Bank of America National Trust and Savings Association v. Commissioner, 61 T. C. 752, 1974 U. S. Tax Ct. LEXIS 138, 61 T. C. No. 81 (1974)

Foreign taxes on gross income without deductions for costs and expenses are not creditable under IRC Section 901 as "income taxes. "

Summary

Bank of America sought a foreign tax credit for taxes paid to Thailand, the Philippines, Taiwan, and Buenos Aires, which were imposed on gross income from its banking operations. The Tax Court held that these taxes did not qualify as creditable "income taxes" under Section 901(b)(1) because they were levied on gross income without deductions, thus not reaching net gain or profit. The court followed the Court of Claims' precedent, affirming that only taxes likely to reach net income are creditable. This ruling reinforces the principle that the foreign tax credit is intended to mitigate double taxation of net income, not gross receipts.

Facts

Bank of America operated branches in Thailand, the Philippines, Taiwan, and Buenos Aires, Argentina, where it paid taxes on gross income from its banking activities. The taxes in question included the Thailand Business Tax, the Philippines Tax on Banks, the Taiwan Business Tax, and the City of Buenos Aires Tax on Profit-Making Activities. These taxes were calculated based on gross receipts without any deductions for costs or expenses. The bank claimed these taxes as foreign tax credits under Section 901 of the Internal Revenue Code.

Procedural History

The IRS disallowed the foreign tax credits, allowing deductions instead. Bank of America filed a petition in the U. S. Tax Court. Prior to this case, the Court of Claims had denied similar credits for the bank's taxes in Thailand, the Philippines, and Buenos Aires for earlier years, which decision was not appealed and formed the basis for the Tax Court's ruling.

Issue(s)

1. Whether Bank of America is collaterally estopped from arguing that the taxes paid to Thailand, the Philippines, and Buenos Aires are creditable under Section 901(b)(1)?
2. Whether the taxes paid to Thailand, the Philippines, Taiwan, and Buenos Aires qualify for the foreign tax credit under Sections 901(a) and 901(b)(1)?

Holding

1. No, because the court did not need to reach the issue of collateral estoppel given its agreement with the Court of Claims' interpretation of Section 901(b)(1).

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2. No, because these taxes were imposed on gross income without deductions, thus not satisfying the requirement of reaching net gain or profit as defined under Section 901(b)(1).

Court's Reasoning

The court followed the Court of Claims' interpretation that an "income tax" under Section 901(b)(1) must be designed to fall on some net gain or profit. The taxes in question, being based on gross income without deductions, did not meet this criterion. The court emphasized that the U. S. tax system targets net income, and the foreign tax credit is intended to avoid double taxation of such income. The court dismissed arguments based on U. S. taxes on gross income as exceptions that do not alter the general rule. It also noted that the statutory language of Section 901, mentioning "profits," supports the focus on net income. The existence of Section 903, which allows credits for taxes "in lieu of" net income taxes, further reinforced the court's interpretation that Section 901(b)(1) does not extend to gross income taxes.

Practical Implications

This decision clarifies that foreign taxes on gross income without deductions for costs and expenses are not creditable under Section 901. It impacts multinational corporations by limiting the scope of foreign tax credits, potentially increasing U. S. tax liabilities where foreign taxes are structured on gross income. Legal practitioners must carefully analyze the structure of foreign taxes to determine their creditable status. The ruling may influence future tax treaties and legislation to address the treatment of gross income taxes. Subsequent cases, such as those involving formulary income taxes, have distinguished this ruling by allowing credits where taxes are designed to reach net income through presumptive expense allowances.

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