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IN THE

**United States Court of Appeals**  
**For the Ninth Circuit**

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UNITED STATES OF AMERICA,  
*Appellant,*

v.

HAROLD C. and OLIVE B. ISAAK,  
*Appellees.*

**No. 22,248**

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BRIEF FOR THE APPELLEES

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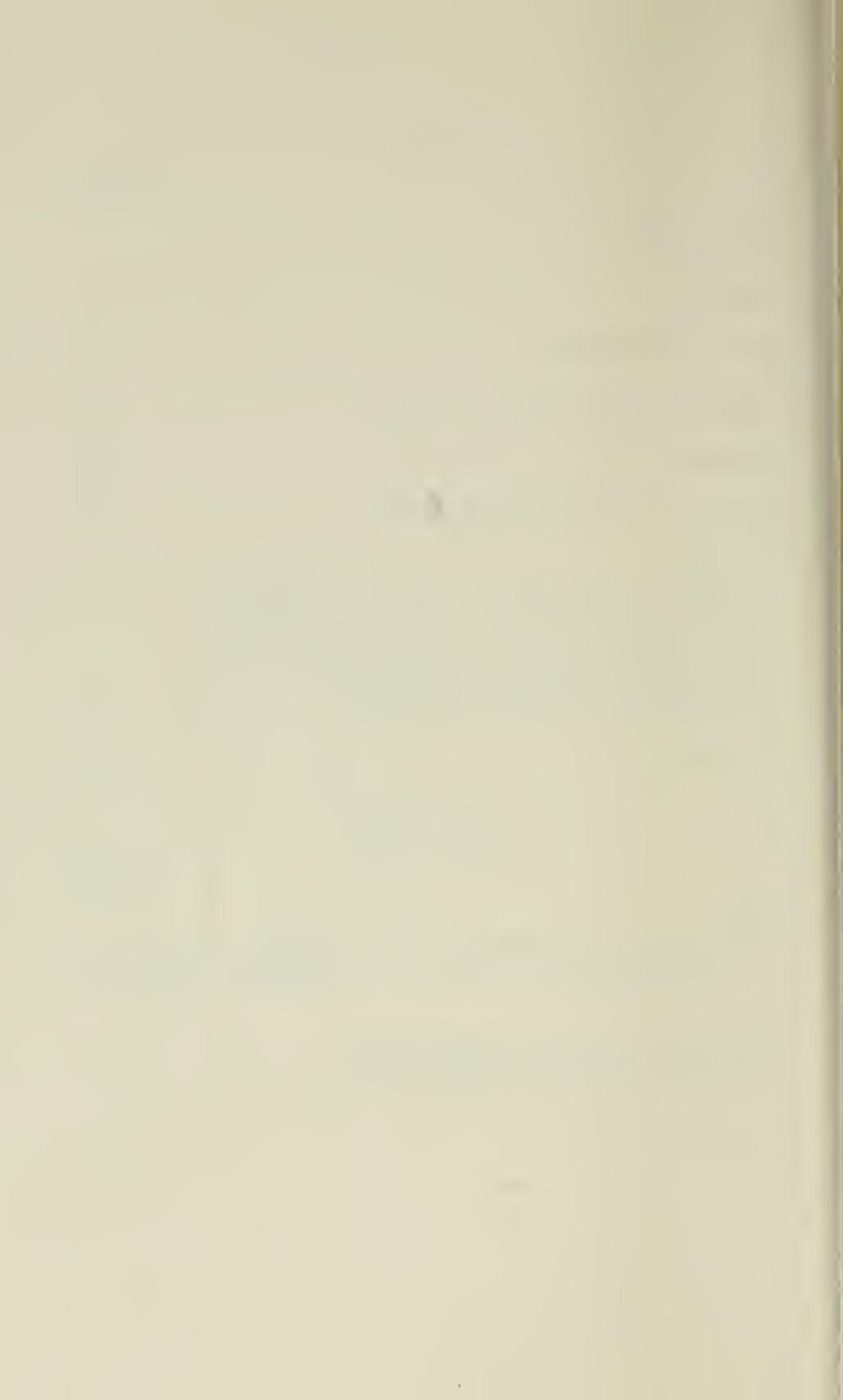


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**OPINION BELOW**

The Opinion of the Court below is reported 267 F. Supp. 595.

**JURISDICTION**

This Appeal involves Federal Income Taxes for 1957. On July 7, 1963, taxpayers paid a deficiency in their taxes for 1957 of \$5,796.51 (R. 2, 38). A Timely Claim for Re-

fund was filed, which was rejected on June 23, 1964 (R. 2, 4). Within the time provided in Section 6532 of the Internal Revenue Code of 1954, on March 21, 1966, taxpayers brought a timely action in the District Court for recovery of the taxes paid (R. 1-3). Jurisdiction was conferred on the District Court by 28 U.S.C. § 1346(a). The judgment of the District Court in favor of the taxpayer was entered on June 6, 1967 (R. 41). Within 60 days thereafter, on August 1, 1967, the United States filed a Notice of Appeal (R. 42). Jurisdiction is conferred on this Court by U.S.C. § 1291.

### QUESTION PRESENTED

Was the District Court correct in holding that a farmer-taxpayer, who has elected under Section 77 of the Internal Revenue Code of 1954 to include in income amounts received as loans from the Commodity Credit Corporation, may exclude from income amounts repaid before the end of the taxable year in redemption of his crops?

### STATUTES AND REGULATIONS INVOLVED

The relevant Statutes and Regulations involved are set forth in Appendix A of Appellee's Main Brief.

### STATEMENT

The entire facts were stipulated and agreed to prior to Argument in the District Court. The facts, as stipulated and found by the District Court are as follows:

Taxpayers are husband and wife, residents of Coulee City, Washington, who own a wheat farm of approximately 3,000 acres in Grant County, Washington, which they have farmed since approximately 1929 (R. 37).

For the taxable year 1957 the Appellees filed a timely Federal Income Tax return with the District Director of Internal Revenue for the District of Washington and paid the tax shown as due thereon (R. 28).

Subsequent to the time that the Appellees filed their Federal Income Tax return for the taxable year 1957, the Commissioner of Internal Revenue, by and through his agents, conducted an audit and investigation of the said income tax return (R. 38).

By registered letter dated November 28, 1962, the Commissioner of Internal Revenue notified the Appellees that he was asserting a deficiency in Federal Income Tax for the taxable year 1957 in the amount of \$5,976.51. The Commissioner's determination was based upon the assertion that the taxpayers had realized income from the sale of grain in the taxable year 1957 (R. 38).

In response to the assertions by the Commissioner of Internal Revenue, as set out above, Appellees, on or about the 7th day of July, 1963, paid the Commissioner the sum of \$5,796.51. Thereafter, Appellees filed with the District Director of Internal Revenue for the District of Washington in Tacoma, Washington, a timely Claim for a refund of Federal Income Taxes for the taxable year

1957, requesting a refund in the total amount of \$5,796.51, plus interest as provided by law (R. 38).

Appellees from time to time, in the years prior to the taxable year 1957, borrowed money from the Commodity Credit Corporation, a part of the United States Department of Agriculture and used wheat as collateral. Prior to the taxable year 1957, Appellees treated the Commodity Credit loans as income on their Federal Income Tax returns as filed for said prior taxable years if the loan had, in fact, not been repaid prior to the end of said taxable year. Appellees have always maintained their book and records on a cash basis (R. 38).

In the operation of the wheat farm, Appellees harvest the wheat in July and August of each year. The wheat is either stored at home, or commercially in the State of Washington. Some of the wheat is sold either prior to harvest or after harvest. The proceeds from the sale of wheat have always been reported by the Appellees on their Federal Income Tax Returns (R. 39).

During the taxable year 1957, Appellees made loans from the Commodity Credit Corporation in the amount of \$35,884.21 (R. 39).

On the 6th day of August, 1957, Appellees borrowed the sum of \$25,341.86 from the Commodity Credit Corporation and pledged, as collateral, wheat that was stored in the Farmer's Union Grain Company, Hartline, Washing-

ton. This loan was repaid December 5, 1957, and the wheat returned to Appellees (R. 39).

The Appellees, on their 1957 Federal Income Tax return reported Commodity Credit loans in the amount of \$7,749.10. Of the wheat that was redeemed from the Commodity Credit Corporation in the year 1957, as set forth above, the Appellees actually sold \$12,000.00 worth of wheat and reported the \$12,000.00 as income on their Federal Income Tax return as filed for the taxable year 1957 (R. 39).

The Appellees did not report, as income in the taxable year 1957, the remaining portion of the loans from the Commodity Credit Corporation which had been repaid prior to the taxable year 1957 (R. 39).

The Commissioner of Internal Revenue, in auditing the appellee's 1957 Federal Income Tax return, increased Appellee's taxable income for said taxable year in the amount of \$16,135.11, upon the theory that all of the loans from the Commodity Credit Corporation should have been reported as income and the fact that some of the loans had been repaid prior to the end of the taxable year did not change the tax picture. In essence, the Internal Revenue adjustment was computed as follows: (R. 39)

Commodity Credit loans received in 1957	\$35,884.21
Commodity Credit loans reported in 1957	7,749.10
Unreported Income	28,135.11
Less Redeemed Wheat Sales Reported	12,000.00
Adjustment to Income	16,135.11

The wheat that was redeemed from the Commodity Credit Corporation by repayment of the loans in 1957, and not reported as income in the taxable year 1957, was sold by the Appellees in the taxable year 1958 and the income from the said wheat was reported on the Appellee's 1958 Federal Income Tax return as filed and the tax due thereon timely paid (R. 40).

During the taxable year 1957 Appellees deducted all costs and expenses incidental to growing, harvesting and handling the wheat that was placed with the Commodity Credit Corporation in August of 1957 as security for the loans set forth above. Appellee also deducted as an interest expense during the taxable year 1957 the interest paid the Commodity Credit Corporation when the loans were redeemed in December of 1957 in connection with the repayment of the loans on the wheat which had been made earlier (R. 40).

The District Court, in holding for the Appellees, found that the Commodity Credit loans which the Appellees repaid during the taxable year 1957 were not income for the Appellees for said taxable year relying upon *Thompson v. Commissioner* (CA-5, 1963) 322 F.2d 122.

### SUMMARY OF ARGUMENT

The Appellant, in his Summary of Argument (Appellant's Brief p. 5 and 6), asserts that the Federal District Court erred in this case.

Basically, the question is simple. Appellee-Taxpayer borrowed money from the Commodity Credit Corporation during the taxable year 1957. Prior to the end of the said taxable year two loans were repaid. For prior years Appellee had reported income under Section 77 of the Internal Revenue Code which provides that such loan shall at taxpayer's election, be treated as income for the year in which received, which election shall be binding for subsequent taxable periods.

The Federal District Court held that repayment of the loan did not result in income to the Appellee-Taxpayers where the amounts of the loan had been redeemed prior to the end of the taxable year (District Court Opinion).

### ARGUMENT

#### **A TAXPAYER WHO ELECTS TO REPORT COMMODITY CREDIT LOANS AS INCOME IN THE YEAR RECEIVED MAY EXCLUDE FROM INCOME LOANS RECEIVED AND LATER REPAYED IN THE SAME TAXABLE YEAR IN REDEMPTION OF PLEDGED COMMODITIES.**

The basic issue involved in this controversy is very simple. Appellee-Taxpayers borrowed money from the Commodity Credit Corporation in 1957. Prior to the end of the taxable year 1957, Appellee-Taxpayers repaid some of the loans. In computing their Federal Income Tax for the taxable year 1957 Appellee-Taxpayers included as income the loans from the Commodity Credit Corporation which had not been redeemed prior to the end of the taxable year.

Section 77 of the Internal Revenue Code of 1954 entitled "Commodity Credit Loans" provides as follows:

(a) *Election to Include Loans in Income.*— Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the taxable year in which received.

(b) *Effect of Election on Adjustments for Subsequent Years.*— If a taxpayer exercises the election provided for in subsection (a) for any taxable year, then the method of computing income so adopted shall be adhered to with respect to all subsequent taxable years unless with the approval of the Secretary of his delegate a change to a different method is authorized.

The election, referred to above, under Section 77 of the Internal Revenue Code is made by treating loans as income on the Federal Income Tax returns as filed. No formal election is provided for.

Appellees, prior to 1957, had treated Commodity Credit loans as income if the loan had *not* been repaid prior to the end of the taxable year. 1957 was no different than prior years. At the end of the taxable year 1957, the Appellees had *repaid* some of the loans which they had taken from the Commodity Credit Corporation. The loans repaid were *not* reported as income. Some of the wheat used as collateral for the loans was sold in 1957 and the income from said sale reported in that taxable year. The remainder of the wheat which had been used as collateral for the

1957 loans was sold in 1958 and the Federal tax paid in that taxable year.

The Appellees contend that the Commodity Credit Corporation loans that were repaid during the taxable year were *not* income to the Appellees for said taxable year.

The Appellant, on the other hand, contends that the Appellees elected to treat the Commodity Credit Loans as income under Section 77 of the Internal Revenue Code and that having chosen to report their income in this manner they must treat all loans consistently.

There is only *one* case considering the identical question presented herein.

In *Thompson v. Commissioner*, (C.A.-5, 1963) 322 F. 2d 122, rev'g in part, (1962) 38 Tax Court 153, the Court stated as follows:

“Concerning the problem under 26 U.S. C.A. Section 77, the facts are uncontradicted. Taxpayer was on a cash basis. He had never used crop inventories in computing farm income. In years prior to 1958, Taxpayer had sometimes put his wheat under parity price support loans with Commodity Credit Corporation. Having reported some of these loans as income in prior years, he had elected to treat loans as income under Section 77. In July of 1958 Taxpayer put two identified lots of wheat under CCC loans aggregating \$15,486.06. In December of 1958, acting on advice or opinions of a probabale rise in the wheat market, Taxpayer repaid the loans as to the two lots and redeemed the wheat. The wheat was on hand at the year's end. No income was reported for the disposi-

tion of these lots. This redeemed wheat was sold in January 1959 and reported as income for that year. Costs incurred in growing and harvesting it were taken as a deduction in 1958.

“The Tax Court determined that the CCC loan was taxable as income in 1958 even though the loan was repaid and the wheat redeemed before the end of the taxable year. Considering the background of this legislation, we do not think that the result urged by the Government and sustained by the Tax Court is essential to achieve the end sought by Section 77. Worse than that, it opens up new and vexing problems—conceptual and administrative—perhaps requiring the judicial creation of a new and counter-fiction to offset this consequence of the congressionally created fiction that a loan is income.”

The Court then explained the purpose of Section 77 of the Internal Revenue Code. In so doing it stated as follows:

“This section was not enacted as a revenue measure. It was not passed to increase the revenue. Indeed, in operative effect, its consequence is just the opposite. Rather, a very small piece to fill out a beneficent and comprehensive program of farm relief, it was enacted to overcome an unintended, but conceptually inescapable, adverse effect on the objects of congressional aid. Under farm legislation the so-called crop loans are an integral, vital part of the scheme of price supports.

“Without any effort to describe accurately the operation of this complex program, the general purpose of the crop loan is to enable the farmer to obtain as a minimum, and in cash, the support price for his crop while giving him a free ride of the market for possible market price advances until expiration of the redemption period. As conceived and practiced, it is, and is intended to be, a major source of governmental

farm support payments. But for these grants, the Government, as the so-called lender, must look solely to the crop as collateral security with no personal liability on the borrower."

The Government in the *Thompson* case argued that the taxable event was the *receipt of the loan*, regardless of what took place thereafter, and that the so-called "*election requirement*" showed a congressional purpose to exact consistency of farmers so that they could not play fast and loose as shifts occurred in the commodity markets.

The Court in the *Thompson* case pointed out that the taxpayer had faithfully adhered to his election, i.e., wheat loans not redeemed at the end of the taxable year had in fact been included in income. The Court stated further in answer to the Government's contentions as follows:

"Actually, the construction now asserted would defeat the paramount aim of Congress. Farm legislation was intended to give farmers a free ride of the market. However, the inescapable income tax rulings prevented that when the loan and the redemption (or foreclosure) overlapped two tax years. This was the problem, and the only problem. There was no problem as to a loan received and repaid within the same year. If the Government's view is accepted, it means that as to an area in which there was no problem, Congress has unwittingly withdrawn from that farmer the right to ride the market to the year's end. Thus an amendment to the Revenue Code designed to 'avoid this harsh result' (see note 18, *supra*) becomes itself a new instrument to frustrate the predominate goal of agricultural relief.

In reviewing the *Thompson* case the District Court adopted the following statement: (R. 36).

*“The Facts in simple outline convince us that Taxpayer is right. At year end 1958 Taxpayer had the wheat. He did not have money. In 1959 he had money, but no wheat. Section 77 does not prescribe that the loan is income. It prescribes that it should be ‘considered as income’ and when so done, the ‘method of computing income so adopted shall be adhered to \* \* \*.’ This terminology and the interpretation we put on it achieves several ends. It adheres to the annual accounting concept of income tax law. It makes possible the payment of the tax in the year in which the income is realized with which to pay the tax. It eliminates either the peril or problems of the taxpayers being taxed in successive years on the same wheat crop, and it eliminates vexing problems on collateral elections.” (Emp. Supp.)*

The facts in the instant case are identical to the facts in the *Thompson* case. Here, Appellees reported on their 1957 Federal Income Tax return as filed, loans made from the Commodity Credit Corporation which were outstanding at the end of said taxable year. As to loans redeemed prior to the end of the taxable years, Appellees did not include those on the Federal Income Tax returns as filed. As in the *Thompson* case, Appellee-Taxpayers at the end of the year 1957 *had wheat*. They did not *have money*. In 1958 they *had money* but *no wheat*. They have, as the Court in the *Thompson* case indicated, “Faithfully adhered to their election.”

Here, as in *Thompson*, Appellees were on a cash basis of accounting. Appellant’s position would place them on an inventory basis. The District Court’s ruling adheres to the annual accounting concept of income tax law and allows the Appellees to pay their tax when the income is received.

Appellant's Main Argument (Appellant's Brief p. 6 through 21), appears to be two-fold:

1. The Fifth Circuit Court of Appeals was wrong in *Thompson v. Commissioner* (1963) 38 T.C. 153 reversed, (C.A.-5th, 1963) 322 F.2d 122, and

2. Section 1016(a) (8) of the Internal Revenue Code of 1954 was over-looked by the Court in deciding the *Thompson* case.

The Appellant first refers to the legislative history of Section 1016(a) (8) of the Internal Revenue Code (Appellant's Main Brief p. 9 to 13 incl.). The Committee reports referred to by the Appellant all refer to an election which is binding as to *all future years* (Appellant's Main Brief p. 10). It is submitted by the Appellee that nowhere in the Legislative History, cited in Appellant's Main Brief, is there a situation concerning two transactions in the same taxable year.

It is true that once a taxpayer elects under Section 77 to treat Commodity Credit loans as sales income, the election is binding in all future years *unless* and *until* the permission to change such method of accounting is obtained from the Commissioner. But, this reasoning does not hold true where as here, the Appellee-Taxpayer had *all* of their transactions in the same taxable year.

It would seem rather presumptuous to Appellees that the Appellants would assume that the Court of Appeals over-

looked a section of the Internal Revenue Code *if* that section of the law was germane to the issue involved (Appellant's Main Brief p. 18).

It is noteworthy that Section 1016(a) (8), relied upon so emphatically by Appellant, was *also* overlooked by the Tax Court of the United States in its Opinion. Appellant, however, fails to mention this fact.

The answer is obvious. Section 1016(a) (8) is contained in the Internal Revenue Code of 1954 under the general heading of "Basic Rules of General Application". The entire chapter applies to basis of property *sold* or *exchanged*. Section 1016(a) (8) was enacted to cover the situation where "A" pledged wheat as collateral in 1958, paid the tax under Section 77, redeemed the wheat in 1959, and later sold it. There must be a provision insuring, under the facts of the above example, that the pledged wheat would not be taxed twice. Section 1016(a) (8) is that insurance.

Section 1016(a) (8) has nothing whatsoever to do with the question presented in this case, i.e., whether wheat redeemed in the year of the loan is taxable under the provisions of Section 77 of the Internal Revenue Code of 1954.

In the instant case the factual pattern is identical to the facts in the *Thompson* case, above. At year's end the Appellees had wheat but no money. The repayment of the loan before year's end closed an otherwise taxable transaction.

**CONCLUSION**

The Judgment of the District Court should be affirmed.

Respectfully submitted,

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**CERTIFICATION**

In connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Dated March 22, 1968.

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