The First National Bank of Chicago v. Commissioner, 22 T.C. 689 (1954)

In determining a bank's excess profits tax, 'borrowed capital' under the Internal Revenue Code does not include deposits by a state government, outstanding cashier's checks, or amounts due on purchases of government securities unless evidenced by specific instruments like bonds or notes.

Summary

The First National Bank of Chicago contested the Commissioner of Internal Revenue's determination of its excess profits tax liability. The central issue was whether certain liabilities—state deposits, outstanding cashier's checks and money orders, and amounts due for government securities—qualified as 'borrowed capital' under Section 719(a)(1) of the Internal Revenue Code of 1939. The court held that none of these constituted borrowed capital because they did not meet the specific requirements for indebtedness, such as being evidenced by the enumerated instruments defined in the statute. This decision clarified that the nature of the liability and the instruments involved were essential in determining whether they could be considered borrowed capital for tax purposes.

Facts

The First National Bank of Chicago sought to claim an excess profits tax credit based on invested capital, which could be increased by 'borrowed capital.' The bank's claimed 'borrowed capital' consisted of deposits made by the State of Illinois, the average daily balances of outstanding cashier's checks and bank money orders, and amounts due to a broker for the purchase of government securities. The bank argued that these items represented indebtedness evidenced by instruments specified in Section 719(a)(1) of the Internal Revenue Code. The Commissioner contested these claims, arguing that these items did not constitute borrowed capital within the meaning of the law.

Procedural History

The case began with the Commissioner of Internal Revenue determining a deficiency in the bank's excess profits tax. The bank petitioned the Tax Court to dispute this determination. The Tax Court reviewed the facts and legal arguments, ultimately siding with the Commissioner, leading to this decision.

Issue(s)

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

2. Whether the average daily balances of outstanding cashier's checks and bank money orders constituted 'borrowed capital' under the same section of the code.

© 2025 SCOTUSreports.com. All rights reserved. 

3. Whether the amounts due on purchases of government securities constituted ‘borrowed capital’ under Section 719(a)(1) of the Internal Revenue Code.

Holding

1. No, because state deposits do not have the characteristics of borrowing and are not evidenced by the required instruments.

2. No, because cashier’s checks and money orders were used by the bank for convenience, not to borrow money, and are not the kind of indebtedness that Congress intended to include.

3. No, because the amounts due to the broker for government securities were not evidenced by the specific instruments as required by the statute.

Court’s Reasoning

The court’s analysis focused on the precise language of Section 719(a)(1) of the Internal Revenue Code, which defined ‘borrowed capital’ as “the amount of the outstanding indebtedness (not including interest) of the taxpayer which is evidenced by bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage or deed of trust.”

Regarding the state deposits, the court cited prior case law that found ordinary bank deposits not to be ‘borrowed capital,’ especially when the nature of the transaction is peculiar to banking and does not resemble typical borrowing. The pledge of collateral and the notice period related to withdrawals did not change this finding.

Concerning the cashier’s checks and money orders, the court referred to Treasury Regulations and prior case law that clarified the distinction between deposit liabilities and commercial indebtedness. The court emphasized that these instruments facilitated the bank’s day-to-day business rather than serving to borrow funds. The bank did not pay interest on these items and even charged fees for their issuance.

For the government securities, the court found that no written instruments, like those specified in the statute, evidenced the amount owed to the broker. The court emphasized that even though there were confirmations and payment instructions, these did not meet the statutory requirements of an instrument.

The court referenced the regulation that clarified what “certificate of indebtedness” meant, which reinforced the court’s distinction of the bank’s activities versus the common understanding of borrowing and lending.

Practical Implications

This case underscores the importance of strictly interpreting tax statutes,

© 2025 SCOTUSreports.com. All rights reserved. 

particularly the precise definitions of ‘borrowed capital’ and the required evidence of indebtedness. The decision highlights that the mere existence of a debt is insufficient; it must be evidenced by a specific type of instrument as enumerated in the statute. Banks and other financial institutions must carefully document all financial transactions in a manner that complies with specific regulations. The case reinforces the idea that the substance of a financial transaction, as well as its form, can significantly influence its tax treatment.

This case informs tax planning by businesses, particularly financial institutions, and demonstrates the need for careful record-keeping and the use of precise financial instruments to qualify for tax benefits related to borrowed capital. Later cases, when analyzing similar issues, would likely review the factual context of the financial arrangements to see if they fall under the same restrictions.

© 2025 SCOTUSreports.com. All rights reserved. 