Brizard-Matthews Machinery Co., 32 T.C. 25 (1959)

To qualify as “borrowed capital” under the Excess Profits Tax Act, a transaction must create an outstanding indebtedness, distinguishable from a sale of assets.

Summary

The case concerns whether a machinery company’s transactions with a bank, involving the assignment of notes and conditional sales contracts, constituted a loan (and thus “borrowed capital” for tax purposes) or a sale. The Tax Court held that the transactions were sales, not loans, and therefore the proceeds received by the company did not qualify as borrowed capital. The Court focused on the language of the assignment agreements, which used terms of sale rather than lending, and the lack of any outstanding indebtedness in the usual sense. The Court distinguished the facts from cases where assignments were clearly made as collateral for loans. This decision emphasizes the importance of the agreement’s terms and the intent of the parties in characterizing a financial transaction for tax purposes, particularly in determining what constitutes borrowed capital.

Facts

Brizard-Matthews Machinery Company assigned notes and conditional sales contracts to the Bank of America. The assignment agreements consistently used language of sale rather than lending, referring to the “purchase” of the contracts. The bank provided cash to the company in return. Brizard was not liable for the assigned contracts unless they became delinquent for more than 60 days. The company did not record the assigned items as accounts or notes payable on its books.

Procedural History

The Commissioner of Internal Revenue determined that the amounts received by Brizard did not qualify as borrowed capital. Brizard-Matthews Machinery Co. petitioned the Tax Court, arguing the cash amounts were proceeds of a loan. The Tax Court ruled in favor of the Commissioner.

Issue(s)

1. Whether the amounts received by Brizard from the Bank of America for the assignment of notes and conditional sales contracts constituted “borrowed capital” under section 439 of the 1939 Code?

Holding

1. No, because the transactions were determined to be sales of assets rather than loans, and therefore did not create an outstanding indebtedness that qualified as “borrowed capital.”

Court’s Reasoning

The Court focused on the substance of the transaction as reflected in the agreements. The agreements between Brizard and the bank consistently used language of “sale,” “purchase,” and “transfer” of the contracts, not lending terminology. The bank’s notice to the installment purchasers also indicated a sale. The Court found that the lack of an actual outstanding indebtedness was crucial. Brizard had no liability to the bank if the contracts remained current. The Court cited the fact that Brizard did not record the transactions as liabilities on its books as another indicator of a sale rather than a loan. The Court distinguished the case from *Brewster Shirt Corporation v. Commissioner*, where the assignment was clearly as collateral for loans, and *Hunt Foods, Inc.* where sight drafts were used to effect a loan. The Court found the transaction analogous to *East Coast Equipment Co.*, where the court determined a similar arrangement to be a sale and not a pledge. The court also stated that California Civil Code provisions regarding a banker’s lien had no application since the bank had acquired title to the contracts and notes.

Practical Implications

This case underscores the importance of carefully drafting agreements to reflect the true nature of a transaction, particularly in the context of tax law. The specific language used – whether the agreement speaks of loans, collateral, or sales – is critical in determining the tax consequences. Lawyers should pay close attention to the details of similar transactions, ensuring the economic substance aligns with the legal form to avoid unintended tax outcomes. The distinction between a sale and a loan can have significant implications for a company’s financial statements. Later courts might consider how the risk is allocated (seller or buyer) in the transaction.

