British-American Oil Producing Co. v. Commissioner, 20 T.C. 589 (1953)

Foreign income taxes, to the extent they are based on income from mineral properties, are considered deductions attributable to those properties and thus reduce the net income from the property for the purpose of calculating the percentage depletion limitation.

Summary

British-American Oil Producing Co., a British corporation operating in the United States, deducted British income taxes on its U.S. income. The Commissioner allocated a portion of these British income taxes as expenses attributable to the petitioner's oil-producing properties, thereby reducing the net income from these properties and consequently the allowable percentage depletion. The Tax Court upheld the Commissioner's determination, reasoning that since the British income taxes were based in part on income derived from the oil properties, they were properly attributable to those properties and should reduce the net income for percentage depletion purposes.

Facts

The petitioner, British-American Oil Producing Co., was a British corporation conducting business in the United States, including oil production and gasoline station operations.

For the fiscal year ending May 31, 1941, the petitioner paid or accrued British income and excess profits taxes and national defense contribution.

The British income taxes were levied on profits or gains arising to persons residing in the United Kingdom from trades or professions carried on in the UK or elsewhere.

The Commissioner allowed the British taxes as a deduction but allocated a portion ($21,277.05) as an expense attributable to the petitioner's oil-producing properties.

This allocation reduced the petitioner's percentage depletion deduction by $7,757.64.

Procedural History

The Commissioner determined a deficiency in income tax for the fiscal year ended May 31, 1941, due to the reduction in percentage depletion.

The petitioner challenged the Commissioner's allocation in the Tax Court.

Issue(s)

1. Whether British income taxes paid by the petitioner are allowable deductions

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“attributable to the mineral property” under Internal Revenue Code section 114(b)(3) such that they reduce the “net income from the property” for the purpose of the 50% limitation on percentage depletion.

Holding

1. Yes. The Tax Court held that a portion of the British income taxes was attributable to the petitioner’s oil-producing properties and therefore properly reduced the net income from those properties for the purpose of calculating percentage depletion limitation, because the British taxes were based, in part, on income from these properties.

Court’s Reasoning

The court relied on Treasury Regulations (Regulations 103, sec. 19.23(m)-1(g)), which define “net income from the property” as gross income from the property less allowable deductions attributable to the mineral property, including taxes.

The court stated, “Deductions not directly attributable to particular properties or processes shall be fairly allocated.”

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