F. W. Woolworth Co. v. Commissioner, 54 T. C. 1233 (1970)

Taxes paid under Schedule A of the English Income Tax Act of 1952 do not qualify as income taxes for U. S. foreign tax credit purposes.

Summary

F. W. Woolworth Co. sought a U. S. foreign tax credit for taxes paid by its English subsidiary under Schedule A of the English Income Tax Act of 1952. The court held that these taxes, based on the annual rental value of property, did not qualify as income taxes under U. S. law. Additionally, the court rejected the IRS's attempt to allocate certain domestic expenses to the company's foreign income for the purpose of calculating the per country limitation on foreign tax credits. The decision underscores the importance of understanding the nature of foreign taxes and the implications of expense allocation in international tax contexts.

Facts

F. W. Woolworth Co. owned 52. 7% of F. W. Woolworth & Co. , Ltd. (England) and 97% of F. W. Woolworth Co. , G. m. b. H. (Germany). The English subsidiary paid taxes under Schedule A, which taxed property ownership based on annual rental value, and Schedule D, which taxed trading profits. Woolworth claimed a U. S. foreign tax credit for these taxes. The IRS allowed credits for taxes paid under Schedule D and a separate profits tax but disallowed credits for Schedule A taxes. Additionally, the IRS attempted to allocate various domestic expenses to Woolworth's foreign income for calculating the per country limitation on foreign tax credits.

Procedural History

Woolworth filed a petition with the U. S. Tax Court challenging the IRS's disallowance of the foreign tax credit for Schedule A taxes and the allocation of domestic expenses to foreign income. The IRS amended its answer to include the allocation of expenses to foreign income from operations in Cuba and Puerto Rico.

Issue(s)

1. Whether the tax paid by Woolworth's English subsidiary under Schedule A of the English Income Tax Act of 1952 qualifies as an income tax or a tax in lieu of an income tax under U. S. tax law for foreign tax credit purposes.
2. Whether various deduction items should be allocated under section 862(b) to Woolworth's foreign source income from its English and German subsidiaries and its operations in Cuba and Puerto Rico for the purpose of computing the per country limitation on foreign taxes paid or deemed paid.

Holding

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1. No, because the tax under Schedule A is not based on net income but on the annual rental value of property, which does not align with the U. S. concept of income tax.
2. No, because the deduction items in question are definitely related to Woolworth's domestic source income, and thus no allocation to foreign source income is warranted under section 862(b).

Court's Reasoning

The court analyzed the nature of the Schedule A tax, noting it was based on the annual rental value of property rather than net income, which is fundamental to the U. S. concept of income tax. The court cited prior cases and the legislative history of section 903, which allows credits for taxes paid in lieu of income taxes, but found the Schedule A tax did not meet these criteria. The court also examined the proposed regulations under section 861, which guide the allocation of expenses between domestic and foreign income, and determined that the expenses in question were definitely related to domestic income based on Woolworth's operational structure and the negligible impact of foreign income on the expenses. The court emphasized that the burden of proof for the allocation of expenses rested with the IRS, which failed to demonstrate a sufficient connection between the expenses and the foreign income.

Practical Implications

This decision clarifies that taxes based on property value rather than net income do not qualify for U. S. foreign tax credits, impacting how multinational corporations analyze foreign tax liabilities. It also affects the practice of allocating expenses for foreign tax credit limitations, emphasizing that expenses must be directly related to foreign income to be allocated. Businesses must carefully consider the nature of foreign taxes and the allocation of expenses when planning their international tax strategies. Subsequent cases have followed this precedent, reinforcing the need for a clear nexus between foreign taxes and U. S. tax credit eligibility.

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