Rohr Aircraft Corp. v. Commissioner, 15 T.C. 439 (1950)

For the purpose of calculating excess profits tax credit, funds obtained via V-loans, where the government guarantees a significant portion of the debt, can qualify as borrowed invested capital if the borrower's creditworthiness is also a factor in the lending decision, and the borrower retains primary liability.

Summary

Rohr Aircraft Corp. sought to include funds obtained through V-loans as borrowed invested capital for excess profits tax purposes. The Tax Court considered whether these loans, largely guaranteed by the government, truly represented borrowed capital or were, in substance, advance payments from the government. The court held that the V-loans qualified as borrowed invested capital because the banks considered Rohr's creditworthiness, and Rohr retained primary liability for the debt. The court also held that a $5,000 payment to Washington University was a contribution, not a deductible business expense.

Facts

Rohr Aircraft Corp., a relatively new company with limited capital, manufactured aircraft parts under government contracts and subcontracts during World War II. To secure necessary funding, Rohr entered into a "V-Loan" arrangement consisting of a Bank Credit Agreement with nine banks and associated Guarantee Agreements with the Federal Reserve Bank of St. Louis, acting as the War Department's fiscal agent. The Bank Credit Agreement established a $6,000,000 line of credit for Rohr, to be used solely for financing its performance under specific contracts. The Guarantee Agreements stipulated that the War Department would purchase 90% of Rohr's outstanding debt upon demand. Rohr assigned payments due under its war contracts to the banks.

Procedural History

Rohr claimed that the amounts received under the V-Loan arrangement constituted borrowed invested capital, increasing its excess profits tax credit. The Commissioner of Internal Revenue disallowed this claim. Rohr then petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether funds obtained through V-loans, with a 90% government guarantee, qualify as borrowed invested capital under Section 719 of the Internal Revenue Code?

2. Whether a $5,000 payment to Washington University is deductible as an ordinary and necessary business expense under Section 23(a)(1)(A) of the Internal Revenue Code, or whether it is a charitable contribution subject to the limitations of Section

23(q)?

Holding

1. Yes, because the loans were made directly to Rohr, evidenced by its notes, made for business purposes, used for working capital, and subject to the risks of the business, and because the banks considered Rohr's creditworthiness in addition to the government guarantee.

2. No, because the payment was intended as a contribution or gift and did not create a binding obligation on the university to provide specific services to Rohr.

Court's Reasoning

The Tax Court found that the V-loans met the formal requirements for borrowed invested capital under Section 719. The court rejected the Commissioner's argument that the loans were effectively advance payments from the government, noting that the loans were made by third-party banks, evidenced by Rohr's notes, and Rohr had the primary obligation to repay. The court emphasized that Rohr's creditworthiness was a factor in the lending decision, citing the restrictive covenants in the Bank Credit Agreement that limited Rohr's financial activities. The court quoted Du Val's Estate v. Commissioner, stating that if the government had been forced to fulfill its guarantee, it would have been entitled to look to petitioner for reimbursement.

Regarding the Washington University payment, the court found that the weight of the evidence indicated that the payment was intended as a contribution, not a business expense. The court noted that Rohr initially treated the payment as a contribution on its tax return and that the communications between Rohr and the university referred to it as such. Despite arguments that the payment was made to encourage the establishment of an aeronautical engineering program, the court found no binding obligation on the university to provide specific services to Rohr in exchange for the payment. "The University could proceed with the project equally as well whether the payment was, as to petitioner, a gift or a business expense."

Practical Implications

This case clarifies the requirements for debt to qualify as borrowed invested capital for excess profits tax purposes. It demonstrates that even with a government guarantee, a taxpayer's own creditworthiness and primary liability for the debt are important factors. This ruling impacts how businesses structure financing arrangements, especially in situations where government guarantees are involved. The case highlights the importance of accurately characterizing payments as either business expenses or charitable contributions, as the deductibility of each is governed by different rules and limitations. Taxpayers should carefully document the purpose and intent of payments to educational institutions to support their desired tax treatment.

