500    |
|                      | $46,200  |

There is no differential between the two years because corporate tax rates are a flat 30% of the first $25,000 and an additional 22% of all income exceeding that figure. Hence, only if the corporate importer's total taxable income in one year is less than $25,000 would an overall tax differential arise. Then, every dollar shifted from the below-$25,000 to the above-$25,000 year would be taxed at the rate of an additional 22%. Of course, the difference in the increased tax burden in the first year—here, $15,600—remains to place an unnecessary if not fatal burden on the taxpayer.

14. Though the facts are not fully spelled out, the opinion in America-Southeast Asia Co., Inc., 26 T.C. 198 (1956), seems to indicate that the court is confusing date of contract execution with date of title passage. "From June 17 through July 26, 1949, petitioner purchased burlap from five different shippers in India for shipment to the United States during August and September 1949." Id. at 198. (Emphasis added.) The court does not state what shipping terms were utilized but most likely the parties dealt on a C.I.F. basis, see note 15 infra, since the transaction involved a prepayment of freight, 26 T.C. at 198, a primary characteristic of a C.I.F. shipment, GILMORE & BLACK, ADJUR-ALITY 97 (1957). Under C.I.F., title passes at time of delivery to the carrier. See note 15
the initial point from which gain or loss on a currency fluctuation should be measured. Until title passes, no change has occurred in the taxpayer's financial position which he can record on his books or report on his tax returns. Likewise, "date of payment" has evidently been construed as meaning either of two distinct events which often do not coincide—the purchase of foreign exchange, and the remittance of funds to the seller. From a tax viewpoint, the crucial date should be that on which the importer actually converts dollars into other monetary units. Once the foreign currency is acquired, fluctuations can no longer affect the dollar cost of the merchandise. Thus, in the usual case, the relevant interval should be defined as that between the passage of title and the acquisition of foreign exchange, not one measured from either the formation of the contract or the final remittance of funds.

Besides failing to identify the period during which pertinent fluctuations may occur, the courts have evidently relied on an inapposite theory to justify finding a taxable event in what is essentially a "bargain" purchase. The view that an advance of foreign credit and subsequent payment in cheaper foreign exchange constitutes a separate transaction has naturally led tribunals to refer infra. Assuming they did so contract, the interval between contract execution and title passage may have been vital. Shipment under the contract was to be made during August and September 1949. The devaluation of the pound, the key issue in the case, occurred on September 18, 1949. If any or all of the sellers shipped after that date, there was no fluctuation (if the exchange was acquired after delivery). Nonetheless, without stating when shipment was made, the court found taxable gain on each transaction.

15. The date that property in the goods—i.e., title—passes to the importer is determinative of many factors—primarily, allocation of risk of loss and ability to maintain actions for breach. Gilmore & Black, Admiralty 94 (1957). Under the so-called property rules, title formerly passed to the buyer at the earliest possible moment. But when buyer and seller were at a distance, early shifting of title was undesirable. Thus, the mercantile terms of shipment—F.O.B., F.A.S., C.I.F.—were developed to postpone title passage until, at the earliest, goods are delivered to the carrier. Id. at 96-99. In international mercantile transactions, the principal shipment term is C.I.F. (Cost, Insurance, Freight), id. at 97, under which title passes when the seller delivers the goods to the carrier, Smith Co. v. Marano, 267 Pa. 107, 110 Atl. 94 (1920). For a full discussion of these mercantile terms, see Revised American Foreign Trade Definitions—1941, reprinted in Honold, Cases on Sales & Sales Financing 225-30 (1954).


17. See Int. Rev. Code of 1954, § 446(a) (taxable income is to be computed on the basis of the taxpayer's normal method of accounting).

18. The general confusion in this area is highlighted by the decision in Seaboard Fin. Co., 20 T.C. 405 (1953), rev'd, 225 F.2d 808 (9th Cir. 1955). The reversal stemmed in large measure from the choice of the date of payment. The Tax Court had used the approximate date that the exchange was purchased. 20 T.C. at 417. The Ninth Circuit, in reversing, used the date the funds were released to the seller from escrow. 225 F.2d at 812, 814 n.4. In this difference lay the question of whether a taxable gain had been realized. To the extent that the funds were used for a purchase, the determination by the Tax Court appears to be the better one.
to the rule that discharging a debt for less than face generates income. No immediately apparent distinction exists between repaying a loan for less than the amount borrowed and liquidating a mercantile extension of credit, with fewer dollars than originally obligated. On the other hand, the leading Supreme Court debt-reduction case, United States v. Kirby Lumber Co., stands for the proposition that taxable income results from a greater decrease in liabilities than assets—in effect, a “balance sheet increment.” And, in the context of a “bargain” repayment of foreign credit, any such increment in net worth is illusory, as it appears on the balance sheet only because, under the separate-transactions rule, inventory must be carried at the inflated date-of-purchase cost. Since the domestic market value of replaceable, foreign-bought inventory decreases as the related foreign currency depreciates, such changes in value after the initial purchase are not reflected on the taxpayer's books.


21. “As a result of its dealings it made available $137,521.30 assets [sic] previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here.” 284 U.S. at 3.

In the language of the accountant, an increment in the net-worth or capital section of the balance sheet occurs as the result of liquidating a debt at less than face. To be taxable, the increment must represent an overall gain in the amount of assets as opposed to outstanding liabilities. Commissioner v. Rail Joint Co., 61 F.2d 751 (2d Cir. 1932) (construction of Kirby per Swan, J.).

22. See Nussbaum 132.

23. See note 7 supra and accompanying text.

24. See Samuelson, ECONOMICS 632 (4th ed. 1958) (“If England cheapens her pound from $4.20 to $2.80, I find that her [goods] ... have become cheaper to me ... so I buy more of them . . . .”).

25. The economic value to an importer of any goods held for resale is measured not in terms of original cost but replacement cost. Hepworth, REPORTING FOREIGN OPERATIONS 64-66 (1956). An importer who purchased before a devaluation does not have property that is “worth” more than his later-buying competitor—he has merely paid more for the same thing. For example, the importer agrees to purchase 100 cases of burgundy in France for 400,000 francs or $2,000. Subsequently, the franc drops from 200-1 to 400-1. The importer's balance-sheet cost is $2,000, but his competitors can now acquire 100 cases of burgundy for only $1,000. In effect, the inventory value is $1,000 less than reflected on the books. No bookkeeping entries will make the goods more or less valuable.
quently, both inventory value and net worth are overstated to the extent that subsequent devaluations have reduced the cost of replacing the inventory.26

Even if it is assumed that the mere existence of any balance sheet increment, however artificial, can fall within the Kirby rule, its rationale should be rejected in "bargain" foreign-exchange cases. Analogous exceptions to Kirby are numerous; indeed, absent economic gain by the taxpayer, Kirby is characterized by its exceptions.27 Since the importer does not realize actual gain until his merchandise is resold, an arbitrarily established balance-sheet increment should not occasion federal taxation.

The separate-transactions approach has probably won judicial adherence, despite its logical inconsistencies, because of the accounting methods and finan-

26. Presumably, if devaluations occur before the end of the year in which the purchase is made, the taxpayer could inventory at "cost or market, whichever is lower" in order to reflect actual market value at the year's end. For a general discussion of how this method operates, see Finney & Miller, Principles of Accounting—Intermediate 375-92 (4th ed. 1951). "Cost or market" is permitted under the 1954 Code. Proposed Treas. Reg. § 1.471-4, 22 Fed. Reg. 9889 (1957). If the devaluation occurs after the year's end, however, "cost or market" will be inapplicable because once inventory is reported at cost, it cannot later be reduced to market. Ibid.

Accountants no longer favor "cost or market" pricing. Its distorting effect on the income statement is considered improper. See Finney & Miller, Principles of Accounting—Intermediate 382-86 (4th ed. 1951). Moreover, from a tax viewpoint, "cost or market" may not be a feasible method of costing inventory. Accountants recognize three ways of compiling the relevant cost and market figures to determine which is lower: item-by-item, categories, or total inventory. Id. at 377-79. Under tax law, only the item-by-item procedure, clearly the most detailed of the three, may be used. Proposed Treas. Reg. § 1.471-4(c), 22 Fed. Reg. 9889 (1957).

27. For cases distinguishing Kirby, see, e.g., Dallas Transfer & Terminal Warehouse Co. v. Commissioner, 70 F.2d 95 (5th Cir. 1934); Commissioner v. Rail Joint Co., 61 F.2d 751 (2d Cir. 1932); Hextell v. Huston, 28 F. Supp. 521 (S.D. Iowa 1939); Edward Mallinckrodt, Jr., 38 B.T.A. 960 (1938). The most striking analogy to the import-purchase situation is Hirsch v. Commissioner, 115 F.2d 656 (7th Cir. 1940). There, the court held that, after a debt had been incurred on the purchase of property, a subsequent settlement for less than face constituted a downward adjustment of the purchase price. The facts and reasoning parallel the economic realities of import purchasing. See text accompanying notes 7-8 supra.

Also see Bradford v. Commissioner, 233 F.2d 935 (6th Cir. 1956) (taxpayer had discharged a debt incurred by her husband for $50,000 less than face; court held that since she had received "nothing of value when the indebtedness was assumed," she had not realized taxable income); Helvering v. American Dental Co., 318 U.S. 322, 331 (1943) ("The fact that the motives leading to the cancellations [of indebtedness] were those of business or even selfish, if it be true, is not significant. The forgiveness was gratuitous, a release of something to the debtor for nothing, and sufficient to make the cancellation here [nontaxable] gifts . . . .").

Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926), though decided before Kirby, stands as an exception to the Kirby reasoning. Kerbaugh-Empire involved a taxpayer who had borrowed German marks to finance an overseas construction project. He had sustained huge losses on the project itself; these were partially offset by a gain realized on discharging the initial loan. Because of the overall loss, the Court found no income. Commentators have said that the effect of the Kerbaugh-Empire decision was vitiated by subsequent decisions. See, e.g., Magill, Taxable Income 245-59 (rev. ed. 1945); Surrey,
cial practices used by petitioners appearing before the courts. Under traditional accounting procedure, all gains on foreign-exchange fluctuations are segregated into a special, nonincome, reserve account against which all losses are offset; but, to the extent that losses exceed gains, they are immediately charged against operating profits. Clearly, this procedure could not be permitted by the courts, for it would result in the deduction of some losses without the reporting of any gains. Alternatively, other taxpayers have closed out their net foreign-exchange balance annually to profit and loss—but have maintained that it was not taxable. Since such a taxpayer calculates his costs as of the date of purchase, a subsequent depreciation of the foreign currency would serve to inflate the cost basis of previously sold goods and present inventory. Unless the foreign-exchange gain was then reported separately, the importer, on reselling the goods, would be able to reduce his reportable profits to the extent of the

The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness, 49 YALE L.J. 1153, 1169 (1940). Nonetheless, the Court in Kirby refused to overrule Kerbaugh-Empire. 284 U.S. at 3. Since the Kerbaugh-Empire taxpayer had experienced no balance-sheet increment, the two decisions are actually altogether consistent.

For a more recent case utilizing, in part, the Kerbaugh-Empire rationale, see William H. Coverdale, 4 CCH Tax Ct. Mem. 713 (1945).

28. In discussing the rules of foreign-exchange-fluctuation accounting, the treatises speak in terms of operating a foreign branch, FINNEY & MILLER, PRINCIPLES OF ACCOUNTING—ADVANCED 600 (4th ed. 1952); KESTER, ADVANCED ACCOUNTING 638 (3d rev. ed. 1933), or of operating subsidiaries, HEPWORTH, REPORTING FOREIGN OPERATIONS 77 (1956); MONTGOMERY, AUDITING 497 (7th ed. 1949). Since the ordinary importer's accounting problems are the same, presumably the traditional accounting rules are also applicable to him. In American Pad & Textile Co., 16 T.C. 1304, 1310-11 (1951), the Tax Court compared the results of various prior foreign-exchange cases and came to the conclusion that no rational principle governs them unless it be that any method of accounting which is not completely unfounded will be acceptable for tax purposes.

29. Current practice is to offset realized gains and losses and carry the balance into income. See AMERICAN INSTITUTE OF ACCOUNTANTS, RESTATEMENT AND REVISION OF ACCOUNTING RESEARCH BULLETINS, BULL. No. 43, at 113 (1953).

30. One taxpayer closed out foreign-exchange gain with a credit to "Other Income," yet claimed that it was not taxable. Willard Helburn, Inc. v. Commissioner, 24 F.2d 815, 818 (1st Cir. 1954). Another credited exchange gain to "Earned Surplus," but did not report it as taxable income. America-Southeast Asia Co., Inc., 26 T.C. 198, 199 (1956). A wholly-owned American subsidiary of a Norwegian firm proposed to share the benefit of a favorable exchange fluctuation with its parent company. The amount of the gain was divided between an "Oslo Special" account and a "Currency Fluctuation" account. The Tax Court determined that the gain was taxable and rejected the petitioner's claim that, because the loan account between parent and subsidiary had been increased and special accounts set up, the parent rather than the subsidiary had made the profit on the exchange fluctuation. Bennett's Travel Bureau, Inc., 29 T.C. 350 (1957). See also Church's English Shoes, Ltd., 24 T.C. 56 (1955).

31. Inventory pricing at cost (in this context, date-of-purchase) is the generally accepted accounting method. FINNEY & MILLER, PRINCIPLES OF ACCOUNTING—INTERMEDIATE 382-85 (4th ed. 1951). This method of pricing is necessary to arrive at a gain on the exchange fluctuation separate from the gain on resale. Date-of-payment pricing would integrate both.
overstated cost basis. The judiciary has therefore favored the separate-transactions approach as the only practical means of imposing a tax. Furthermore, and not unexpectedly, the cases are increasingly relied on for the proposition that a foreign-exchange fluctuation constitutes a separate transaction as a matter of law—irrespective of whether the underlying circumstances would warrant offsetting an exchange fluctuation against the related date-of-purchase cost.

The inequities of the present rule would be avoided if the courts were to presume that, when an importer purchases goods and foreign exchange needed to discharge the related liability, he engages in an integrated transaction, not two separate ones. To take advantage of this presumption, the taxpayer would have to recompute the value of his inventory as of the date of payment. Accordingly, in calculating taxable income, he would subtract the adjusted inventory value from his proceeds on reselling the inventory—his tax liability on both the proceeds and the movement of foreign exchange being subsumed under this difference. Thus, relevant exchange fluctuations would be reflected

32. Assume, for example, that imported goods were taken into inventory at a date-of-purchase cost of $50,000 and that in the same year, they were resold for $75,000, $25,000 in taxable income being reported. If the original $50,000 debt to a foreign creditor is later discharged at a cost of $25,000 but no taxable income is reported, the taxpayer will in effect have sold goods costing $25,000 for $75,000 and reported only a $25,000 profit.

33. Before us, as before the Tax Court, petitioner put itself in the impossible position of asking to have it both ways. As stated by Judge Murdock in the opinion of the Tax Court, petitioner wants to use the amount representing what it would have paid for the skins in dollars at the exchange rate of $4.04 "had it not borrowed from or through Shipley, as the cost of the skins to it, but it does not want to report as income the difference between that amount and the smaller number of dollars which it used to pay off the loans". Willard Helburn, Inc. v. Commissioner, 214 F.2d 815, 819 (1st Cir. 1954); see 68 Harv. L. Rev. 717 (1955).

34. The judiciary now evidently regards the purchases of foreign exchange and foreign goods as distinct beyond question. For example, in Church's English Shoes, Ltd., 24 T.C. 56, 59 (1955), the court stated: "[T]he proper method of accounting is to account for any profit or loss in the payment for foreign exchange in and as a transaction which is separate from the purchase and sale . . . ." But see Willard Helburn, Inc. v. Commissioner, 214 F.2d 815, 818 (1st Cir. 1954) (dictum). In any event, the separate-transactions approach has become so universally accepted that petitioners are conceding its applicability to their own situations. E.g., America-Southeast Asia Co., Inc., 26 T.C. 198, 199 (1956) (petitioner agreed at the outset that the decision in Willard Helburn, Inc., 20 T.C. 740 (1953), aff'd, 214 F.2d 815 (1st Cir. 1954), was controlling). America-Southeast Asia was in turn stipulated as controlling in a similar case decided the same day. Bevmore Corp., 15 CCH Tax Ct. Mem. 513 (1956).

35. More particularly, the taxpayer would ascertain the dollar cost of the relevant foreign currency at the date of each invoice payment, translate it into a dollar cost per unit of goods purchased, and then determine what inventory items were covered by each remittance. To be usable, this information would have to be compiled on worksheets and summarized in statement form. The amount of time involved in this operation would of course vary with the number and complexity of the transactions but, most likely, the necessary accounting would not prove insubstantial or inexpensive.
in his cost of goods sold and would receive appropriate tax treatment. A de-
preciation of the foreign currency between purchase and payment, for example,
would result in a lower value of inventory and, eventually, in larger taxable
proceeds on resale. If the goods had been resold in a tax period preceding
the date of payment, the proposed integrated-transaction procedures would
necessitate reopening the tax returns for the year of resale in order to recom-
pute cost of goods sold. In this event, if the goods involved are specifically
identifiable or the transaction is otherwise sufficiently distinctive, the importer
should be required to prove the actual relationship between the prior resale

36. If all or part of the goods had been resold in a period for which a return had
been filed before payment was made, the cost-of-goods-sold deduction would necessarily
have been based on the date-of-purchase cost. In this situation, even if the "cost or
market" formula were used, date-of-payment accounting would necessitate reopening
the prior return, since cost would have been determined at the date of purchase. See note
26 supra. See also Finney & Miller, Principles of Accounting—Advanced 589-90

The taxpayer doubtless would not elect to reopen his return, however, unless separate
reporting would work severe hardship on him. Fairly often, the importer's income will
be relatively constant over a period of years, so that given stable tax rates, the advantage
of transferring a gain or loss from one tax period to another would be slight. Also, when
the net effect of a foreign exchange fluctuation is minor—i.e., the extent of the fluctuation
itself is small or the importer's investment is minimal or various fluctuations offset each
other—the taxpayer may be unwilling to incur the additional expense involved in re-
opening prior returns.

A strong analogy supporting the proposed reopening of prior returns is found in
Eureka Fire Brick Works, 5 CCH Tax Ct. Mem. 1106 (1946). There, the court upheld
the Commissioner in his reopening of a prior return in order to adjust closing inventory;
the inventory had been based on an arbitrary figure not unlike date-of-purchase cost.
See text accompanying notes 28-29 supra. Moreover, in the foreign-transactions field
generally, a number of instances have arisen in which the requirement of strict annual
reporting has been relaxed. For example, a taxpayer claiming a foreign tax credit who
used the accrual method of accounting is to utilize the exchange rate prevailing on the
last day of the taxable year in which the foreign tax accrues. I.T. 1645, II-1 Cum. Bull.
141 (1923). When the tax is finally paid, the rate prevailing at the date of payment
is to be employed; any difference resulting from a fluctuation in the exchange rate is
resolved by recomputing the tax liability based on the originally accrued foreign tax
also Stuetzer, Tax Problems Raised by Foreign Currency Devaluation and Blocked
Foreign Income, 6 Tax L. Rev. 255, 260 (1951). If the taxpayer excludes foreign income
from his United States tax return because of blockage or other restrictions but still pays
a tax to a foreign government on the income, any foreign tax credits may be deferred
until the taxpayer eventually reports the income on his domestic tax return. Treas. Reg.
§ 1.905-1(b) (1957).

On balance, the integrated foreign-exchange and import transaction would appear to
merit an exception to the rule enunciated in Burnet v. Sanford & Brooks Co., 282 U.S. 359,
363-65 (1931), that a tax year once closed should remain closed. Moreover, the rigidity
of Burnet was later modified in Dobson v. Commissioner, 320 U.S. 489, 502, 506-07 (1943):

Whether an apparently integrated transaction shall be broken up into several steps
and whether what apparently are several steps shall be synthesized into one whole
transaction is frequently a necessary determination in deciding tax consequences.
... We only hold that no statute or regulation having the force of one and no
and a foreign-exchange gain or loss on payment.\(^{37}\) When, however, the taxpayer deals in fungible or semi-fungible goods,\(^{38}\) the relationship should be deemed established if, by reasonable estimate, he offsets exchange fluctuations pro rata against present inventory and previous cost of goods sold.\(^{39}\)

In many instances, potential tax savings might not justify the cost of the accounting procedures needed to relate foreign-exchange fluctuations with economically integral purchases and resales.\(^{40}\) For this reason, importers should normally be allowed to adopt either the separate-transactions or the integrated approach. In a few exceptional situations, however, the taxpayer should either be precluded from treating purchase and payment as integrated, or prohibited from exercising his option to the contrary.

If the importer engages in foreign-exchange activities which are more likely to be currency-speculation or tax-avoidance devices than genuine commercial undertakings, he should be required to prove that his gain or loss on a fluctuation was in fact part of an integrated import transaction. Such situations would include payments delayed beyond a commercially or administratively reasonable length of time;\(^{41}\) fortuitously connected loan and purchase agreements;\(^{42}\) and principle of law compels the Tax Court to find taxable income in a transaction where as a matter of fact it found no economic gain . . . .

What is in conflict here is the policy of the annual accounting period, Int. Rev. Code of 1954, § 441, and the requirement that the accounting method used should "clearly reflect income," Int. Rev. Code of 1954, § 446(b). The equitable considerations in accurate, undistorted income reporting would seem paramount. See Comment, 67 Yale L.J. 1394 n.2 (1958) (collecting provisions of the 1954 Code "mitigating certain of the harsh effects which strict annualization and progressive tax rates may have on fluctuating income"). See also Int. Rev. Code of 1954, § 172(b) (two-year carryback of net operating losses).

37. The importer will probably keep a perpetual inventory—a record on separate cards of each item as it is taken into stock and later resold. See Kennedy, Esterly & Von Minden, Introductory Accounting 576 (1942); Montgomery, Auditing 198 (7th ed. 1949).

38. See the fact situations in, e.g., America-Southeast Asia Co., Inc., 26 T.C. 198 (1956) (burlap); Church's English Shoes, Ltd., 24 T.C. 56 (1955) (shoes); Willard Helburn, Inc., 20 T.C. 740 (1953) (lambskins); Bernuth Lembcke Co., 1 B.T.A. 1051 (1925) (creosote oil).

39. The taxpayer's method of taking inventory will probably be periodical—usually annual counts. See Scott & Moyer, Fundamentals of Accounting 90 (1940). Rather than go through the detailed accounting procedures needed to match purchases and payments, the following method could be used.

Assume that, during the year, a firm purchases $40,000 in goods of which $10,000 remain on hand at closing; and that subsequently, the $40,000 debt is discharged for $30,000. The $10,000 exchange gain could be offset pro rata, three fourths going to costs of goods sold and one fourth to closing inventory. Thus, of the $30,000 actual cost, $22,500 would be in the first period's cost of goods sold and $7,500 would be carried forward as inventory.

40. See second paragraph, note 36 supra.

41. See, e.g., Church's English Shoes, Ltd., 24 T.C. 56 (1955) (twelve-year delay), discussed note 45 infra.

42. See, e.g., Bernuth Lembcke Co., 1 B.T.A. 1051 (1925) (exchange acquired from bank before contract for purchase of creosote oil was executed).
attempts to disguise or postpone payment.\textsuperscript{43} Moreover, if the importer's primary objective is shown to be exchange speculation, with his mercantile purchase merely ancillary, he should not enjoy a presumption that the purchase and the speculation were integral.\textsuperscript{44} In all these cases, absent taxpayer proof of identity, the speculation should be reported separately.\textsuperscript{45} Separate reporting need not be required, however, when the goods are still in inventory at the time of payment.\textsuperscript{46} The importer could have realized no tax advantage in an earlier period, since the date-of-purchase cost remained as part of inventory and was not shifted into taxable income through cost of goods sold.

In some situations, separate reporting would enable the taxpayer to channel an entire foreign-exchange gain or loss into the most beneficial of several tax years. If an importer experiences cyclical income variations, he could reduce his overall taxes by reporting foreign-exchange gains (or losses) in selected low (or high) income years.\textsuperscript{47} Whenever substantial tax avoidance

\textsuperscript{43} See, \textit{e.g.}, Bennett's Travel Bureau, Inc., 29 T.C. 350 (1957), discussed note 30 supra.

\textsuperscript{44} Hence, if exchange were acquired in advance far in excess of the amount eventually used to purchase goods, the burden of proof would shift to the importer to show that this was not in fact a separate speculation in foreign exchange.

\textsuperscript{45} A recent case illustrates a situation in which integrated reporting should be denied. Church's English Shoes, Ltd., 24 T.C. 56 (1955), \textit{aff'd per curiam}, 229 F.2d 957 (2d Cir. 1956). The taxpayer was the wholly-owned subsidiary of a wholly-owned subsidiary of Church & Co., Ltd., a British corporation. 24 T.C. at 57. The American taxpayer purchased goods from its British affiliate on open-account credit in 1935. The goods were entirely resold by the end of 1937. Ten years after all the goods had been resold, a favorable exchange fluctuation (the dollar price of the pound dropped from $4.86 to $4.03) enabled the importer to discharge his debt for $2,063 less than that recorded on his books (at the $4.86, "date of purchase" price). \textit{Ibid}. Though the firm claimed no taxable event, its failure to prove mitigating circumstances coupled with the close corporate relationship and the protracted credit extension should be deemed to convert this arrangement into a separate speculation. The Tax Court and Second Circuit decisions, \textit{supra}, reached the separate-transaction result through different reasoning. For a contrary view of the \textit{Church} case, see Comment, 67 \textit{Yale L.J.} 1394, 1413-15 (1958).

Corporate affiliation, in and of itself, should not determine whether a currency transaction is separate, since related corporations can and do deal on an arm's-length basis. Suspicious circumstances coupled with a corporate interrelationship, however, see, \textit{e.g.}, Bennett's Travel Bureau, 29 T.C. 350 (1957), would increase the petitioner's problems of proof in seeking to obtain integrated treatment.

In one case, a loss was allowed solely on the basis of a finding that the purchase of merchandise and the purchase and sale of foreign exchange were separate and distinct transactions. Max Sarfert, 5 B.T.A. 977 (1926).

\textsuperscript{46} No matter how long goods remain in inventory, they do not affect income. In computing cost of goods sold, opening inventory is added to purchases and closing inventory is then deducted. \textit{Kennedy, Esterly & Von Minden, Introductory Accounting} 29 (1942). Goods on hand cancel out between the opening and closing figures.

\textsuperscript{47} Assume that the taxpayer, an individual, realizes a $20,000 exchange gain in 1956, $10,000 of which is properly attributable to (because half the goods were sold in) 1955, and the remaining $10,000 to 1956 (when the remaining goods were sold). Assume further that in 1955 taxpayer has $100,000 and in 1956 he has only $10,000 in other income. The
would result, the Commissioner should require reporting on an integrated basis despite the attendant accounting complexities.

Once the purchase of imported goods and payment in foreign currency are generally regarded as one integral transaction, a rationale would be available to refute the claim that profits on foreign-exchange speculation are necessarily capital gains. Importers often procure foreign currency through an open-market purchase or a letter of credit. Because the judiciary has viewed dealings in foreign exchange as separate from related mercantile transactions, the importers have contended that applying the exchange toward a purchase abroad should produce capital gain or loss. They reason that foreign currency is a capital asset, and that its "conversion" into goods should receive capital asset treatment. Although the courts have rejected this argument, following illustrates the taxpayer's advantage in reporting exchange gain separately in 1956.

<table>
<thead>
<tr>
<th>820,000 Gain Evenly Distributed</th>
<th>820,000 Gain Channeled Into 1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>1955 Tax on $110,000 $76,220</td>
<td>1955 Tax on $100,000 $67,320</td>
</tr>
<tr>
<td>1956 Tax on $20,000 7,260</td>
<td>1956 Tax on $30,000 13,220</td>
</tr>
<tr>
<td>$83,480</td>
<td>$80,550</td>
</tr>
</tbody>
</table>

Net Savings $2,930

Computations based on INT. REV. CODE OF 1954, § 1 (a).

Election by a corporation would have no net tax consequences unless income in one year would become less than $25,000. See note 13 supra. Here again, however, the actual cash outlay differential between the two years may have a hidden impact on the corporate or individual taxpayer's financial position. See ibid.

48. What constitutes substantial avoidance would of course vary with the individual case. Probably no fixed criteria can be set; instead, a good-faith standard should be utilized on the administrative level. A de minimis differential—say $500—below which the importer would have free choice in his method of reporting should be established by regulation for administrative convenience. Probably no appreciable revenue loss would be involved, as the variations would tend to even out over a period of years.

49. A somewhat different proposal—a return to the date-of-payment pricing standard established by O.D. 489, see note 6 supra—has been advocated as the overall solution. Note, 1955 U. ILL. L.F. 595. This proposal does not make allowances for accounting complexities or exceptional situations.

50. See, e.g., Bernuth Lembcke Co., 1 B.T.A. 1051 (1925).


52. See, e.g., America-Southeast Asia Co., Inc., 26 T.C. 198, 200-01 (1956) (collecting cases denying importers' claims for capital gains treatment). Compare I.T. 3810, 1945-2 CUM. BULL. 55 (gain or loss on conversion of foreign money in a personal transaction held to be capital gain or loss).

53. See America-Southeast Asia Co., Inc., supra note 52, at 200.

Foreign currency is apparently a capital asset under INT. REV. CODE OF 1954, § 1221. See 1 CCH 1958 STAND. FED. TAX REP. § 635.198.

54. The opinion of the Ninth Circuit in Seaboard Fin. Co. v. Commissioner, 225 F.2d 808 (9th Cir. 1955), reversing 20 T.C. 405 (1953), discussed note 18 supra, has been cited
they have not met the thrust of the reasoning. Undoubtedly, they have felt that a purchase for cash should receive the same treatment as a purchase on open-account or convenience credit, and have noted that, under the latter arrangements, the importer's liability is not a capital asset. The integrated-transaction approach will enable the courts to reach the same desirable result in a more satisfactory manner: exchange fluctuations being absorbed into inventory, all income must be taxed as ordinary resale profits. Even when prohibitive accounting costs or administrative feasibility necessitate separate reporting, the essential indivisibility of the transaction will justify taxing the exchange fluctuation as ordinary income. Indeed, a general rule of tax law is that capital asset conversions intimately connected with a transaction producing ordinary income are taxable at ordinary income rates. In sum, exchange speculation should be held to produce ordinary gain or loss to the extent that the speculation subserves a mercantile purchase; and should receive capital treatment only if the underlying transaction gives rise to capital gain or loss.

as applying capital gains treatment to the exchange transaction. 5 Mertens, Federal Income Taxation § 28.82 n.39 (Supp. 1958). Under the agreed statement of facts, however, the parties had stipulated that if there was any gain at all, it was Canadian and not taxable under Canadian law. 20 T.C. at 416. Admittedly, the court said that it was treating part of the money "as if it had come home to the United States," 225 F2d at 816, but any intention to treat the resulting gain as capital must be inferred from the court's treatment of hypothetical gain from the sale of Seaboard stock, id. at 815. The then applicable capital gains provision, Int. Rev. Code of 1939, § 117, is not mentioned in the opinion. To make this inference, it is necessary to assume that the court viewed the transaction as an integrated one, not as a separate speculation in foreign exchange. See note 18 supra.


56. Foreign money is a capital asset, except in the case of dealers in foreign exchange, and it would appear, therefore, that on its conversion into United States money, or its use to purchase property or to pay a liability of the taxpayer, the gain or loss due to difference in the foreign exchange rate, is a capital gain or loss. Logic and equity demand that gain or loss by one who converts foreign money to pay for merchandise in his regular trade or business should be an ordinary gain or loss. However, the question is unsettled.


57. See Nussbaum 214-15. One taxpayer actually argued that a debt to a foreign creditor was a capital asset; the argument was summarily dismissed. Church's English Shoes, Ltd., 24 T.c. 56, 59 (1955).


59. Kenneth S. Battelle, 47 B.T.A. 117, 127 (1942); see Corn Products Ref. Co. v. Commissioner, 350 U.S. 46 (1955), and authorities collected id. at 53 n.8.

60. Compare America-Southeast Asia Co., Inc., 26 T.C. 198, 200 (1956) (mercantile purchase giving rise to ordinary income), with Columbia Sand and Gravel Co., 11 CCH Tax Ct. Mem. 794 (1952) (taxpayer realized capital loss on a foreign-exchange transaction because it was related to the acquisition of a capital asset). This approach would provide a more satisfactory rationale than that in Foundation Co., 14 T.C. 1333, 1342-47 (1950) (foreign currency paid to building contractor characterized as "held by petitioner for sale to its customers in the ordinary course of business").
This rule should benefit those importers who commonly convert their exchange within six months of purchase. Were they instead accorded short-term capital treatment, their losses would be of limited deductibility, while their gains would be taxable at ordinary rates.

Finally, the integrated-transaction approach would enable the courts to reach economically realistic results in exchange-fluctuation cases outside the context of the commercial importer. At present, when foreign currency is borrowed for nonmercantile purposes and later repaid, the courts do not reason from whether the borrowing was a separate transaction or integral to some investment or purchase. Rather, they have advanced the proposition that no gain or loss can result because the taxpayer has repaid the same number of monetary units that he was loaned.

In thus treating foreign currency as a commodity, the courts ignore its primary function as a medium of exchange and overlook any changes in the

61. For corporate taxpayers, annual capital losses are only deductible to the extent of gains, INT. REV. CODE OF 1954, § 1211(a), while individual taxpayers can in addition offset them against a maximum of $1,000 ordinary income, INT. REV. CODE OF 1954, § 1211(b). All taxpayers may carry the loss over to the five succeeding taxable years. INT. REV. CODE OF 1954, § 1212.


63. The leading case is B. F. Goodrich Co., 1 T.C. 1098 (1943). The taxpayer borrowed eleven million francs from a French bank at a time when the conversion ratio was approximately $650,000. The money was then lent to the taxpayer's French subsidiary. The franc depreciated in value so that the taxpayer was able to repay the loan for approximately $514,000. The Tax Court held that no gain had been realized on the transaction, because "a mere borrowing and returning of property does not result in taxable gain." Id. at 1103. To clarify and illustrate, they analogized to a loan and subsequent repayment of eleven bars of metal rather than a loan and repayment of francs. Ibid.

A similar decision was reached in North American Mortgage Co., 18 B.T.A. 418 (1929) (Dutch firm financing mortgages in dollars held not subject to tax when dollars repaid had more purchasing power in Dutch guilders; court treated the dollar as commodity). The Commissioner originally acquiesced in part. IX-2 CUM. BULL. 44 (1930) (acquiescence limited to income from depreciated value of currencies); IX-2 CUM. BULL. 80 (1930) (nonacquiescence limited to issue of income from purchase of own debentures). After a sharp attack on the currency aspect of North American Mortgage in Willard Helburn, Inc., 20 T.C. 740, 744 (1953) (concurring opinion), the Commissioner withdrew his prior acquiescence. 1955-1 CUM. BULL. 8.

The most recent commodity-theory case is William H. Coverdale, 4 CCH Tax Ct. Mem. 713 (1945). Taxpayer had borrowed Canadian dollars to purchase certain common stocks. He later resold the stock over a period of years at a $696,726.38 loss. The loss was partially offset by a $53,000 gain realized when he repaid the loan in depreciated Canadian dollars. The court first discussed the case on the basis of the "overall loss" theory enunciated in Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926), discussed note 27 supra. Because Kerbaugh-Empire is no longer considered strong authority, see ibid., the Coverdale tribunal went on to hold that, since the same number of Canadian dollars that was borrowed was repaid, no gain had been realized. 4 CCH Tax Ct. Mem. at 715.

64. See NUSSEBAUM 2, stating that money is a common denominator of value, a medium of exchange and a standard of deferred payment. None of these classifications comports with the proposition that money is a commodity. Foreign currency has been held a
taxpayer's domestic financial position. Consequently, all gains are rendered nontaxable and losses are unrecognized. Viewed in terms of dollars, on the other hand, a given debt might have been discharged for less than originally anticipated. Here, however, as when an importer purchases goods, the dollar value (and hence the replacement cost) of the foreign asset which was acquired with the borrowed currency will have diminished each time the foreign currency depreciates. Consequently, the taxpayer has no real balance-sheet increment—only an exchange gain offset by shrinkage in the actual value of the related asset—and, under the Kirby doctrine, no taxable occasion has arisen.

In nonmercantile situations, as elsewhere, every exchange fluctuation should normally be treated as integral with the underlying economic transaction. Accordingly, a fluctuation would either reduce or increase the cost basis of the corresponding asset, and no taxable event would occur until an actual gain or loss was realized through eventual disposition. Congress has adopted closely analogous provisions for gains realized through the discharge of domestic liabilities at less than face. Sections 108 and 1017 of the 1954 code allow the tax-

commodity in cases outside the tax field. See, e.g., McAdoo v. Southern Pac. Co., 10 F. Supp. 953, 955 (N.D. Cal. 1935); Gross v. Mendel, 171 App. Div. 237, 157 N.Y. Supp. 357 (1916), aff'd, 225 N.Y. 633, 121 N.E. 871 (1918). But these cases have been attacked as incorrect. See also id. at 115 ("[T]he treatment of foreign money as a commodity is subject to important qualifications . . . . [A] debt contracted for in foreign currency should be held a 'monetary' obligation . . . .")

Assume that in William H. Coverdale, 4 CCH Tax Ct. Mem. 713 (1945), discussed note 63 supra, there had been an appreciation in the value of the Canadian dollar. Had the court then indulged in similar reasoning, the effect of the commodity theory would have been to increase the taxpayer's overall American-dollar loss. (Clearly, the reasoning of the decision does not rest on the fact that the related transaction had resulted in an overall loss. Roberts, Borrowings in Foreign Currencies, 26 Taxes 1033 n.4 (1948).) But see James A. Wheatley, 8 B.T.A. 1246 (1927) (commodity theory construed to arrive at a deductible loss). If the taxpayer in Coverdale, see note 63 supra, had kept his records in United States dollars, he would have recorded his outstanding liability to the Canadian bank at approximately $290,000. He was able to discharge the entire liability by borrowing only $237,000. He thus had lowered his liabilities by $53,000 without the "expenditure" of any assets; indeed, he initially reported this debt reduction as a capital gain. 4 CCH Tax Ct. Mem. 713 (1945). In the Coverdale situation, the commodity theory—resulting in a denial of a taxable event—and Kirby—taxing a debt reduction at less than face, see note 20 supra—are the same approach. The difference is simply the monetary unit used to measure gain or loss. Under both rationales, the separateness of the transactions is assumed and the inquiry is directed only toward the change, if any, in the taxpayer's financial position. But, under the commodity theory, since the accounts are examined in terms of the foreign currency, no change will be evident in the taxpayer's balance sheet. If all the accounts were translated into dollar terms, however, a Kirby-type gain would be found.

See notes 19-27 supra and accompanying text.

In B. F. Goodrich Co., 1 T.C. 1098 (1943), discussed note 63 supra, the court recognized the possibility of integration but refused to decide the question. The court said by way of dictum that the loan to the subsidiary might have a basis of $514,000 because of the repayment differential. 1 T.C. at 1103.
payers to offset such gains against the cost basis of certain property and thereby to postpone tax incidence until the sale of the property.\textsuperscript{70} In effect, then, reporting on an integrated basis would preclude tax avoidance under the commodity theory. Furthermore, as with foreign purchases generally, integration would permit only realized gains and losses to serve as taxable occasions.

\textsuperscript{70} No amount shall be included in gross income by reason of the discharge, in whole or in part, within the taxable year, of any indebtedness for which the taxpayer is liable, or subject to which the taxpayer holds property, if (1) the indebtedness was incurred or assumed (A) by a corporation, or (B) by an individual in connection with property used in his trade or business, and (2) such taxpayer makes and files a consent to the regulations prescribed under section 1017 (relating to adjustment of basis) then in effect at such time and in such manner as the Secretary or his delegate by regulations prescribes.

\textit{Int. Rev. Code of 1954, § 108(a)}.

Where any amount is excluded from gross income under section 108(a) (relating to income from discharge or indebtedness) on account of the discharge of indebtedness the whole or a part of the amount so excluded from gross income shall be applied in reduction of the basis of any property held . . . by the taxpayer during any portion of the taxable year in which such discharge occurred.