*23 T.C. 479 (1954)*

For the purposes of calculating the excess profits tax credit, deposits by the State of Illinois, outstanding cashier's checks and bank money orders, and amounts due on the purchase of Government securities did not constitute "borrowed capital" within the meaning of Section 719(a)(1) of the Internal Revenue Code, which defined borrowed capital as indebtedness evidenced by specific written instruments like bonds or notes.

**Summary**

The United States Tax Court addressed whether certain liabilities of La Salle National Bank qualified as "borrowed capital" under the excess profits tax regulations. The bank claimed that deposits by the State of Illinois, outstanding cashier's checks and bank money orders, and amounts owed to a broker for government securities purchases, should be considered borrowed capital, thus increasing its excess profits credit. The court disagreed, ruling that these items did not meet the specific criteria of "outstanding indebtedness" as defined in Section 719(a)(1) of the Internal Revenue Code, because they were not evidenced by the types of instruments (bonds, notes, etc.) required by the statute. This case clarifies the scope of what constitutes borrowed capital for tax purposes, particularly for banks.

**Facts**

La Salle National Bank, a national banking association, filed its excess profits tax return for 1945. The bank had deposits from the State of Illinois, which were subject to specific state regulations, including the posting of collateral. The bank also issued cashier's checks and bank money orders. Finally, the bank purchased government securities from a broker on credit, paying interest on the outstanding balance.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in the bank's excess profits tax for 1945. The Tax Court considered the issues raised by the Commissioner's determination of the tax deficiency, specifically whether the bank's liabilities to the State of Illinois, holders of its cashier's checks, and a securities broker should be considered borrowed capital for excess profits tax credit purposes. The case was heard by the United States Tax Court, which ruled in favor of the Commissioner.

**Issue(s)**

1. Whether deposits by the State of Illinois constituted borrowed capital under Section 719(a)(1) of the Internal Revenue Code.

2. Whether outstanding cashier's checks and bank money orders represented

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borrowed capital.

3. Whether amounts due to a broker on the purchase of Government securities constituted borrowed capital.

**Holding**

1. No, because the court held that ordinary bank deposits do not constitute borrowed capital under the statute.

2. No, because the court found these instruments were not used to borrow money, as contemplated by the statute.

3. No, because the indebtedness was not evidenced by the instruments (bond, note, etc.) required by the statute.

**Court's Reasoning**

The court relied on the interpretation of Section 719(a)(1) of the Internal Revenue Code. This section specified that borrowed capital includes outstanding indebtedness evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust. The court found that the deposits by the State of Illinois were not similar to borrowing money and did not involve the issuance of a qualifying instrument. It also cited *Commissioner v. Ames Trust & Savings Bank*, which held that deposit liability does not constitute borrowed capital. The Court's reasoning was that cashier's checks and money orders are merely instruments used in the day-to-day operation of the bank, and not a means of borrowing funds within the scope of the statute. Regarding the purchase of government securities, the court found that the debt to the broker was not evidenced by the required written instruments, but rather by confirmations and payment instructions.

The Court cited a regulation stating, "The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals."

**Practical Implications**

This case highlights the importance of strict adherence to the specific requirements of tax law, especially regarding what qualifies as borrowed capital. Banks and other financial institutions must carefully analyze their liabilities to determine if they meet the criteria outlined in the tax code to maximize their tax credits. The case further reinforces that ordinary bank deposits and instruments used in daily business operations (like cashier's checks) are generally not considered "borrowed capital" for excess profits tax purposes, unless they are evidenced by instruments that specifically fall within the definition. Finally, it underscores that oral agreements or

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customary business practices do not satisfy the requirement for written instruments under the relevant code section.

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