31 T.C. 734 (1959)

Installment thrift certificates issued by a corporation, similar to investment securities, can be considered "certificates of indebtedness" under section 439(b)(1) of the Internal Revenue Code for calculating borrowed capital for tax purposes, even if they lack a fixed maturity date.

Summary

The Investors Thrift Corp. sought to include its installment thrift certificates in its calculation of borrowed capital, which would increase its invested capital credit for excess profits tax purposes. The Commissioner of Internal Revenue argued that the certificates were not "certificates of indebtedness" as defined by the relevant tax code. The Tax Court, reviewing the regulations and prior case law, held that the installment thrift certificates, which the company issued, were essentially investment securities rather than standard debt instruments or bank deposits. Therefore, the corporation was entitled to include them in the computation of its borrowed capital.

Facts

Investors Thrift Corp. issued various types of certificates, including term thrift certificates, full-paid investment certificates, unit thrift certificates, employee certificates, and installment thrift certificates. The corporation's primary source of working capital was the sale of these certificates. The issue involved the installment thrift certificates. The certificates were issued under express authority from the department of corporations, and described as "investments."

Procedural History

The case came before the Tax Court to determine whether the installment thrift certificates qualified as "certificates of indebtedness" under section 439(b)(1) of the Internal Revenue Code. The Tax Court considered the arguments presented by Investors Thrift Corp. and the Commissioner of Internal Revenue, reviewed relevant case law, and issued its decision.

Issue(s)

Whether the petitioner is entitled, in computing its excess profits credit under section 439(b)(1), to include the amount evidenced by its installment thrift certificates in the computation of its borrowed capital.

Holding

Yes, because the installment thrift certificates issued by Investors Thrift Corp. were "certificates of indebtedness" within the meaning of section 439(b)(1) and were to be included in the computation of the invested capital credit.

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Court’s Reasoning

The court focused on whether the installment thrift certificates had the general character of investment securities, as opposed to debts arising from ordinary transactions. The court noted that the corporation was not a bank and prohibited from receiving deposits, and its certificates were not certificates of deposit. The interest specified in the certificates was to be paid in any event and was not limited to payment out of earnings. The court relied on the regulations, which stated that the name of the certificate is of little importance but that attributes such as the source of payment of interest and rights of enforcement are more relevant. The court concluded that the installment thrift certificates represented investments by the holders and were similar to the other evidences of indebtedness listed in section 439(b)(1). The court distinguished the case from those involving banks and certificates of deposit, emphasizing that Investors Thrift Corp. was an industrial loan company and that its certificates were intended as investments.

The court cited the following quote: “Depositors place their money in banks primarily for safekeeping, secure in the knowledge that many governmental restrictions, both state and federal, are placed upon banks to assure and sometimes, as in the case of Federal Deposit Insurance banks, to insure the safety of the deposit. “Bank” and “bank deposit” are terms as well known in common parlance as they are in technical commercial use. And the terms do not include industrial loan companies nor monies received by sale of thrift certificates either in actual or technical understanding. Money paid for thrift certificates (or other evidences of indebtedness whatever called) are intended as investments, influenced largely by the promise of payment of a high rate of interest, here 4%, but with a concomitant risk. Bank deposits are made at a lower rate of interest, here 2%%, for safekeeping.”

Practical Implications

This case provides guidance on how to classify financial instruments for tax purposes. It underscores the importance of examining the substance over the form of the instrument. Tax attorneys and accountants should carefully evaluate the characteristics of financial instruments to determine if they qualify as “certificates of indebtedness” for the purpose of calculating borrowed capital. This case also highlights the significance of regulations and prior case law in interpreting tax code provisions. The distinction between banking functions and those of industrial loan companies is important.

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