Carborundum Co. v. Commissioner, 58 T. C. 909 (1972)

The grossed-up dividend, including the foreign tax deemed paid, should be used as the numerator in calculating the indirect foreign tax credit under section 902(a).

Summary

Carborundum Co. elected to treat dividends from its UK subsidiaries as grossed-up under the US-UK tax treaty, including the UK standard tax in its US gross income and claiming a direct credit. The issue was whether the grossed-up amount should be used in calculating the indirect credit for the UK profits tax under section 902(a). The Tax Court held that the grossed-up dividend should be used as the numerator in the calculation, reasoning that the purpose of section 902(a) is to credit foreign taxes on income taxable in the US, and the gross amount was included in US income due to the treaty election.

Facts

Carborundum Co. , a US corporation, owned all the stock of two UK subsidiaries. In 1961 and 1962, the subsidiaries paid dividends to Carborundum, which elected under the US-UK tax treaty to include the UK standard tax in its US gross income and claim a direct foreign tax credit. Carborundum also sought an indirect credit under section 902(a) for the UK profits tax paid by the subsidiaries, using the grossed-up dividend amount as the numerator in the calculation.

Procedural History

The Commissioner determined deficiencies in Carborundum's 1961 and 1962 income taxes, arguing that only the amount actually received should be used in the section 902(a) calculation. Carborundum filed a petition in the US Tax Court, which held in favor of Carborundum, sustaining its method of calculation.

Issue(s)

1. Whether the grossed-up dividend, including the UK standard tax deemed paid by Carborundum under the tax treaty, should be used as the numerator in calculating the indirect foreign tax credit under section 902(a)?

Holding

1. Yes, because the purpose of section 902(a) is to provide a credit for foreign taxes on income taxable in the US, and the grossed-up amount was included in US income due to the treaty election.

Court's Reasoning

The Tax Court reasoned that the grossed-up dividend should be used as the

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numerator in the section 902(a) calculation because the purpose of the statute is to credit foreign taxes on income taxable in the US. By electing to treat the UK standard tax as paid under the treaty, Carborundum included the gross amount in its US income, and thus a larger portion of the foreign income became taxable in the US. The court rejected the Commissioner's argument that the treaty election only applied to the direct credit under section 901, holding that it also affected the section 902(a) calculation. The court noted that if Carborundum had directly paid the UK standard tax, the gross amount would clearly be the numerator, and the treaty election put Carborundum in the same position as if the tax had been withheld from the dividend. The court also observed that the 1962 amendments to section 902, which were not applicable to this case, indicated Congress's intent to increase the indirect credit when foreign taxes are included in US income.

Practical Implications

This decision clarifies that when a US corporation elects to gross-up dividends under a tax treaty, the grossed-up amount should be used in calculating the indirect foreign tax credit under section 902(a). This ruling benefits US corporations with foreign subsidiaries by allowing them to maximize their foreign tax credits when they elect to include foreign taxes in US income. The decision also highlights the interplay between tax treaties and the US tax code, demonstrating how treaty elections can affect the calculation of credits under domestic law. Practitioners should carefully consider the impact of treaty elections on both direct and indirect foreign tax credits when advising clients on international tax planning. This case has been cited in subsequent decisions and IRS guidance related to the calculation of foreign tax credits under section 902.

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