Georgia-Pacific Corp. v. Commissioner, 93 T. C. 434 (1989)

A letter of credit does not qualify as a deductible payment under section 461(f) for a contested liability unless it involves an actual transfer of money or property beyond the taxpayer's control.

Summary

Georgia-Pacific Corp. sought to deduct $20 million on its 1981 tax return for a contested antitrust liability secured by a letter of credit. The Tax Court held that a letter of credit does not constitute a deductible payment under section 461(f) because it does not involve an actual transfer of money or property. The court reasoned that a letter of credit merely substitutes one contingent liability for another, without a real outlay of funds. This decision clarifies that for a deduction to be allowed under section 461(f), there must be an actual payment or transfer of assets to satisfy a contested liability, not just a financial arrangement like a letter of credit.

Facts

Georgia-Pacific Corp. was involved in antitrust litigation concerning plywood pricing practices. In December 1981, the company obtained a $20 million letter of credit from Bank of America, which was placed in a trust to cover potential antitrust liabilities. Georgia-Pacific claimed a $20 million deduction on its 1981 tax return under section 461(f) for contested liabilities. The litigation was settled in 1983, with Georgia-Pacific paying its share of the settlement directly and through draws on the letter of credit.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction, leading to a dispute in the Tax Court. The Tax Court assigned the case to a Special Trial Judge, whose opinion was adopted by the full court. The court focused on whether the letter of credit constituted a deductible payment under section 461(f).

Issue(s)

1. Whether a letter of credit constitutes a "transfer of money or other property" under section 461(f)(2) of the Internal Revenue Code?

Holding

1. No, because a letter of credit does not involve an actual transfer of money or property beyond the taxpayer's control; it merely substitutes one contingent liability for another.

Court's Reasoning

The Tax Court reasoned that a letter of credit is not equivalent to a payment or transfer of property as required by section 461(f). The court emphasized that section 461(f) was intended to allow deductions in the year of actual payment, not when a financial arrangement like a letter of credit is established. The court cited previous cases and legislative history to support its view that a deduction requires an actual outlay of cash or property. The court distinguished this case from Chem Aero v. United States, where a certificate of deposit was pledged, which was not done here. The court concluded that Georgia-Pacific's arrangement with the letter of credit did not meet the requirements of section 461(f) because it did not result in an actual transfer of assets to satisfy the contested liability.

Practical Implications

This decision impacts how taxpayers can deduct contested liabilities under section 461(f). Taxpayers must make an actual payment or transfer of property to qualify for a deduction, not just arrange for a letter of credit. This ruling may affect how businesses handle financial planning for potential liabilities, requiring them to consider the tax implications of using letters of credit. Legal practitioners advising clients on tax matters should be aware that such financial instruments do not satisfy the requirements for a deduction under section 461(f). Subsequent cases have reinforced this principle, ensuring that the tax treatment of contested liabilities remains consistent with the court's interpretation in Georgia-Pacific.

