U. S. Padding Corp. v. Commissioner, 86 T. C. 187 (1986)

Administrative practices and policies of a foreign country can be considered 'laws' under IRC section 1504(d) for the purpose of allowing a U. S. corporation to consolidate its tax returns with a foreign subsidiary.

Summary

In U. S. Padding Corp. v. Commissioner, the Tax Court ruled that a U. S. corporation could consolidate its tax returns with its wholly owned Canadian subsidiary under IRC section 1504(d). The decision hinged on whether the subsidiary was maintained solely for complying with Canadian laws regarding title and operation of property. U. S. Padding formed Trans Canada Non Woven, Ltd. to operate in Canada due to an administrative practice by the Foreign Investment Review Agency, which favored incorporation for foreign entities. The court held that such administrative practices could be considered 'laws' under the statute, allowing consolidation and thus the offsetting of losses. This ruling broadens the interpretation of what constitutes foreign laws for tax purposes, impacting how U. S. corporations structure their foreign operations.

Facts

U. S. Padding Corp. , a Michigan-based company, formed Trans Canada Non Woven, Ltd. in 1977 to operate in Canada after purchasing assets in St. Catharines, Ontario. The operation was approved by Canada's Foreign Investment Review Agency (FIRA), which typically favored incorporation for foreign businesses. For fiscal years ending June 30, 1978, and June 30, 1979, Trans Canada operated at a loss, and U. S. Padding consolidated its tax returns with Trans Canada, claiming these losses. The IRS disallowed the consolidation, arguing Trans Canada was not formed solely to comply with Canadian laws regarding title and operation of property.

Procedural History

The IRS issued a statutory notice of deficiency to U. S. Padding for the fiscal years in question, disallowing the consolidation of returns with Trans Canada. U. S. Padding appealed to the Tax Court, which ruled in favor of the petitioner, allowing the consolidation of tax returns with its Canadian subsidiary.

Issue(s)

1. Whether the term 'laws of such country' in IRC section 1504(d) includes administrative practices and policies of a foreign country?

Holding

1. Yes, because the administrative practices and policies of Canada, particularly those of the Foreign Investment Review Agency, were such that U. S. Padding found

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it necessary to maintain Trans Canada as a Canadian corporation to operate in Canada.

Court's Reasoning

The Tax Court interpreted 'laws of such country' in IRC section 1504(d) to encompass not just explicit statutory or constitutional provisions but also any existing administrative practice or policy of a foreign country. The court relied on legislative history and prior IRS regulations to conclude that Congress intended to alleviate inequalities faced by U. S. corporations needing to form foreign subsidiaries. The court noted that the practice in Canada at the time was to approve foreign investments as Canadian corporations, with 90 to 95 percent of new businesses approved under this model. The court cited Booth Fisheries Co. , Ohio v. Commissioner, which supported the view that administrative practices could be considered within the scope of 'laws' under the statute. The court emphasized that Trans Canada's incorporation was necessary to operate in Canada due to these administrative practices.

Practical Implications

This decision expands the scope of what U. S. corporations can consider as foreign 'laws' for the purpose of tax consolidation under IRC section 1504(d). It allows U. S. companies to offset losses from foreign subsidiaries in contiguous countries if the subsidiary was formed due to administrative practices or policies. Legal practitioners should consider this ruling when advising U. S. corporations on structuring foreign operations, especially in countries with similar administrative approval processes. The decision may encourage more U. S. companies to incorporate foreign subsidiaries in countries like Canada, potentially affecting cross-border investment strategies. Subsequent cases, such as those involving other foreign jurisdictions, may reference this ruling to argue for broader interpretations of 'laws' under similar tax provisions.

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