Hunt v. Commissioner, 90 T. C. 1289 (1988)

Income from sales of backup crude oil is sourced according to the title passage rule, not the location of the original production.

Summary

Hunt International Petroleum Co. (HIPCO) sold backup Persian Gulf crude oil received under the Libyan Producers' Agreement (LPA) following Libyan production cutbacks. The issue was whether the income from these sales should be sourced in Libya for foreign tax credit purposes. The U. S. Tax Court held that the income must be sourced in the Persian Gulf nations where title to the oil passed to HIPCO's customers, applying the title passage rule under IRC § 861(a)(6) and § 862(a)(6). The decision emphasized the actual point of sale over the indirect connection to Libyan production, impacting how similar transactions are treated for tax purposes.

Facts

HIPCO, a partnership owned by the Hunt family, was involved in oil production in Libya under Concession No. 65. Due to Libyan government actions, including nationalization and production cutbacks, HIPCO entered into the Libyan Producers' Agreement (LPA) with other oil companies. Under the LPA, HIPCO was entitled to receive substitute Libyan crude and backup Persian Gulf crude oil at 'tax-paid cost' when its production was cut. HIPCO sold this backup crude oil to its customers, with title passing at Persian Gulf ports. The sales occurred in 1974, and HIPCO claimed foreign tax credits based on the income sourced in Libya.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Hunts' income taxes for the years 1972-1978, disallowing the carryover of 1973 Libyan tax credits to 1974 due to the sourcing of income from backup crude oil. The Hunts contested this in the U. S. Tax Court, which consolidated the cases and ultimately ruled in favor of the Commissioner's position.

Issue(s)

1. Whether income from sales of backup Persian Gulf crude oil received under the LPA should be sourced in Libya for purposes of calculating the Hunts' foreign tax credit under IRC § 901.

Holding

1. No, because the income from the sales of backup Persian Gulf crude oil is sourced in the Persian Gulf nations where title passed to the buyer, under the title passage rule as outlined in IRC § 861(a)(6) and § 862(a)(6).

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Court’s Reasoning

The court applied the title passage rule, determining that the income from the sales of backup crude oil was sourced in the Persian Gulf nations, where the actual transfer of title to the oil occurred. The court rejected the Hunts’ arguments that the income should be sourced in Libya due to its indirect connection to Libyan production cutbacks. The court emphasized that the income was derived from HIPCO’s purchase and subsequent sale of the oil, not from its Libyan operations. The court also noted that the LPA facilitated a purchase and sale arrangement, not merely a risk-sharing or compensation scheme. The decision was in line with the purpose of the foreign tax credit provisions to prevent double taxation while ensuring proper allocation of income sources.

Practical Implications

This decision clarifies that income from sales of backup or substitute crude oil must be sourced where the title to the oil is transferred to the buyer, not where the original production occurred or where the oil was intended to be sourced. This impacts how multinational oil companies structure their sales agreements and manage their tax liabilities, particularly in situations involving substitute or backup oil supplies. The ruling may influence how similar agreements and transactions are drafted and interpreted for tax purposes, ensuring that the location of title passage is a critical factor in income sourcing. Subsequent cases have continued to apply the title passage rule in similar contexts, reinforcing its significance in tax law.

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