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Recent Developments

Reflections on Lincoln Savings and Loan

As of June 10, 1970, 2,487 savings and loan associations had deducted $72.5 million[1] in Section 1727(d)[2] premium payments to the Secondary Reserve of the Federal Savings and Loan Insurance Corporation (FSLIC) as Section 162 business expenses.[3] In *Lincoln Savings and Loan Association v. Commissioner*,[4] the question presented was whether these payments were properly expended. In the Tax Court Judge Raum disallowed Lincoln's Section 162 deduction characterizing Section 1727(d) payments as akin to capital investments. In a split decision, the Ninth Circuit Court of Appeals reversed. Since this diversity of opinion stems primarily from the hybrid nature of Section 1727(d) payments, an analysis of both the Tax Court and Ninth Circuit decisions will be deferred until the statutory scheme of Section 1727(d) payments is examined.

The Statutory Scheme

Normally, an FSLIC insured savings and loan association is required by statute to make two types of payments to the FSLIC. First, it must pay regular insurance premiums in an amount equal to one-twelfth of one percent of the total of its savings accounts and creditor obligations.[5] These regular payments,

1. Petitioner's Brief for Certiorari at 8, Lincoln Savings and Loan Ass'n v. Comm'r, — U.S. —.
2. INT. REV. CODE of 1954, § 162 reads:

> There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . .

3. 12 U.S.C. § 1727(d) (1964).
4. 51 T.C. 82 (1968), *rev'd*, 422 F.2d 90 (9th Cir. 1970), *cert. granted*, 400 U.S. 901 (1971).
5. National Housing Act, 12 U.S.C. § 1727(b)(1) (1964):

> Each institution whose application for insurance is approved by the Corporation shall pay to the Corporation, in such manner as it shall prescribe, a premium for such insurance equal to one-twelfth of 1 per centum of the total amount of all accounts of the insured members of such institution plus any creditor obligations of such institution.

which represent ordinary income to the FSLIC, are used to defray current expenses and losses of the FSLIC, with any yearly excess transferred to the FSLIC's Primary Reserve.[6] The function of the Primary Reserve is to provide coverage for future FSLIC losses which cannot be currently paid from regular premiums. Although the regular premiums are deductible under Section 162, the character of additional Section 1727(d) payments is the question to be analyzed.

Since 1962 insured institutions are required to pay additional Section 1727 (d) premiums in an amount equal to two percent of any net increase in their insured accounts.[7] Characterized by statute as "additional premium[s] in the nature of prepayment[s] with respect to future premiums,"[8] Section 1727 (d) payments differ from regular premiums in two respects. First, Section 1727(d) premiums do not represent ordinary income to the FSLIC, but rather are accumulated in the FSLIC's Secondary Reserve, and are available to only a limited extent to meet future losses of the FSLIC, *i.e.*, not until the Primary Reserve has been totally depleted.[9] Second, the taxpayer maintains an interest, a pro rata share, in the Secondary Reserve whereas he has no interest in the Primary Reserve. This pro rata interest is reflected in an annual account rendered to each member by the FSLIC stating the amount of the member's "prepayment" together with an annual interest credit on its share.[10] After the total of the Primary and Secondary Reserves reaches a specified

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6. *Id.* § 1727(a):

The Corporation shall establish a primary Reserve which shall be the general reserve of the Corporation and a Secondary Reserve to which shall be credited the amounts of the prepayments made by insured institutions pursuant to subsection (d) of this section and the credits made pursuant to the first sentence of subsection (e) of this section.

7. *Id.* § 1727(d)(1), (3) state:

Each insured institution, except as otherwise provided in this section, shall annually pay to the Corporation, at such time and in such manner as the Corporation shall by regulations or otherwise prescribe, an additional premium in the nature of a prepayment with respect to future premiums of such institution under subsection (b) of this section equal to 2 per centum of the net increase in all accounts of its insured members during the next preceding calendar year, less an amount equal to any requirement, as of the end of such calendar year, for the purchase of stock of the Federal Home Loan Bank of which institution is a member, calculated in accordance with the provisions of subsection (c) of section 1426 of this title and without regard to any net increase during such calendar year in its holdings of such stock, and such prepayments shall be credited to the Secondary Reserve. . . .

8. *Id.*

9. *Id.* § 1727(e):

. . . the Secondary Reserve shall be available to the Corporation only for losses of the Corporation and shall be so available only to such extent as other accounts of the Corporation which are available therefor are insufficient for such losses.

10. *Id.*, *discussed* in Lincoln Sav. & Loan Ass'n, 51 T.C. 82, 95 (1968).

level, an institution's pro rata share of the Secondary Reserve will be automatically credited toward its obligation to pay regular insurance premiums to the FSLIC.[11] The unused remainder may be recovered in cash if: (1) a member's insured status is terminated, either voluntarily on involuntarily, (2) it goes into voluntary or involuntary liquidation, or (3) the Secondary Reserve is distributed before a member has otherwise fully recovered his share.[12] An institution's pro rata share may be transferred to another insured institution in a merger, consolidation, or bulk sale.[13] The Commissioner will allow a Section 162 deduction for Section 1727(d) payments when, the taxpayer's pro rata share is credited toward his regular FSLIC premiums. Since the taxpayer will be allowed a Section 162 deduction eventually the question in *Lincoln* is one of deferral.

The Tax Court Opinion

Speaking for a unanimous Tax Court, Judge Raum held that the taxpayer should defer his deduction. However, his opinion demonstrates the difficulties of trying to pigeonhole Section 1727(d) payments. Judge Raum tried several approaches. He distinguished Section 1727(d) payments from regular FSLIC premiums ordinary prepaid insurance premiums and ordinary capital investments.

In distinguishing Section 1727(d) payments from regular FSLIC premiums, the Tax Court noted the statutory differences mentioned in the preceding section. First, regular premiums represent gross income to the FSLIC and are readily available to meet future losses. On the other hand, Section 1727(d) payments may be used ". . . only to such extent as other accounts of the Corporation which are available therefor are insufficient for such losses."[14] Second, the taxpayer has no interest in the Primary Reserve but maintains an annually appreciating interest in a pro rata share of the Secondary Reserve.[15]

11. National Housing Act, 12 U.S.C. § 1727(g) (1964):

> If, at the close of any December 31, the aggregate of the Primary Reserve and Secondary Reserve equals or exceeds 2 per centum of the total amount of all accounts of insured members and creditor obligations of all insured institutions but the Primary Reserve does not equal or exceed such 2 per centum, no insured institution shall be obligated to make any prepayment under subsection (d) of this section during the year beginning with May 1 next succeeding such close, and each insured institution's pro rata share of the Secondary Reserve shall be used to the extent available, to discharge such institution's obligation for its premium under subsection (b) of this section for the premium year beginning in such year . . .

12. *Id.* §§ 1727(f), 1727(g).

13. *Id.* § 1727(e).

14. *Compare* National Housing Act, 12 U.S.C. § 1727(a) (1964), *with* 12 U.S.C. § 1727(e) (1964).

15. *Id.* § 1727(e).

Lincoln argued that this interest was valueless since not readily assignable or transferable. The Tax Court found this argument unpersuasive[16] and ruled that Section 1727(d) payments should not be classified as similiar to regular insurance premiums. Rather, the court held that they were akin to a capital investment in the FSLIC since they were part of a pool set aside for the payment of unexpected losses.

Judge Raum reasoned that Section 1727(d) payments were also distinguishable from ordinary prepaid insurance premiums.[17] He characterized prepaid insurance premiums as an insurer's obligation to provide coverage for a specified period. However, the FSLIC incurs no such obligation when it receives a Section 1727(d) payment. The obligation arises only when the taxpayer's pro rata share of the Secondary Reserve is credited toward his regular premium payments. Since the life of the asset created by a Section 1727 (d) payment is unascertainable on the date of payment, the payment cannot be amortized over a definite period. The court then discussed those statutory provisions relating to the initiation and termination of an association's obligation to make Section 1727(d) payments. It found they required insured institutions to make and keep capital investments in the FSLIC until the FSLIC has retained enough of its own earnings to provide adequate protection for insured savers.

Although he distinguished the Section 1727(d) payments from prepaid insurance premiums, Judge Raum covered all the available alternatives by stating that prepaid insurance premiums were nondeductible anyway. He hedged:

> . . . though if we were to give it the prepayment label binding effect here, we should most certainly adopt the characterization of 'prepayment' as controlling, and would therefore have to deny petitioner a current deduction for its 1727(d) payments under a long line of decisions by this court holding that prepaid insurance premiums are capital expenditures to be expensed over the years in which coverage is actually obtained.[18]

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16. The taxpayer argued that since his pro rata share could not be assigned or transferred he could not realize its value. Judge Raum noted that the value was realizable in several ways. It might be recovered in cash if the taxpayer terminated FSLIC insurance or if the Secondary Reserve was distributed. Furthermore it might be transferred in a merger, consolidation or bulk sale. In any case, the taxpayer was reasonably assured of recovering its value when it was credited toward his regular FSLIS premiums. For the Tax Court discussion *see* Lincoln Sav. & Loan Ass'n., 51 T.C. 82, 96 (1968). Although they did not render it valueless, the court recognized that the limited circumstances in which the taxpayer's pro rata share could be recovered or transferred cut against characterizing it as a capital asset.

17. 51 T.C. at 97-98.

18. *Id.* at 94.

Commissioner v. Boylston Market[19] is in accord with this reasoning since it held that prepaid insurance premiums are not deductible in the year of payment but rather in the years they provide coverage. However, *Waldheim Realty and Investment Co. v. Commissioner*[20] allowed a cash receipts and disbursements taxpayer to deduct insurance premiums in the year of payment. The court reasoned that expenses are deductions in the year they are paid out. The purpose of the *Waldheim* rationale is to prevent a taxpayer from bunching deductions in years that he has a large income. However, the *Waldheim* holding permits bunching whenever the taxpayer decides to prepay insurance premiums. *Boylston Market* appears the sounder principle and is in accord with analogus precedent.[21] As Judge Mahoney said in *Boylston*:

> We are nevertheless unable to find a real basis for distinguishing between prepayment of rentals . . . bonuses for the cancellation of leases . . . commissions for negotiating leases . . . and prepaid insurance.[22]

Although there are distinctions between Section 1727(d) payments and insurance premiums,[23] the court also noted some differences between the payments and ordinary capital investments. First, if the taxpayer wants to insure with the FSLIC he is required by law to make the Section 1727(d) payments. Second, the amount of the taxpayer's Section 1727(d) investment is not fixed but is determined by the growth of his business, *i.e.*, the increase in his savings accounts. Third, the asset acquired by the payments, a pro rata share in the Secondary Reserve, is not readily transferable. However, these differences do not alter the fact that Section 1727(d) payments do not purchase coverage in the year of payment. Instead, they purchase an item which, if held to maturity and not refunded by FSLIC, will benefit the taxpayer through insurance in future years,[24] thus, they are governed by the unamortizable investments rule:

> If an expenditure results in the creation of an asset having a use-

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19. 131 F.2d 966 (1st Cir. 1942).
20. 245 F.2d 823 (8th Cir. 1957).
21. *See, e.g.*, Main and McKenney Bldg. Co. v. Comm'r, 113 F.2d 81 (5th Cir. 1940), *cert. denied*, 311 U.S. 688 (1941); Southwestern Hotel Co. v. United States, 115 F.2d 686 (5th Cir. 1940), *cert. denied*, 312 U.S. 703 (1940); Baton Coal Co., 19 B.T.A. 169, *aff'd*, 51 F.2d 469 (3d Cir. 1931), *cert. denied*, 284 U.S. 674 (1931); and University Properties Inc., 45 T.C. 416 (1966). These cases all stand for the proposition that prepaid rent is not deductible in the year it is paid.
22. Comm'r v. Boylston Market, 131 F.2d 966, 968 (1st Cir. 1942).
23. The taxpayer's argument that Section 1727(d) payments are insurance premiums is bolstered by the fact that the Secondary Reserve is presently being credited toward payment of regular FSLIC premiums. The total of the Primary and Secondary Reserve reached the 2 percent suspension level in 1969. Beginning in 1970 the Secondary Reserve is being used as a credit. Brief for Petitioner at 8 n.9, Lincoln Sav. & Loan Ass'n. v. Comm'r, — U.S. — (1970).
24. Lincoln Sav. & Loan Ass'n., 51 T.C. 82, 98 (1968).

> ful life which extends substantially beyond the close of the taxable year, such an expenditure may not be deductible . . . for the taxable year in which made.[25]

The court reinforced its conclusion with an analogy to the purchase of stock in a federal home loan bank (FHLB). Just as Section 1727(d) payments are conditional to membership in the FSLIC, the stock purchase is required for membership in the bank. Lincoln had made, and not deducted, the stock purchases. Initially, an institution must purchase stock equal to 1 percent of the unpaid principal of its home mortgage loans.[26] Then it must buy additional stock sufficient to maintain the 1 percent ratio at the close of each year.[27] This stock is not generally transferable and may be redeemed only when the association withdraws from membership. Even then, if the FHLB finds the capital of the retiring member's regional bank impaired through losses or depreciation of its assets, the bank may retain the member's pro rata share of the bank's impairment.[28] Membership in the bank entitles an association to obtain limited loans from the bank on the security of its home mortgages, United States obligations, and obligations guaranteed by the United States. This provides the institution with an additional source of liquidity and funds for mortgage lending.

The Tax Court determined that the only distinction between investments in FHLB stock and Section 1727(d) payments was that the former were evidenced by stock certificates while the latter were not. This distinction was found not controlling for tax purposes.[29] In support of this, the court noted that, in 1962, when Congress added Section 1727(d) it also reduced the ratio of FHLB stock to outstanding mortgage loans from 2 percent to the

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25. Treas. Reg. 1.461-1(a) (1957).

26. Federal Home Loan Bank Act, 12 U.S.C. § 1426(c) (1958) states:

> The original stock subscription for each institution eligible to become a member under section 4 shall be an amount equal to 1 per centum of the aggregate of the unpaid principal of the subscriber's home mortgage loans, but not less than $500.

27. *Id.* § 1426(1) (1958):

> Within one year after the enactment of this subsection, each member of the Federal Home Loan Bank shall acquire and hold and thereafter maintain its stockholding in an amount equal to at least 2 per centum of the aggregate of the unpaid principal of such member's home mortgage loans, home purchase contracts, and similar obligations (but not less than $500).

28. Petitioner argued that FHLB stock purchases were distinguishable from Section 1727(d) payments because dividends paid on the bank stock were immediately available and because regional banks have the discretion to retire any member's stock to the extent it exceeds the required ratio. But, Section 1727(d) payments are returned only in limited circumstances, and then and only then, does the interest they earn become available. In a footnote, the court dismissed this argument and reiterated that both payments are capital investments. Lincoln Sav. & Loan Ass'n, 51 T.C. 82, 99 n.5 (1968).

29. Federal Home Loan Bank Act, 12 U.S.C. § 1426(1) (1958).

present 1 percent.[30] An analysis of the legislative history of these two amendments convinced the court that Congress considered the two payments interrelated. Consequently, the taxpayer's Section 1727(d) payments represented capital outlays similar to investments in FHLB stock.[31] Judge Raum's analogy is tight. However, he cited no cases to support his conclusion. Since Lincoln had not tried to deduct the stock purchases it was in a poor position to dispute the conclusion. However, it is at least arguable that the analogy shows only that the taxpayer's arguments for deduction of Section 1727(d) payments should have equal force when applied to the stock purchases.[32]

The Ninth Circuit Opinion

With one judge dissenting, the Ninth Circuit reversed the Tax Court and found Lincoln's payments currently deductible as a Section 162 business expense. The court relied heavily on two prior district court opinions, *First Federal Savings and Loan Ass'n v. Commissioner*[33] and *Washington Federal Savings and Loan v. United States*[34]:

30. *Id.* § 1426(c)(1).

31. Lincoln Sav. & Loan Ass'n., 51 T.C. 82, 101-102 (1968). *See also* S. REP. No. 778, 87th Cong. 1st Sess., 2, 12, and H.R. REP. No. 823, 87th Cong. 1st Sess., 2 (1961).

32. The Tax Court also considered a prior ruling by the Commissioner. In Rev. Rul. 66-49, 1966-1 CUM. BULL. 36 the Commissioner denied the taxpayer a deduction for his Section 1727(d) payments while holding that the appreciation of his share of the Secondary Reserve was not includible in gross income until it became available to the taxpayer. Petitioner urged that these two positions were inconsistent in that it was improper to treat the taxpayer's share in the Secondary Reserve as a capital asset and then not tax him on the dividends earned by that asset. The court found no inconsistency saying:

> Though we prefer to rest our holdings on the reasons set forth in this opinion we do agree with the conclusion reached in Rev. Rul. 66-49 that section 1727(d) payments are not ordinary and necessary business expenses in the year of payment and are not deductible until they are used to pay regular premiums or losses or the possibility of their return to the institution is otherwise precluded.

Lincoln Sav. & Loan Ass'n v. Comm'r, 51 T.C. 82, 104 (1968). In light of this, the amount of discussion spent on the ruling by the ninth circuit seems inordinate. *See* Lincoln Sav. & Loan Ass'n v. Comm'r, 422 F.2d 90, 92-93 (1970).

33. 288 F. Supp. 477 (W.D. Mo. 1968).

34. 304 F. Supp. 1072 (S.D. Fla. 1969). In using these district court opinions the majority rejected the argument that, since Lincoln was state-charted and not required by statute to insure with the FSLIC, as is a Federal savings and loan association, the voluntary nature of his payments precluded a Section 162 deduction. The majority agreed with the taxpayer that the payments were necessary because loss of FSLIC-insured status would cause a mass withdrawal of his depositors. There was no mention of Welch v. Helvering, 290 U.S. 111 (1933) which denied a deduction to the successor to a bankrupt merchant, forced to pay his predecessor's debts in order to enhance his reputation and regain old business. Judge Cardozo commented: "Reputation and learning are akin to capital assets. . . . The money spent in acquiring them is well and wisely spent. It is not an ordinary expense." Nevertheless rejection

> We deem both the *St. Joseph* [First Federal] and *Miami Beach* [*Washington Federal*] opinions to be persuasive authority in support of the contention of this taxpayer and we adopt the cogent arguments in those opinions by reference, without repetition.[35]

The majority emphasized that the Tax Court's focus on the FSLIC's use of Section 1727(d) payments was myopic. The court substituted a motive test for the Tax Court's use test reasoning that emphasis should be placed on the effect of Section 1727(d) payments on the taxpayer's business rather than on their use by the payee. This is the crux of the problem. The different tests, based on different perspectives, lead inextricably to different results.

In his dissent, Judge Hufstedler resolved the question without benefit of either the use or motive tests. He relied on the Tax Court finding that:

> . . . for all practical purposes, the payments will definitely be used to discharge the obligation of the insured institution to pay regular annual premiums in the future, assuming it has previously transferred its pro rata share of the Secondary Reserve or received a cash payment in respect thereof from the FSLIC.[36]

By his reading of the record, the taxpayer was assured of eventually receiving the full value of the payments. Since they resulted in the creation of an asset they should be classed as capital investments.

The district court in *First Federal* read the record differently. It reasoned that the plaintiff's Section 1727(d) payments were insurance premiums because they could be used to cover the FSLIC's losses, and because the plaintiff's insured status was contingent on them. The possibility of recovering Section 1727(d) premiums or of their use as a credit toward his regular premium obligations was dismissed as remote. Since the taxpayer lost control of the payments they could not be pigeonholed as capital investments.[37] The *Washington Federal* court found no distinction between Section 1727(d) payments and regular FSLIC premiums. The mere contingency that Section 1727(d) payments might be recovered was insufficient to transform them into capital investments because "[t]he possibility of their recovery depends on circumstances which cannot be influenced by plaintiff and which are wholly beyond its ability to control."[38] The *Washington Federal* took exception to

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of this distinction will provide a much more administrable rule. *See* Lincoln Sav. & Loan Ass'n v. Comm'r, 422 F.2d 90 (9th Cir. 1970).

35. Lincoln Sav. & Loan Ass'n v. Comm'r, 422 F.2d 90, 92 (9th Cir. 1970).

36. Lincoln Sav. & Loan Ass'n, 51 T.C. 82, 102 (1968), as quoted in Lincoln Sav. & Loan Ass'n v. Comm'r, 422 F.2d 90, 94 (9th Cir. 1970).

37. The fact that the Secondary Reserve is now being sued to defray regular FSLIC premium obligations takes some force away from this argument. *See* note 22 *supra*.

38. Washington Fed. Sav. & Loan Ass'n v. United States, 304 F. Supp. 1072, 1078

the Tax Court finding that the FSLIC incurs an obligation to provide insurance upon receipt of a regular insurance premium, but not upon receipt of a Section 1727(d) payment. It rationalized: "It is the view of this court, on the contrary that neither premium payment gives rise to the FSLIC's obligation to provide insurance coverage. The obligation is created by statute."[39] Though departing from Judge Raum's opinion, *Washington Federal* did not contradict it. Instead, it distinguished *Lincoln* because the taxpayer was state-chartered and not required by law to insure with the FSLIC.[40]

Two Analogies

As presented in the Tax Court and the Ninth Circuit the question is very close. We shall resort to two analogies to aid in its resolution. The first, *Wichita State Bank and Trust v. Commissioner*,[41] was relied on as precedent by the Tax Court, and distinguished in the *First Federal* decision. During the depression, Texas required its state banks to protect depositors through insurance, bonds, or contributions to the Depositor's Guaranty Fund. The taxpayer, which chose the last course, was required to contribute 25 percent of each guaranty fund payment to the state treasury; the remainder was credited to the State Banking Board. Money needed to pay depositors was taken from the Fund, which was immediately reimbursed by a special cash assessment levied on the remaining members. These special assessments were found analogous to insurance premiums. The 25 percent payments to the permanent reserve were classed as capital investments. Reimbursement was unavailable until a member withdrew from the Fund, however each member eventually recovered a pro rata share of that reserve, *i.e.*, his payments plus interest. This analogy supports the Tax Court's position in *Lincoln*.

The second analogy is the Farm Credit Act of 1933[42] which provides a statutory structure similiar to that involved in *Lincoln*. The Act created twelve regional banks to provide low interest loans to farmers' cooperatives. A cooperative borrower must buy Class C stock in the bank and must purchase stock equivalent to a prescribed percentage of the interest due each quarter.[43] Although Class C stock is non-transferable, the taxpayer recoups

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(S.D. Fla. 1969). The circumstances are set out in National Housing Act, 12 U.S.C. § 1727(e) (1964), and discussed *supra* at 2, 3, 5.

39. Washington Fed. Sav. & Loan Ass'n v. United States, 304 F. Supp. 1072, 1080 (S.D. Fla. 1969). This analysis misses the point. The statutes create an obligation to insure those institutions that have made the required payments. Thus, payment of a Section 1727(d) premium conditions the obligation of the FSLIC. In this sense it creates it.

40. This argument is discussed in note 33 *supra*.

41. 69 F.2d 595 (5th Cir. 1934).

42. 12 U.S.C. § 1134 (1964).

43. *Id.*

its investment when it rotates out of the bank. Class C stock will be retired, oldest shares first, only after the full retirement of Class A and B stock.[44] Like the statutes, the case law on Class C stock purchases is closely analogous to the *Lincoln* situation. The purchases have been reviewed four times by various courts and put in three different pigeonholes. They were classified once each as capital investments[45] and business expenses[46] and twice as interest payments.[47] This last classification appears to support a Section 162 deduction in *Lincoln* since it is difficult to conceive of corporate interest payments as other than business expenses. However, the Court of Claims, after a thorough discussion of the problem in *Penn Yan Agway v. United States*,[48] expressly declined to do so. Instead, it concluded that the interest characterization was a more logical basis on which to allow a deduction. *Mississippi Chemical v. United States*[49] went the same way. In his dissent, Judge Godbold propounded some considerations that seem equally applicable to the *Lincoln* question.

> The relationship to the member stockholder who contributes capital is not strictly debtor-creditor, for there is no loan with a maturity date, nor corporation-shareholder in the commercial sense. Though styled corporation-shareholder it is in fact *sui generis*.[50]

Consequently payments for the evidences of such a relationship will not be easily classified using the normal tests of a capital investment, or a Section 162 expense. This seems particularly appropriate to Section 1727(d) payments, the use and motive tests. The dissent went on to consider the benefits that accrue through the ownership of Class C stock. First, the taxpayer receives low-cost credit. Also, he indirectly enjoys other benefits. Stock purchases push the bank toward the point of becoming an established, fully capitalized and staffed financial institution wholly owned by the taxpayer and other member cooperatives. The benefits arising from this situation persuaded Judge Godbold to class stock purchases as capital investments.

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44. *Id.*
45. MFA Central Co-op. v. Bookwalter, 427 F.2d 1341 (8th Cir. 1970). The court found that the payments were capital investments because Class C stock met the Section 1221 definition of a capital asset. INT. REV. CODE of 1954, § 1221.
46. MFA Central Co-op. v. Bookwalter, 286 F. Supp. 956 (E.D. Mo. 1968). The district court was moved by the fact that the taxpayer was required to make the payments in order to borrow from the bank and that he had no control over the timing of the stock redemption. This is similar to the rationale of the St. Joseph case discussed *supra* at 13.
47. Mississippi Chem. Corp. v. United States, No. 28271 (5th Cir. 1970); Penn Yan Agway v. United States, 417 F.2d 1372 (Ct. Cl. 1969). Interest is money paid for the use of money. The stock is purchased so that the taxpayer may borrow from the bank. So, the money paid for the stock is actually for the loan.
48. 417 F.2d 1372 (Ct. Cl. 1969).
49. No. 28271 (5th Cir. 1970).
50. *Id.* at 24.

A similar argument succeeded in *Exposition Souvenir Corp. v. Commissioner.*[51] The taxpayer had been awarded concession rights at the New York World's Fair provided that he purchased debenture bonds of the Fair. The purchase was held to be a capital investment because:

> The only reasonable inference is that petitioner hoped to make sufficient profit in its operations at the Fair to offset any loss incurred by reason of its purchase of the debentures.[52]

At this juncture, a short summary of the arguments appears warranted. The taxpayer argues that Section 1727(d) payments and regular FSLIC premiums are indistinguishable; or, in the alternative that Section 1727(d) payments are akin to insurance premium payments. Its most forceful argument is that it is required to insure with the FSLIC, either by statute or economic circumstances and this necessitates making Section 1727(d) payments. These payments are not capital investments for the item purchased is worthless: it cannot be freely transferred, and the taxpayer has no control over the time of its redemption or use. The taxpayer asserts the payments are business expenses because it had to make them to remain insured and stay in business. Because Section 1727(d) payments do not give rise to an obligation to provide insurance on a specified date or for a specified period, the Commissioner contends that they are not analogus to any type of insurance preminum. They become deductible as insurance premiums when credited toward the taxpayer's regular FSLIC premiums. Until then the FSLIC's use of the Section 1727(d) payments shows that they are investments. The question is not easily resolved. By applying the Ninth Circuit's motive test the Section 1727(d) hybrid turns into a Section 162 expense. If the Tax Court's use test is employed the payments are capital investments.

Conclusion

Judge Raum's analysis that Section 1727(d) payments should not be classified as insurance premiums is persuasive.[53] They do not purchase insurance coverage until credited toward the taxpayer's regular premium obligation. If they did, it would be impossible to re-use them to purchase more coverage. We have seen that the time when the payments will be used to cover losses or credited toward the taxpayer's regular FSLIC premiums cannot be prede-

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51. 163 F.2d 283 (2d Cir. 1947).

52. *Id.* at 285. *But see* Comm'r v. Bagley & Sewall Co., 221 F.2d 944 (2d Cir. 1955) which allowed a business deduction for expenditures to purchase bonds, required of the taxpayer as security for performance of a contract. The court reasoned that the expenditure could not be separated from the contract, and that it was made only to enhance the taxpayer's business.

53. National Housing Act, 12 U.S.C. §§ 1727(a), (b)(1) (1964).

termined.[54] Once the desirability of matching gains and losses in the year of actual occurrence is recognized, it appears consistent to defer the deduction until the "prepayments" purchase coverage or until the possibility of their return vanishes. Until then, they are better viewed as prerequisites to the FSLIC's obligation to provide coverage upon receipt of the taxpayer's regular premium payments.

Even as prerequisites, the Section 1727(d) payments are not deductible. There is solid reasoning behind the statute's requirement that the taxpayer make Section 1727(d) payments before becoming eligible to insure with the FSLIC. The Secondary Reserve strengthens the financial foundation of the FSLIC by providing an account to meet emergency losses. It is designed to give the FSLIC sufficient capital to provide for the insurance needs of its members.[55] Thus, Section 1727(d) payments indirectly benefit the taxpayer because they contribute to the economic stability of the FSLIC which serves him by insuring his losses. These intangible benefits might be loosely analogized to the good will of a business. Alone, they might not suffice to classify the taxpayer's Section 1727(d) expenditures as capital investments. But, other benefits are also derived from the payments: the pro rata share of the Secondary Reserve appreciates annually; it might be recovered in cash; it is transferable in limited circumstances; it might be credited toward the taxpayer's regular premiums. These indirect benefits accruing from Section 1727(d) payments lead to the conclusion that the payments more closely resemble capital investments than business expenses. Consequently, the taxpayer's deduction should be deferred until the payments are used by the FSLIC.

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54. *Id.* §§ 1727(d)(1), (e).

55. *See* Lincoln Sav. & Loan Ass'n, 51 T.C. 82, 101-102 (1968), S. REP. No. 778, 87th Cong. 1st Sess., 2, 12, and H.R. REP. No. 823, 87th Cong. 1st Sess., 2 (1961).