Miami Purchasing Service Corp. v. Commissioner, 76 T. C. 818 (1981)

To qualify as a Western Hemisphere trade corporation, 95% of gross income must be derived from non-U. S. sources, determined by where title to goods passes.

Summary

Miami Purchasing Service Corp. and Miami Aviation Service, Inc. , sought to qualify as Western Hemisphere trade corporations under IRC section 921 to claim a special deduction under IRC section 922. The key issue was whether their income was derived from non-U. S. sources, as required by the statute. The Tax Court held that the corporations failed to prove that 95% of their gross income was from non-U. S. sources because title to the goods passed within the U. S. according to the F. O. B. terms used in their invoices. The court emphasized the legal significance of these terms and the lack of evidence showing an intent to pass title outside the U. S. , thus denying the deduction.

Facts

Miami Purchasing Service Corp. and Miami Aviation Service, Inc. , were engaged in selling and exporting domestically produced goods to Western Hemisphere countries. Both corporations filed for a Western Hemisphere trade corporation deduction under IRC section 922 for the tax years 1974-1976. Miami Purchasing sold goods to Double A Leasing Corp. , a U. S. entity, which were then exported to Costa Rica. Miami Aviation sold goods to the Panamanian National Guard, with goods loaded onto Panamanian aircraft at Miami International Airport. Both corporations used the F. O. B. term on their invoices, indicating that title to the goods passed in Miami.

Procedural History

The IRS issued deficiency notices for both corporations for the tax years in question. The corporations petitioned the U. S. Tax Court, arguing that they were entitled to the Western Hemisphere trade corporation deduction. The Tax Court consolidated the cases for trial and opinion, ultimately ruling in favor of the Commissioner.

Issue(s)

1. Whether the statute of limitations barred the assessment and collection of any deficiencies against the petitioners?
2. Whether more than 5% of each petitioner’s gross income for the 3-year period immediately preceding the close of each taxable year in issue was derived from sources within the United States, thereby precluding them from claiming the Western Hemisphere trade corporation deduction?

Holding

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1. No, because the statute of limitations was extended by agreement until December 31, 1978, and the notices of deficiency were mailed on December 26, 1978, within the extended period.
2. Yes, because the petitioners failed to prove that 95% or more of their gross income for the relevant periods was derived from sources without the United States, as required by IRC section 921(a). The court found that the use of F. O. B. terms on invoices indicated that title to the goods passed within the U. S.

Court’s Reasoning

The court applied the title-passage test to determine the source of income under IRC sections 861 and 862. The well-defined, commercially recognized meaning of the F. O. B. term, as per the Uniform Commercial Code, was used to conclude that title to the goods passed in Miami, not outside the U. S. The court rejected the petitioners’ argument that they intended for title to pass outside the U. S. , emphasizing the lack of written agreements and the significance of the F. O. B. terms used. The court also noted that the insurance policies did not alter the commercial understanding of the F. O. B. terms. The policy considerations included the need for clear compliance with statutory requirements for tax deductions, emphasizing that deductions are a matter of legislative grace and require strict adherence to the law’s terms.

Practical Implications

This decision underscores the importance of clearly documenting where title to goods passes in international transactions to qualify for tax benefits like the Western Hemisphere trade corporation deduction. Businesses must be meticulous in using terms like F. O. B. and C. I. F. and should ensure that their contractual agreements explicitly state the intent for title to pass outside the U. S. if they wish to claim foreign-source income. This case has been influential in subsequent rulings on the sourcing of income for tax purposes, emphasizing the need for strict adherence to statutory requirements. It serves as a reminder to businesses to align their transactional practices with tax law to avoid unintended tax consequences.

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