Riggs National Corp. & Subsidiaries v. Commissioner, 107 T. C. 301 (1996)

A foreign tax credit must be reduced by the amount of any subsidy received by the foreign borrower, as determined by the foreign tax or its base.

Summary

Riggs National Corporation sought foreign tax credits for Brazilian withholding taxes on interest payments from its loans to Brazilian borrowers. The court held that the credit for taxes paid by non-tax-immune borrowers must be reduced by the pecuniary benefits these borrowers received from the Brazilian government. However, the court ruled that the Central Bank, being tax-immune, was not legally liable for withholding taxes on its interest payments, thus disallowing credits for those payments.

Facts

Riggs National Corporation, a U. S. bank, made loans to borrowers in Brazil, including during a period when Brazil restructured its foreign debt. Non-tax-immune Brazilian borrowers paid withholding taxes on interest payments to Riggs, while the Central Bank of Brazil, a tax-immune entity, also paid withholding taxes on interest during the restructuring period. Riggs claimed foreign tax credits for these payments but did not initially reduce the credit by the pecuniary benefits provided by the Brazilian government to the borrowers.

Procedural History

Riggs filed its income tax returns for 1980-1986, claiming foreign tax credits for Brazilian withholding taxes. The IRS challenged these credits, leading to a dispute over the legal liability for the taxes and the impact of subsidies. The case was heard by the U. S. Tax Court, which issued its decision on December 10, 1996.

Issue(s)

1. Whether Riggs is legally liable for Brazilian withholding taxes paid by non-tax-immune Brazilian borrowers on their net loan interest remittances to Riggs?
2. Whether the Central Bank's purported withholding tax payments on its Brazilian restructuring debt interest remittances are creditable to Riggs?
3. Whether the foreign tax credit claimed by Riggs must be reduced by the pecuniary benefit provided by the Brazilian Government to the Brazilian borrowers?

Holding

1. Yes, because under Brazilian law, Riggs is considered legally liable for the withholding taxes paid by non-tax-immune borrowers.
2. No, because the Central Bank, being tax-immune under Brazilian law, is not legally liable for the withholding taxes, and thus, these payments are not creditable

to Riggs.
3. Yes, because the regulations require that the foreign tax credit be reduced by any pecuniary benefit received by the borrowers, as these benefits are determined by the foreign tax or its base.

Court’s Reasoning

The court applied U. S. tax principles to determine the creditable nature of the foreign taxes, while considering Brazilian law for legal liability. The court found that non-tax-immune borrowers were required to withhold taxes under Brazilian law, making Riggs legally liable for those taxes. However, the Central Bank’s tax immunity under Article 19 of the Brazilian Constitution exempted it from withholding taxes on net loans. The court rejected Riggs’ arguments about the applicability of certain Brazilian Supreme Court decisions and the act of state doctrine. The court upheld the validity of U. S. regulations requiring the reduction of foreign tax credits by subsidies received by foreign borrowers, as these regulations were consistent with the purpose of the credit to mitigate double taxation.

Practical Implications

This decision impacts how U. S. taxpayers analyze foreign tax credits, especially when foreign governments provide subsidies linked to taxes. Taxpayers must carefully assess the legal liability for foreign taxes and adjust their credits for any subsidies received by foreign entities. The ruling underscores the importance of understanding foreign tax laws and their interaction with U. S. tax regulations. Subsequent cases, such as Norwest Corp. v. Commissioner and Continental Ill. Corp. v. Commissioner, have followed this precedent, further shaping the application of foreign tax credits in similar scenarios.

