56 T.C. 588 (1971)

A domestic corporation with operations in a U.S. possession is not automatically excluded from filing a consolidated return if it experiences a net operating loss, as it does not derive 'benefits' from Section 931 in such a tax year, despite meeting the income percentage thresholds.

Summary

Burke Concrete Accessories sought to include its Puerto Rican subsidiary, Caribe, in its consolidated tax return for 1965. The IRS argued Caribe was ineligible due to Section 1504(b)(4), which excludes corporations 'entitled to the benefits of section 931.' Caribe met the income source requirements of Section 931 but incurred a net operating loss, thus receiving no tax benefit from Section 931's exclusions. The Tax Court held that 'entitled to the benefits' implies actual benefit, not just meeting criteria. Since Caribe received no benefit due to its loss, it was includible in the consolidated return. Revenue Ruling 65-293, which mandated exclusion based solely on meeting Section 931 requirements, was invalidated.

Facts

Burke Concrete Accessories, Inc. (Burke) was a California corporation. Burke had three wholly-owned subsidiaries: Form Ties, Inc., H & B Concrete Specialties Co. (both California corporations), and Burke Caribe (Caribe), also a California corporation operating in Puerto Rico. In 1965, Caribe conducted all business in Puerto Rico, deriving over 95% of its gross income from Puerto Rican sources and over 90% from active business in Puerto Rico, meeting the percentage thresholds of Section 931. For 1965, Caribe incurred a net operating loss of $37,243. Burke and its three subsidiaries filed a consolidated tax return for 1965, including Caribe's loss.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Burke's income taxes, arguing Caribe was improperly included in the consolidated return. Burke petitioned the Tax Court. The Tax Court reviewed the case to determine if Caribe was an 'includible corporation' under Section 1504(b) for consolidated return purposes.

Issue(s)

1. Whether a domestic corporation operating in Puerto Rico, which meets the percentage of income requirements of Section 931 but incurs a net operating loss, is 'entitled to the benefits of section 931' within the meaning of Section 1504(b)(4), thus precluding its inclusion in a consolidated return.

Holding

1. No. The Tax Court held that Caribe was not ‘entitled to the benefits of section 931’ because it experienced a net operating loss and thus derived no tax benefit from Section 931 in 1965. Therefore, Section 1504(b)(4) did not exclude Caribe from being an ‘includible corporation,’ and it was properly included in Burke’s consolidated return.

Court’s Reasoning

The court reasoned that the phrase ‘entitled to the benefits’ in Section 1504(b)(4) implies actual benefit, not merely meeting the income percentage requirements of Section 931. The court emphasized the common meaning of ‘benefit’ as ‘profit, advantage, gain, good, avail.’ It noted that Section 931 was intended as a relief provision. The court examined the legislative history, prior interpretations, and related statutory provisions, finding no indication that Congress intended Section 1504(b)(4) to operate independently of actual benefit under Section 931. The court invalidated Revenue Ruling 65-293, which asserted that meeting the requirements of Section 931 alone, regardless of actual benefit, excluded a corporation from consolidated returns. The court stated, “We hold that, since Caribe could derive no benefit from section 931, it properly joined in the filing of the consolidated return involved herein.”

Practical Implications

This case clarifies that the exclusion from consolidated returns under Section 1504(b)(4) for corporations operating in U.S. possessions is not automatic upon meeting the income thresholds of Section 931. It establishes a ‘benefits received’ test, meaning a corporation must actually derive a tax benefit from Section 931 to be excluded. This decision is crucial for tax planning involving U.S. possessions corporations, particularly when losses are anticipated. It allows corporations like Burke to utilize losses from possession operations within a consolidated group, reflecting economic reality. Later cases and rulings must consider whether a tangible tax benefit was actually realized in the tax year in question, not just if the corporation technically qualified for Section 931 treatment. This case highlights the importance of analyzing the practical effect of tax code provisions, not just literal compliance with percentage tests.