F. W. Woolworth Co. v. Commissioner, 55 T. C. 378 (1970)

A foreign tax must be the substantial equivalent of a U. S. income tax to qualify for a foreign tax credit, and allocation of expenses to foreign source income for per country limitation must be supported by a clear connection to the income.

Summary

F. W. Woolworth Co. challenged the IRS's denial of a foreign tax credit for taxes paid under Schedule A of the UK's Income Tax Act of 1952, arguing they should be considered income taxes. The Tax Court held that these taxes were not equivalent to U. S. income taxes and thus not creditable. Additionally, the court rejected the IRS's allocation of certain expenses to foreign source income for computing the per country limitation, finding insufficient connection between the expenses and the foreign income.

Facts

F. W. Woolworth Co. owned a majority stake in its British subsidiary, which paid taxes under Schedule A of the UK Income Tax Act of 1952, based on the annual rental value of property. The company claimed these taxes as a foreign tax credit under U. S. tax law. The IRS allowed credits for other taxes paid but denied the credit for Schedule A taxes, arguing they were not income taxes. Additionally, the IRS sought to allocate certain expenses of Woolworth's executive office and other general expenses to foreign source income for the purpose of calculating the per country limitation on the foreign tax credit.

Procedural History

Woolworth previously litigated the Schedule A tax issue in 1936 and lost, with the decision affirmed by the Second Circuit in 1937. In the current case, the Tax Court reviewed both the credit eligibility of the Schedule A taxes and the IRS's proposed expense allocations for the per country limitation.

Issue(s)

1. Whether taxes paid by Woolworth's British subsidiary under Schedule A of the UK Income Tax Act of 1952 qualify as income taxes eligible for a foreign tax credit under U. S. tax law?
2. Whether the IRS's allocation of certain expenses to foreign source income for the purpose of computing the per country limitation on the foreign tax credit is justified?

Holding

1. No, because the Schedule A taxes are not the substantial equivalent of U. S. income taxes, being based on notional income rather than actual gain or profit.
2. No, because the IRS failed to establish a sufficient connection between the

© 2025 SCOTUSreports.com. All rights reserved.

allocated expenses and the foreign source income.

Court’s Reasoning

The court applied the U. S. concept of income tax, which focuses on gain or profit, and found that Schedule A taxes, based on the annual rental value of property, did not fit this definition. The court referenced prior case law, including Biddle v. Commissioner and Judge Learned Hand’s opinion in a previous Woolworth case, to support its conclusion. Regarding the allocation of expenses, the court examined whether these were definitely related to foreign source income under existing and proposed regulations. It concluded that the expenses were primarily related to domestic operations, and the IRS’s allocation was not supported by sufficient evidence of a direct connection to foreign income. The court emphasized the need for a clear nexus between expenses and foreign income for allocations to be justified.

Practical Implications

This decision clarifies that for a foreign tax to qualify for a credit, it must closely align with the U. S. definition of an income tax, focusing on actual gain or profit. Practitioners must carefully analyze the nature of foreign taxes to determine credit eligibility. Additionally, when allocating expenses for the per country limitation, there must be a clear and direct relationship to the foreign income. This case may influence how multinational corporations structure their operations and report taxes to ensure proper credit eligibility and expense allocation. Subsequent cases have applied these principles to similar tax credit disputes and expense allocations.

© 2025 SCOTUSreports.com. All rights reserved.