16 T.C. 769 (1951)

Certificates of deposit and savings passbooks issued by a bank in the ordinary course of business do not constitute "certificates of indebtedness" and therefore are not includible in borrowed capital for excess profits tax purposes under Section 719(a)(1) of the Internal Revenue Code.

Summary

National Bank of Commerce sought to include outstanding certificates of deposit and savings deposits evidenced by passbooks in its borrowed invested capital to reduce its excess profits tax. The Tax Court ruled against the bank, holding that these instruments did not qualify as "certificates of indebtedness" under Section 719(a)(1) of the Internal Revenue Code. The court relied on precedent and legislative history indicating that Congress did not intend for bank deposits to be treated as borrowed capital. This decision clarifies the scope of "borrowed capital" for banks in the context of excess profits tax.

Facts

National Bank of Commerce issued interest-bearing, non-negotiable certificates of deposit with 6- or 12-month maturity dates. These certificates were not subject to check. The bank also accepted savings deposits evidenced by passbooks, which were not subject to check and required 60 days' notice for withdrawal. The bank sought to include the outstanding amounts of these certificates and savings deposits in its borrowed invested capital for the years 1943 and 1945 to calculate its excess profits credit.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the bank's excess profits tax liability, disallowing the inclusion of certificates of deposit and savings deposits in borrowed invested capital. The bank challenged this determination in the Tax Court. The Tax Court initially ruled against the Commissioner in *Commissioner v. Ames Trust & Savings Bank*, but the Eighth Circuit reversed that decision. Faced with conflicting precedent, the Tax Court reconsidered its position.

Issue(s)

Whether the bank's outstanding indebtedness evidenced by certificates of deposit is includible in borrowed capital under Section 719(a)(1) of the Internal Revenue Code.

Whether the bank's outstanding indebtedness evidenced by savings deposits through passbooks is includible in borrowed capital under Section 719(a)(1) of the Internal Revenue Code.

Holding

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No, because certificates of deposit do not have the general character of investment securities and Congress did not intend for them to be treated as borrowed capital.

No, because savings deposits evidenced by passbooks are similar in character to certificates of deposit and are also not intended to be included in borrowed invested capital under Section 719(a)(1).

Court's Reasoning

The court relied on the Eighth Circuit's decision in *Commissioner v. Ames Trust & Savings Bank*, which held that time certificates of deposit are not "certificates of indebtedness" within the meaning of Section 719(a)(1). The court also cited legislative history, specifically the Senate Finance Committee's report on the Excess Profits Tax Act of 1950, which stated that indebtedness evidenced by a bank loan agreement does not include the indebtedness of a bank to its depositors. The court reasoned that if depositors were already included under the certificate of indebtedness definition, this specific exclusion would be meaningless. The court quoted 5 Zollmann, Bank and Banking § 3154, noting: "The main purpose of a loan is investment. The main purpose of a deposit is safe-keeping… The depositor deals with the bank not merely on the basis that it is a borrower, but that it is a bank subject to the provisions of law relating to the custody and disposition of the money deposited and that the bank will faithfully observe such provisions." The court found no substantial distinction between time certificates of deposit and savings deposits evidenced by passbooks, concluding that neither should be included in borrowed invested capital.

Practical Implications

This case clarifies that traditional bank deposits, even those evidenced by certificates of deposit or passbooks, are not considered borrowed capital for excess profits tax purposes. This distinction is crucial for banks calculating their excess profits credit and determining their tax liability. The decision reinforces the principle that "certificates of indebtedness" should be interpreted narrowly to include only instruments resembling investment securities. Later cases involving similar questions of what qualifies as borrowed capital would likely refer to this decision, particularly the emphasis on Congressional intent and the nature of bank deposits as safekeeping rather than investment. It also highlights the importance of closely examining legislative history and regulatory interpretations when construing tax statutes. The dissenting opinion shows that such tax questions can be open to interpretation.

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