King v. Commissioner, 89 T. C. 445 (1987)

Interest paid on debt incurred for commodity futures trading as part of a trade or business is not subject to investment interest limitations.

Summary

Marlowe King, a professional commodity futures trader, took delivery of 10,000 ounces of gold under futures contracts in 1978 and sold it in 1980, realizing a long-term capital gain. He deducted the interest expenses incurred to carry the gold. The issue was whether these interest deductions were subject to the investment interest limitations of IRC § 163(d). The U. S. Tax Court held that because King's activities were part of his trade or business of trading commodity futures, the interest expenses were not subject to the limitations, allowing full deduction of the interest costs.

Facts

Marlowe King, a registered member of the Chicago Mercantile Exchange (CME), engaged in the trade or business of commodity futures trading. In December 1978, he took delivery of 10,000 ounces of gold under 100 long gold futures contracts. He financed the gold purchase with a loan from the King & King, Inc. Profit Sharing Plan and Trust, paying interest in 1979 and 1980. In May 1980, he sold the gold by delivering it against 100 short gold futures contracts, realizing a long-term capital gain. King deducted the interest expenses incurred to carry the gold, which the Commissioner challenged under IRC § 163(d).

Procedural History

King filed a petition in the U. S. Tax Court challenging the Commissioner's disallowance of certain interest deductions. The court had previously granted King's motion for partial summary judgment on another issue. The remaining issue was whether the interest deductions were subject to the investment interest limitations of IRC § 163(d). The Tax Court ruled in favor of King, holding that the interest deductions were not subject to these limitations.

Issue(s)

1. Whether the interest paid by King on indebtedness incurred to carry the physical gold was subject to the investment interest limitations of IRC § 163(d).

Holding

1. No, because the interest was incurred in connection with King's trade or business of commodity futures trading, and thus not subject to the limitations of IRC § 163(d).

Court's Reasoning

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The court distinguished between traders and investors, noting that traders seek short-term market swings while investors look for long-term appreciation. King was a trader engaged in frequent and substantial trading of commodity futures, which produced capital gains and losses. The court emphasized that IRC § 163(d) was intended to address the abuse of deducting interest on investments held for postponed income, which did not apply to King's short-term trading activities. The legislative history of IRC § 163(d) also explicitly stated that interest on funds borrowed in connection with a trade or business would not be affected by the limitation. The court rejected the Commissioner's argument that Miller v. Commissioner controlled, as it dealt with a different factual scenario involving stock held for investment. The court found that King's gold transaction was part of his regular trading activities, not a separate investment, and therefore the interest paid on the debt incurred to carry the gold was deductible without limitation.

Practical Implications

This decision clarifies that interest incurred by traders in the course of their trade or business is not subject to the investment interest limitations of IRC § 163(d). This ruling impacts how traders should report their interest expenses, allowing them to fully deduct interest costs associated with their trading activities. It also affects how the IRS audits traders, requiring them to distinguish between trading and investment activities. The decision has broader implications for financial planning and tax strategies for traders, potentially influencing their borrowing and investment decisions. Subsequent cases, such as Vickers v. Commissioner, have cited King v. Commissioner to support the treatment of traders' interest expenses.

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