Crawford Music Corp. v. Commissioner, 40 B.T.A. 284 (1939)

A U.S. corporation is not entitled to a foreign tax credit for taxes withheld from royalty payments by a British licensee when the tax is levied on the British company's profits, even if the British company withholds a portion of the royalties to account for the tax.

Summary

Crawford Music Corp. sought a tax credit for income taxes withheld by a British licensee from royalty payments. The Board of Tax Appeals denied the credit, holding that the tax was levied on the British company's profits, not directly on Crawford Music. The court reasoned that the British company's withholding was merely a mechanism to collect taxes on its own profits, even though the royalty payments were theoretically a non-deductible expense. The decision emphasizes that the U.S. corporation must directly pay the foreign tax to qualify for the credit.

Facts

- Crawford Music Corp., a U.S. corporation, received royalty payments from a British licensee.
- The British licensee withheld a portion of the royalty payments under General Rule 19(2) of British tax law.
- The withheld amount represented the British income tax on the royalty income.
- The British company paid tax on its profits without deducting the royalty payments as an expense.

Procedural History

Crawford Music Corp. claimed a credit on its U.S. income tax return for the taxes withheld by the British licensee. The Commissioner of Internal Revenue denied the credit. Crawford Music Corp. appealed to the Board of Tax Appeals.

Issue(s)

1. Whether Crawford Music Corp. is entitled to a credit under Section 131(a)(1) of the 1934 Act for income taxes withheld from royalty payments by a British licensee.

Holding

1. No, because the tax was levied on the British company's profits, and the withholding was merely a mechanism for the British company to pay its own taxes, not a direct payment of tax by Crawford Music Corp.

Court's Reasoning

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The court relied on *Biddle v. Commissioner*, 302 U.S. 573, which held that the determination of whether a foreign tax credit is available depends on whether the taxpayer has done something equivalent to paying the tax under foreign law. The court found that the British company paid tax on its profits, without deducting royalty payments. General Rule 19(2) merely allowed the British company to withhold a portion of the royalties, but this did not transform the tax into a tax paid by Crawford Music. The court highlighted the fact that the amount of the British company's tax liability was the same whether or not it withheld from the royalty payments. The court cited *Commissioners of Inland Revenue v. Dalgety & Co., Ltd.*, emphasizing that a company paying tax on its entire profit is paying its own tax, even if it withholds a portion from payments to others. As the court stated, "It is foreign to our law to regard the same tax as paid by two different taxpayers." The court concluded that "The tax paid in the instant case was not petitioner's tax within the meaning of our statute."

Practical Implications

This case clarifies that a U.S. taxpayer must directly pay the foreign tax to be eligible for a foreign tax credit. Withholding by a foreign entity is insufficient if the underlying tax is levied on the foreign entity's profits. This decision emphasizes the importance of understanding the specific nature of foreign tax laws and how they apply to cross-border transactions. Attorneys advising clients on international tax matters must analyze whether the client directly paid the foreign tax or whether it was merely withheld as part of the foreign entity's tax obligations. Subsequent cases will likely distinguish situations where the foreign tax is directly levied on the U.S. taxpayer's income, even if collected through withholding.

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