The Limited, Inc. v. Commissioner of Internal Revenue, 113 T. C. 169, 1999 U. S. Tax Ct. LEXIS 40, 113 T. C. No. 13 (1999)

Deposits by a controlled foreign corporation in a related domestic bank do not qualify for the exception from U. S. property under IRC section 956(b)(2)(A) and thus may be treated as subpart F income.

Summary

The Limited, Inc. had a subsidiary, World Financial Network National Bank (WFNNB), a domestic credit card bank, and a controlled foreign corporation, Mast Industries (Far East) Ltd. (MFE), with a subsidiary, MFE (Netherlands Antilles) N. V. (MFE N. V.). MFE N. V. purchased certificates of deposit (CDs) from WFNNB, which were then used to reduce WFNNB's debt to The Limited. The IRS argued these CDs were U. S. property under IRC section 956, thus triggering subpart F income for The Limited. The Tax Court agreed, holding that the CDs were not exempt as 'deposits with persons carrying on the banking business' due to WFNNB's limited activities and the related-party nature of the transaction. The court's decision was based on the legislative intent to tax repatriated earnings of controlled foreign corporations, particularly when invested in related U. S. entities.

Facts

The Limited, Inc. , a major U. S. retailer, operated through various subsidiaries, including World Financial Network National Bank (WFNNB), a domestic credit card bank, and Mast Industries (Far East) Ltd. (MFE), a controlled foreign corporation in Hong Kong. MFE had a subsidiary, MFE (Netherlands Antilles) N. V. (MFE N. V.), which in January 1993 purchased certificates of deposit (CDs) worth $174. 9 million from WFNNB. These funds were used to reduce a line of credit that WFNNB owed to another Limited subsidiary, Limited Service Corp. The IRS challenged this transaction, claiming it constituted an investment in U. S. property under IRC section 956, thereby requiring The Limited to include the amount in gross income as subpart F income.

Procedural History

The IRS issued a notice of deficiency to The Limited, Inc. , determining tax deficiencies for the years ending February 1, 1992, and January 30, 1993, due to the CDs purchased by MFE N. V. from WFNNB. The Limited contested this in the U. S. Tax Court, which ruled in favor of the IRS, holding that the CDs were U. S. property and not exempt under IRC section 956(b)(2)(A).

Issue(s)

1. Whether the certificates of deposit purchased by MFE N. V. from WFNNB are considered U. S. property under IRC section 956(b)(1)(C)?
2. Whether these certificates of deposit qualify as an exception under IRC section

© 2025 SCOTUSreports.com. All rights reserved.

956(b)(2)(A) as ‘deposits with persons carrying on the banking business’?

Holding

1. Yes, because the CDs are obligations of a U. S. person and do not fit within any exceptions to U. S. property.
2. No, because WFNNB does not carry on the ‘banking business’ as intended by Congress in IRC section 956(b)(2)(A), and the related-party nature of the transaction aligns with the dividend equivalency theory underlying subpart F.

Court’s Reasoning

The Tax Court analyzed the legislative history of subpart F, noting its aim to tax repatriated earnings of controlled foreign corporations when invested in U. S. property, particularly related U. S. entities. The court found that WFNNB, limited to credit card operations and unable to provide typical banking services, did not carry on the ‘banking business’ as intended by Congress. Additionally, the court inferred a related-party prohibition in the deposit exception based on the overall purpose of subpart F to tax repatriated earnings used by U. S. shareholders. The court also upheld the IRS’s attribution of the CDs to MFE under temporary regulations, as a principal purpose for creating MFE N. V. was to avoid subpart F income. The court emphasized the dividend equivalency theory, concluding that the CDs’ purchase by MFE N. V. and subsequent use by The Limited was substantially equivalent to a dividend.

Practical Implications

This decision impacts how multinational corporations structure their transactions with related domestic banks to avoid triggering subpart F income. It clarifies that deposits by controlled foreign corporations in related domestic banks may be treated as U. S. property, subject to taxation under subpart F, especially if the domestic bank’s activities are limited. This ruling influences tax planning strategies, encouraging the use of unrelated banks for deposits to avoid subpart F implications. Subsequent cases have cited this decision when analyzing similar transactions, reinforcing the principle that the nature of the banking activities and related-party status are crucial in determining subpart F income.

© 2025 SCOTUSreports.com. All rights reserved.