Varian Medical Systems, Inc. v. Commissioner, 163 T. C. No. 4 (2024)

The U. S. Tax Court ruled that Varian Medical Systems, Inc. could deduct dividends deemed received under IRC Section 78 during a gap period created by the Tax Cuts and Jobs Act (TCJA), where Section 245A was effective but amendments to Section 78 were not. This decision highlights the significance of statutory text and effective dates in tax law, allowing certain fiscal year taxpayers to claim deductions that would otherwise be disallowed.

Parties

Varian Medical Systems, Inc. and its subsidiaries, as the Petitioner, brought this action against the Commissioner of Internal Revenue, as the Respondent, before the United States Tax Court.

Facts

Varian Medical Systems, Inc. , a U. S. corporation, operates through subsidiaries in various countries, including controlled foreign corporations (CFCs) with fiscal years not aligned with the calendar year. For the fiscal year ending September 28, 2018, Varian filed a consolidated federal income tax return, electing to claim foreign tax credits under IRC Section 960. Varian included a section 78 dividend of approximately $159 million in its taxable income and claimed a deduction of approximately $60 million under Section 245A for this deemed dividend. The Commissioner issued a Notice of Deficiency disallowing the Section 245A deduction and increasing the section 78 dividend by $1. 9 million. Varian petitioned the Tax Court for a redetermination, seeking to claim additional Section 245A deductions related to its lower-tier CFCs.

Procedural History

Varian filed a Motion for Partial Summary Judgment seeking a determination that it was entitled to a deduction under Section 245A for its section 78 dividend for the 2018 tax year. The Commissioner filed a Cross-Motion for Partial Summary Judgment, arguing the opposite. After briefing and a hearing, the Tax Court issued its opinion, granting Varian’s motion in part and the Commissioner’s motion in part.

Issue(s)

Whether Varian Medical Systems, Inc. is entitled to a deduction under IRC Section 245A for dividends deemed received under IRC Section 78 for its 2018 tax year, given the effective date mismatch between Section 245A and the amendments to Section 78 under the Tax Cuts and Jobs Act?

Rule(s) of Law

IRC Section 245A, enacted by the TCJA, allows a domestic corporation a deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations. IRC Section 78, as it existed before the TCJA amendments, provides that certain amounts deemed paid by a domestic corporation under Section 960 shall be treated as dividends received for purposes of the Code, excluding Section 245. The TCJA amended Section 78 to exclude Section 245A dividends, but this amendment had a different effective date from Section 245A.

Holding

The Tax Court held that Varian is entitled to a deduction under Section 245A for amounts properly treated as dividends under Section 78 for its 2018 tax year. The Court further held that Treasury Regulation § 1. 78-1 does not alter this conclusion and that IRC Section 245A(d)(1) disallows foreign tax credits to the extent they are attributable to amounts treated as dividends under Section 78 and deducted under Section 245A.

Reasoning

The Court's reasoning focused on the plain text of the relevant statutory provisions. Section 245A allows a deduction for any dividend received from a specified 10-percent owned foreign corporation, and Section 78 treats certain amounts as dividends received for all purposes of the Code except Section 245. The effective date mismatch between Section 245A and the amendments to Section 78 created a window during which Section 245A was in effect but the amendments to Section 78 were not, allowing fiscal year taxpayers like Varian to claim the deduction. The Court rejected the Commissioner's arguments that Section 78 dividends were not qualifying dividends under Section 245A, emphasizing that the statutory text did not require an actual distribution. The Court also found that Treasury Regulation § 1. 78-1 could not override the clear statutory text, and that Section 245A(d)(1) properly limited Varian's foreign tax credits.

Disposition

The Tax Court granted Varian's Motion for Partial Summary Judgment to the extent it sought a deduction under Section 245A for its section 78 dividend and denied the Commissioner's Motion to the extent it sought the opposite conclusion. The Court granted the Commissioner's Motion so far as it sought to limit Varian's foreign tax credits under Section 245A(d)(1).

Significance/Impact

This case clarifies the interaction between Section 245A and Section 78 dividends during the gap period created by the TCJA's effective date provisions. It underscores the importance of adhering to statutory text and effective dates in tax law, potentially affecting other taxpayers with fiscal years who might benefit from similar deductions. The decision also highlights the limits of agency regulations in altering clear statutory provisions and the application of Section 245A(d)(1) in limiting foreign tax credits related to Section 78 dividends.

