Estate of Leonard E. Whitlock, Deceased, Georgia M. Whitlock, Executrix, and Georgia M. Whitlock, Petitioners v. Commissioner of Internal Revenue, Respondent, 59 T. C. 490 (1972)

A U. S. shareholder of a controlled foreign corporation (CFC) that is also classified as a foreign personal holding company (FPHC) is not required to include any amount in gross income under Subpart F for the same year the shareholder is subject to tax under the FPHC provisions.

Summary

The Whitlocks, who owned all the stock of a Panamanian corporation, faced taxation under both the FPHC and CFC rules. The court held that for the years the corporation was both an FPHC and a CFC, the Whitlocks were not required to include any amounts in their gross income under Subpart F due to the operation of section 951(d), which prevents double taxation when a corporation is subject to both sets of rules. However, for the year when the corporation was only a CFC, they had to include the increase in earnings invested in U. S. property in their income. This ruling invalidated a Treasury regulation that conflicted with the statute's plain language, and also addressed constitutional concerns and statute of limitations issues.

Facts

Leonard and Georgia Whitlock owned all the stock of Whitlock Oil Services, Inc. , a Panamanian corporation, as joint tenants until Leonard's death in 1967, after which Georgia owned all the stock. The corporation was classified as a CFC from 1963 through 1967 and as an FPHC from 1964 through 1967. The corporation's earnings were invested in U. S. property, which triggered inclusion in the Whitlocks' gross income under Subpart F. The Whitlocks included some but not all of these amounts in their tax returns, leading to a deficiency notice from the IRS.

Procedural History

The Whitlocks filed a petition with the U. S. Tax Court contesting the IRS's deficiency determination for the years 1963 through 1967. The court addressed the validity of a Treasury regulation, the constitutionality of the tax, and the applicability of the statute of limitations.

Issue(s)

1. Whether a U. S. shareholder of a corporation that is both a CFC and an FPHC must include in gross income under Subpart F any amount attributable to the corporation's increase in earnings invested in U. S. property for the years the shareholder is subject to tax under the FPHC provisions.
2. Whether the tax imposed on a U. S. shareholder's pro rata share of a CFC's increase in earnings invested in U. S. property is unconstitutional.

3. Whether the IRS's determination of a deficiency for 1963 was barred by the statute of limitations.

Holding

1. No, because section 951(d) clearly states that a U. S. shareholder subject to tax under the FPHC provisions shall not be required to include any amount under Subpart F for the same taxable year.
2. No, the tax on the increase in earnings invested in U. S. property is constitutional as it falls within the power given to Congress under the 16th Amendment.
3. No, the IRS's determination was not barred by the statute of limitations as the Whitlocks did not adequately disclose the omitted gross income on their 1963 return.

Court's Reasoning

The court relied on the plain language of section 951(d), which prevents the inclusion of any amount under Subpart F for a shareholder already subject to tax under the FPHC provisions. The court invalidated a Treasury regulation that attempted to limit this exclusion to only certain types of income, stating that the regulation was inconsistent with the statute. The court also addressed the constitutional issue by affirming that the tax on the increase in earnings invested in U. S. property was a tax on income and thus within Congress's power under the 16th Amendment. Finally, the court held that the statute of limitations did not bar the IRS's action for 1963 because the Whitlocks did not provide adequate disclosure of the omitted income on their return.

Practical Implications

This decision clarifies that when a corporation qualifies as both a CFC and an FPHC, the FPHC provisions take precedence over Subpart F for the same taxable year, preventing double taxation. Practitioners should ensure that clients with foreign corporations understand the interplay between these two sets of rules and plan accordingly to avoid unintended tax consequences. The invalidation of the Treasury regulation highlights the importance of clear statutory language over regulatory interpretations. This case also reaffirms the constitutionality of taxing undistributed corporate income to shareholders under certain conditions, which may impact future challenges to similar tax provisions. Subsequent cases should consider this ruling when analyzing the taxation of foreign corporations under both FPHC and CFC regimes.