Vulcan Materials Company and Subsidiaries, Petitioner v. Commissioner of Internal Revenue, Respondent, 96 T. C. 410, 1991 U. S. Tax Ct. LEXIS 13, 96 T. C. No. 13 (1991)

In calculating indirect foreign tax credits under Section 902, only the portion of a foreign corporation's accumulated profits allocable to U. S. shareholders should be considered in the denominator of the credit formula.

Summary

Vulcan Materials Co. challenged the IRS's calculation of its indirect foreign tax credit under Section 902 for dividends received from Tradco-Vulcan Co. , Ltd. (TVCL), a mixed corporation in Saudi Arabia. The issue was whether the term 'accumulated profits' in the denominator of the Section 902 formula should include all of TVCL's profits or only those allocable to U. S. shareholders, given that Saudi tax law only taxed the portion of profits attributable to non-Saudi shareholders. The U. S. Tax Court held that 'accumulated profits' should be limited to the portion allocable to U. S. shareholders, aligning the indirect credit with the objectives of avoiding double taxation and treating foreign subsidiaries similarly to branches.

Facts

Vulcan Materials Co. owned 48% of TVCL, a Saudi Arabian corporation, with the remaining shares split between other U. S. corporations and a Saudi Arabian company, Tradco. TVCL's profits were allocated to shareholders based on their ownership percentages. Under Saudi law, only the portion of TVCL's profits allocable to non-Saudi shareholders was subject to Saudi income tax, while the portion allocable to Saudi shareholders was subject to a capital tax called Zakat. In 1984, Vulcan received dividends from TVCL and claimed an indirect foreign tax credit under Section 902. The IRS calculated the credit using TVCL's total accumulated profits in the denominator, while Vulcan argued that only the portion of profits allocable to U. S. shareholders should be used.

Procedural History

The IRS determined a deficiency in Vulcan's 1984 federal income tax, leading Vulcan to petition the U. S. Tax Court. The court addressed the sole issue of the proper calculation of the indirect foreign tax credit under Section 902, considering the interpretation of 'accumulated profits' in the formula.

Issue(s)

1. Whether the term 'accumulated profits' in the denominator of the Section 902 formula should include all of TVCL's profits or only the portion allocable to U. S. shareholders, given the unique structure of Saudi tax law?

Holding

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1. No, because the court determined that ‘accumulated profits’ under Section 902 should be limited to the portion of TVCL’s profits allocable to U. S. shareholders, in line with the objectives of the foreign tax credit and to avoid double taxation.

Court’s Reasoning

The court analyzed the statutory language of Section 902, finding it ambiguous regarding whether ‘accumulated profits’ should include all profits or only those subject to foreign tax. The court looked to the objectives of the foreign tax credit, as articulated in United States v. Goodyear Tire & Rubber Co. , to avoid double taxation and treat foreign subsidiaries similarly to branches. The court reasoned that using only the portion of profits allocable to U. S. shareholders in the denominator aligned with these objectives, as it would prevent double taxation on the U. S. shareholders’ share of profits. The court rejected the IRS’s argument that Goodyear required using all profits, noting that Goodyear addressed the methodology for calculating income, not the apportionment of profits. The court also found support for its interpretation in prior rulings and examples where the IRS had used a sourcing method for profits.

Practical Implications

This decision provides clarity on the calculation of indirect foreign tax credits under Section 902 for U. S. shareholders of mixed corporations in countries with unique tax structures. It emphasizes that the denominator of the credit formula should reflect only the portion of foreign corporation profits allocable to U. S. shareholders, ensuring that the credit accurately offsets the foreign taxes borne by those shareholders. This ruling may influence how similar cases are analyzed, particularly those involving mixed corporations and differential tax treatment of shareholders. It also highlights the importance of considering the economic burden of foreign taxes in apportioning indirect credits, which may impact tax planning and compliance strategies for multinational corporations. Subsequent cases may need to address how this ruling applies to other countries with similar tax regimes.

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