14 T.C. 192 (1950)

Amounts borrowed by a corporation and used to purchase U.S. Government bonds as bona fide business investments for profit can constitute borrowed invested capital for excess profits tax purposes.

Summary

Globe Mortgage Company, engaged in the investment and finance business, borrowed funds to purchase U.S. Government bonds. The company included 50% of this borrowed capital in its calculation of borrowed invested capital for excess profits tax purposes. The Commissioner of Internal Revenue disallowed this inclusion, arguing the borrowing was not for legitimate business reasons. The Tax Court held that the borrowed funds did qualify as borrowed invested capital because the bond purchases were bona fide business investments made for profit, not solely for tax avoidance, distinguishing the case from situations where borrowings were made solely to increase excess profits credit without genuine business purpose.

Facts

Globe Mortgage Company, involved in the investment and finance business, borrowed heavily from banks for various activities, including acting as a loan correspondent, promoting construction projects, and investing in securities. Due to wartime restrictions on private building, the company's credit lines became available for other investments. Based on the advice of investment experts, Globe's principal shareholder, Charles F. Clise, believed the company could profit by investing borrowed funds in government bonds. The banks were willing to lend a high percentage of the bond values. Globe invested in U.S. Government securities between 1944 and 1948, using borrowed funds and depositing the securities as collateral. The company's officers were aware that maintaining a large average indebtedness would result in tax savings.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Globe Mortgage Company's excess profits taxes for the fiscal years 1944, 1945, and 1946. The Commissioner eliminated a portion of the borrowed capital used to purchase U.S. bonds from Globe's calculation of borrowed invested capital. Globe Mortgage Company petitioned the Tax Court for a redetermination of the deficiencies.

Issue(s)

Whether amounts borrowed by Globe Mortgage Company and used to purchase U.S. Government bonds constituted borrowed invested capital for excess profits tax purposes under Section 719 of the Internal Revenue Code.

Holding

Yes, because the court found that the amounts were borrowed as bona fide business investments made for profit, not solely for tax avoidance, and were thus includible in the company's borrowed invested capital under Section 719 of the Internal Revenue Code.

Court's Reasoning

The Tax Court considered Section 719 of the Internal Revenue Code, which defines borrowed invested capital, and Section 35.719-1 of Regulations 112, which requires that indebtedness be bona fide and incurred for business reasons, not merely to increase the excess profits credit. The court distinguished this case from *Hart-Bartlett-Sturtevant Grain Co.*, where borrowings to purchase U.S. Government securities during war loan drives were deemed not to be borrowed invested capital because they were not for business reasons. Here, the court emphasized that Globe Mortgage was engaged in the investment business and regularly borrowed funds for investments. The court found that the company invested in government securities as a normal course of its business, subjecting the borrowed capital to business risks for profit. The court noted, "The fundamental purpose of the legislation defining invested capital for excess profits tax purposes was to establish a measure by which the amount of profits which were 'excess' could be judged. The capital funds of the business, including borrowed capital, which were placed at the risk of the business are entitled to an adequate return." The court acknowledged the tax benefits but found that the motive to make a profit was the primary driver behind the investment, citing *Gregory v. Helvering*, 293 U.S. 465. This negated the argument that the transactions were solely for tax avoidance.

Practical Implications

This case clarifies that borrowed funds used for investments can be considered borrowed invested capital for excess profits tax purposes, provided the investments are bona fide business transactions with a profit motive. It emphasizes that merely being aware of tax benefits does not automatically disqualify a transaction if it is primarily driven by business reasons and subjects capital to genuine business risks. This decision provides guidance for determining whether borrowed funds qualify as borrowed invested capital, emphasizing the importance of demonstrating a clear business purpose and profit motive. Later cases applying this ruling would likely focus on scrutinizing the taxpayer's primary motive for borrowing and investing, examining the nature of their business, and assessing the level of risk involved in the investment. The case also underscores the principle that taxpayers are not obligated to structure transactions to avoid tax savings if the primary purpose is a legitimate business objective.

