9 T.C. 78 (1947)

A taxpayer on the accrual basis can claim a foreign tax credit in the year the foreign tax liability is incurred, regardless of whether the tax was accrued on the taxpayer's books or paid in a later year.

Summary

The Texas Company (South America) Ltd., a U.S. corporation, sought foreign tax credits for Brazilian income taxes. The company, on the accrual basis, hadn't accrued these taxes on its books for 1938, 1940, and 1941 but paid them in 1942. The Tax Court held that the company was entitled to the foreign tax credits for each year the Brazilian tax liability was incurred, regardless of the fact that the taxes were not accrued on its books for those years and were paid later. The court emphasized that the critical factor was the existence of the tax liability under Brazilian law during those years.

Facts

The Texas Company (South America) Ltd. marketed petroleum products in Brazil and used the accrual method of accounting.

Brazilian law imposed a general corporate income tax and an additional tax on income belonging to residents abroad (foreign owner's income tax).

The company paid the general corporate income tax and claimed a credit for it.

Prior to 1942, the company didn't accrue the foreign owner's income tax on its books or claim a credit for it on its U.S. tax returns.

In December 1942, Brazil ordered the company to pay the foreign owner's income tax for prior years, which it did.

Procedural History

The Commissioner of Internal Revenue denied the foreign tax credit for the years 1938, 1940, and 1941.

The Texas Company petitioned the Tax Court for a redetermination of the deficiencies.

The Tax Court ruled in favor of The Texas Company, allowing the foreign tax credits.

Issue(s)

Whether a taxpayer on the accrual basis is entitled to a foreign tax credit in the year the foreign tax liability is incurred, even if the tax is not accrued on the taxpayer's books and is paid in a subsequent year?

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Holding

Yes, because the foreign tax credit can be taken in the year the foreign taxes accrued, irrespective of the taxpayer's accounting method and regardless of when the tax was actually paid.

Court's Reasoning

The court reasoned that the existence of a legal liability for the Brazilian tax was the key factor, not the taxpayer's accounting treatment. The court stated that "when all events have occurred which control any tax deduction, the same is allowable even though the books may be silent on the deduction."

The court noted that the Brazilian statute of limitations applied to the foreign owner's income tax, indicating that it was intended to be an annual tax.

The court distinguished the Commissioner's argument that the tax was contingent upon the removal of income from Brazil, stating that the tax was due as earned annually.

The court cited *United States v. Anderson, 269 U.S. 422*, which holds that income taxes ordinarily accrue in the year the income is earned on which the tax is imposed.

The court found that the payment of the tax by the taxpayer, even before remitting the income to the U.S., suggested the existence of a valid tax liability.

Practical Implications

This case clarifies that taxpayers using the accrual method can claim foreign tax credits when the liability for the foreign tax is established, regardless of when the tax is actually paid or recorded on their books.

This decision emphasizes the importance of understanding foreign tax laws to determine when a liability is incurred.

Attorneys should advise clients to maintain detailed records of foreign tax liabilities, even if the actual payment is deferred, to support potential foreign tax credit claims.

Later cases have cited this ruling to support the principle that the substance of a transaction, rather than its form or accounting treatment, should govern tax consequences.

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