Central Aguirre Sugar Company, et al., Petitioners, v. Commissioner of Internal Revenue, Respondent, 24 T.C. 630 (1955)

When a domestic corporation receives a dividend from a foreign subsidiary consisting of both cash and property with a fair market value exceeding its adjusted basis, the foreign tax credit under Section 131(f) of the 1939 Code is calculated based on the fair market value of the distributed property, not its adjusted basis.

Summary

The Central Aguirre Sugar Company (Associates) received dividends from its Puerto Rican subsidiary, Central Aguirre Sugar Company (Sugar Company), including cash and shares of another subsidiary's stock (Railroad Company). The stock's fair market value at the time of distribution exceeded its adjusted basis. The IRS argued the foreign tax credit should be based on the adjusted basis, while Associates claimed the fair market value. The Tax Court ruled in favor of Associates, holding that the dividend's value for the foreign tax credit calculation included the stock's appreciated value because the subsidiary had sufficient earnings and profits.

Facts

Central Aguirre Associates, a domestic corporation, owned nearly all of the stock of Central Aguirre Sugar Company, a Puerto Rican corporation (Sugar Company). Sugar Company owned all of the stock of Ponce and Guayama Railroad Company (Railroad Company). During the fiscal year ending July 31, 1945, Sugar Company paid dividends to Associates consisting of cash and 3,608 shares of Railroad Company stock. The stock's fair market value was $400 per share, and the adjusted basis to Sugar Company was $100 per share. Sugar Company had accumulated profits in excess of the total dividends paid. Associates reported the dividends at fair market value. The IRS determined a deficiency, arguing the dividend should be valued at the stock's adjusted basis.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Associates' income tax and excess profits tax. The case was brought before the United States Tax Court to resolve the dispute concerning the proper calculation of the foreign tax credit under section 131(f) of the 1939 Code. The Tax Court ruled in favor of the petitioner, Central Aguirre Sugar Company.

Issue(s)

1. Whether the value of a dividend paid from a foreign subsidiary to a domestic parent, including property (stock) with a fair market value exceeding the adjusted basis, should be calculated using the fair market value or the adjusted basis for the purpose of computing the foreign tax credit under section 131(f) of the 1939 Code?

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Holding

1. Yes, because the foreign tax credit is to be computed based on the fair market value of the stock distributed, in addition to the cash.

Court’s Reasoning

The Tax Court relied on sections 115(a) and (b) of the 1939 Code, which define dividends as distributions from a corporation’s earnings and profits, and which include distributions of property as well as money. The court emphasized that the distributions from Sugar Company constituted dividends, as the subsidiary had sufficient accumulated profits to cover them, even without accounting for the appreciation of the Railroad Company stock. The court highlighted that the IRS was attempting to apply one definition of

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