12 T.C. 1064 (1949)

Under the Current Tax Payment Act of 1943, a foreign tax credit must be applied to reduce the tax liability for the year the credit was earned (here, 1942) before calculating the 1943 tax liability under the Act's forgiveness provisions, rather than being applied directly against the 1943 tax.

Summary

The case concerns the proper application of a foreign tax credit in calculating tax liability under the Current Tax Payment Act of 1943. The taxpayer, Isenbarger, argued that the foreign tax credit from 1942 should be applied directly against his 1943 tax liability. The Tax Court disagreed, holding that the credit must first reduce the 1942 tax before calculating the 1943 tax under the Act's provisions. The court reasoned that the Act's forgiveness features applied only to the net tax owing to the U.S. after the credit and that the taxpayer's interpretation was inconsistent with the regulations and the separate computation of tax liabilities for each year.

Facts

In 1942, Isenbarger worked in Canada and earned income from sources outside the United States. He was entitled to a foreign tax credit of $808.81 under Section 131 of the Internal Revenue Code. His income tax for 1942, before the credit, was $1,452.08, and after the credit, it was $643.27. Isenbarger's 1943 income tax liability, before considering the Current Tax Payment Act, was $1,825.97. Isenbarger applied the $808.81 credit against his 1943 tax, then added 25% of his 1942 tax liability after the foreign tax credit, resulting in a lower tax liability than the Commissioner determined.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Isenbarger's 1943 income tax. Isenbarger petitioned the Tax Court, contesting the Commissioner's calculation of his 1943 tax liability under the Current Tax Payment Act of 1943. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether the foreign tax credit to which the petitioner was entitled in 1942 under the provisions of Section 31 of the Internal Revenue Code must be applied against the petitioner's Federal income tax liability for 1942 as calculated before making the computations required by Section 6(a) of the Current Tax Payment Act of 1943, or whether that credit must be applied against the amount resulting after the computations under Section 6(a) have been made.

Holding

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No, the foreign tax credit must be applied against the petitioner's Federal income tax liability for 1942 as calculated before making the computations required by Section 6(a) of the Current Tax Payment Act of 1943 because the Act's forgiveness provisions apply only to the net tax owing to the U.S. for 1942 after the credit is applied.

Court's Reasoning

The Tax Court relied on the regulations promulgated under the Current Tax Payment Act of 1943, which specified that the foreign tax credit should be applied to the 1942 tax before calculating the 1943 tax under the Act. The court rejected Isenbarger's argument that the foreign tax credit should be treated as a tax withheld at the source, which would be excluded from the 1942 tax calculation under Section 6(a) of the Act. The court emphasized the distinction between a foreign tax credit (taxes paid to a foreign government) and taxes withheld at the source (taxes already in the hands of the U.S. government). The court cited *Bartlett v. Delaney, 173 F.2d 535*, stating, "the tax liabilities for 1942 and 1943 must first be computed separately without reference to the special provisions of the Current Tax Payment Act; and then that Act operates in effect to forgive 75 per cent of the lesser liability. The tax for each year must be computed in accordance with the usual rules for determining liability for the particular tax accounting period."

Practical Implications

This case clarifies the proper application of the Current Tax Payment Act of 1943, specifically regarding the treatment of foreign tax credits. It confirms that foreign tax credits must be applied to the tax year in which they are earned before calculating any tax forgiveness or adjustments under the Act. This decision is important for understanding the interaction between tax credits and tax relief provisions. Although the Current Tax Payment Act of 1943 is no longer in effect, the principle of applying credits to the relevant tax year before calculating overall tax liability remains relevant. This case demonstrates the importance of adhering to tax regulations and the distinction between different types of tax credits.

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