Concrete Construction Co. v. Commissioner, 3 T.C. 106 (1944)

A taxpayer is entitled to include in its borrowed invested capital, for the purpose of calculating excess profits tax credit, amounts borrowed from a bank even if the loans are secured by assignment of rights to receive payments from government contracts.

Summary

Concrete Construction Co. sought to include loans from a bank, secured by assignment of payments from government contracts, as borrowed capital in calculating its excess profits tax credit. The Commissioner argued that the loans were effectively made to the government, not the company. The Tax Court held that the loans qualified as borrowed capital under Section 719 of the Internal Revenue Code because the company was directly liable for the debt, evidenced by promissory notes, and the government had no obligation to the bank beyond payments for work performed by the company. This case clarifies that assigning contract proceeds as collateral does not negate the borrower's direct liability for the debt.

Facts

Concrete Construction Co. (petitioner) engaged in engineering and contracting, primarily with the War and Navy Departments under cost-plus-fixed-fee contracts.

The War and Navy Departments required the petitioner to demonstrate sufficient capital and credit to perform the contracts.

A Philadelphia bank agreed to lend money to the petitioner, advising the War and Navy Departments of the arrangement.

The petitioner executed demand notes to the bank for the loans and assigned to the bank its right to receive payments from the government under the contracts as security.

The government sent checks directly to the bank after the assignments, and the bank credited these payments against the petitioner's outstanding notes. The petitioner received monthly statements.

Procedural History

The Commissioner determined a deficiency in the petitioner's excess profits tax for 1942 and 1943.

The petitioner appealed the Commissioner's determination to the Tax Court, contesting the disallowance of borrowed capital in the excess profits credit calculation.

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Issue(s)

Whether advances of credit made to a taxpayer by a bank, where the taxpayer assigns to the bank the right to collect monies due under its government contract as security for the loan, constitute "borrowed invested capital" under Section 719 of the Internal Revenue Code for purposes of computing the excess profits tax credit.

Holding

Yes, because the petitioner was directly liable to the bank for the loans, the loans were evidenced by notes, and the government's payments to the bank were merely a mechanism to secure the debt, not to assume it directly.

Court's Reasoning

The court relied on the plain language of Section 719(a)(1) of the Internal Revenue Code, which defines borrowed capital as "the amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by a bond, note * * *."

The court emphasized that the petitioner was directly indebted to the bank, evidenced by promissory notes, and responsible for repaying both the principal and interest.

The court rejected the Commissioner's argument that the loan was effectively made to the government, stating: "The Government was in no way obligated to pay either principal or interest. It did not arrange for the loans and it was in no sense the debtor."

The court found that the assignment of payments was merely a security measure insisted upon by the bank and did not alter the fundamental nature of the transaction as a loan to the petitioner.

The court concluded that both the form and substance of the transaction met the statutory requirements for borrowed capital, finding no reason to believe Congress intended to exclude such arrangements.

Practical Implications

This case provides clarity on what constitutes borrowed capital for the excess profits tax credit, specifically when government contract payments are assigned as collateral.

It confirms that a taxpayer's direct liability for a debt, evidenced by a note, is a key factor in determining whether funds qualify as borrowed capital, even if a third party (like the government) makes payments directly to the lender as a security measure.

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The ruling prevents the IRS from denying borrowed capital treatment solely because contract payments are assigned, fostering greater certainty for businesses financing government contracts.

Later cases would likely distinguish this ruling where the government directly guarantees the loan or assumes primary responsibility for repayment, rather than simply making payments to the lender on behalf of the borrower.

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