Imported Wines Corp. v. Commissioner, 14 T.C. 53 (1950)

For excess profits tax purposes, a taxpayer can include accepted drafts under letters of credit as borrowed invested capital because these drafts represent an outstanding indebtedness evidenced by a bill of exchange.

Summary

Imported Wines Corp. sought to include outstanding letters of credit and accepted drafts under those credits in its borrowed invested capital calculation for excess profits tax purposes. The Tax Court held that while the letters of credit themselves did not constitute borrowed capital, the drafts accepted by banks under those letters did, as they represented an outstanding indebtedness evidenced by a bill of exchange, thereby increasing the taxpayer's excess profits credit. This case clarifies what constitutes borrowed capital under Section 719 of the Internal Revenue Code.

Facts

Imported Wines Corp. (petitioner) applied for and obtained irrevocable commercial letters of credit from banks to finance the import of goods. Banks issued these letters of credit, and drafts were drawn under them. Upon acceptance of these drafts by the banks, the banks turned over the bills of lading to the petitioner. The petitioner claimed that both the outstanding letters of credit and the accepted drafts should be included in the computation of its average borrowed invested capital for excess profits tax purposes.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's excess profits tax. The Commissioner disallowed the inclusion of the banks' outstanding letters of credit in the borrowed invested capital. The petitioner appealed to the Tax Court, contesting the deficiency. The Commissioner then amended the answer to assert that the accepted drafts should also be excluded from borrowed invested capital.

Issue(s)

1. Whether outstanding irrevocable commercial letters of credit issued by banks pursuant to the petitioner's applications constitute borrowed capital under Section 719 of the Internal Revenue Code?

2. Whether banks' accepted drafts under said letters of credit constitute borrowed capital under Section 719 of the Internal Revenue Code?

Holding

1. No, because the letters of credit themselves do not represent an outstanding

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indebtedness evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust until a draft has been drawn and accepted.

2. Yes, because the accepted drafts represent an outstanding indebtedness of the taxpayer evidenced by a bill of exchange.

Court's Reasoning

Regarding the letters of credit, the Court reasoned that until a draft is drawn and accepted, the letter of credit does not represent an "indebtedness" as defined by Section 719. The Court emphasized that while the petitioner had an obligation to reimburse the bank, this obligation was conditional until a draft was actually drawn. The Court cited Deputy v. DuPont, 308 U.S. 488, noting that "although an indebtedness is an obligation, an obligation is not necessarily an 'indebtedness.'"

Regarding the accepted drafts, the Court found that these did represent an outstanding indebtedness of the taxpayer. The Court acknowledged the Commissioner's argument that the acceptances were the banks' bills of exchange, not the petitioner's. However, the Court stated that the statute only requires that the indebtedness be that "of the taxpayer" and that it be "evidenced by" one of the specified instruments. The fact that the bank was also liable did not negate the petitioner's indebtedness. The court noted, "True, the bank was liable for the indebtedness, but so was petitioner. It had been contracted for petitioner's account and in a very true sense was petitioner's indebtedness. Petitioner was the one that ultimately had to pay."

Practical Implications

This case clarifies the treatment of letters of credit and accepted drafts in the context of excess profits tax calculations. It establishes that a taxpayer cannot include letters of credit as borrowed capital until they are converted into actual indebtedness through accepted drafts. This decision is vital for businesses that utilize letters of credit for financing imports or other transactions and need to accurately calculate their excess profits credit. Later cases may distinguish this ruling based on specific contractual language or variations in the financial arrangements, but the core principle remains that the indebtedness must be real and directly tied to the taxpayer.

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