Eaton Corporation and Subsidiaries v. Commissioner of Internal Revenue, 164 T. C. No. 4 (U. S. Tax Ct. 2025)

In a significant ruling on foreign tax credits, the U. S. Tax Court denied Eaton Corporation's claim for deemed-paid foreign tax credits under sections 902 and 960 of the Internal Revenue Code. The decision hinges on the interposition of a domestic partnership between two tiers of foreign corporations, which the court found precludes Eaton from claiming credits for taxes paid by lower-tier corporations. This ruling underscores the strict interpretation of statutory provisions governing foreign tax credits and the consequences of corporate structuring on tax outcomes.

Parties

Eaton Corporation and Subsidiaries (Petitioner) v. Commissioner of Internal Revenue (Respondent). Petitioner is the domestic parent corporation of a multi-tier corporate structure, while Respondent is the federal official responsible for enforcing the Internal Revenue Code.

Facts

Eaton Corporation, a domestic corporation, was the ultimate parent of two tiers of controlled foreign corporations (CFCs) with a domestic partnership, Eaton Worldwide, LLC (EW LLC), interposed between the tiers. For tax years 2007 and 2008, EW LLC included in its gross income the subpart F income and amounts determined under section 956 from the lower tier CFCs. However, EW LLC made no distributions to its partners, the upper tier CFCs, during these years. Consequently, Eaton did not increase its gross income based on EW LLC's inclusions under section 951. In a prior case, Eaton I, the court held that EW LLC's inclusions under section 951 increased the earnings and profits (E&P) of its partners, all of which were CFCs.

Procedural History

The case was before the U. S. Tax Court on cross-motions for partial summary judgment filed by Eaton and the Commissioner. The court had previously addressed the impact of section 951 inclusions on the E&P of the upper tier CFCs in Eaton I. The current motions sought a ruling on Eaton's entitlement to deemed-paid foreign tax credits under sections 902 and 960 for taxes paid by the lower tier CFCs.

Issue(s)

Whether Eaton Corporation is entitled to foreign tax credits under sections 902 and 960 for income taxes paid or accrued by the lower tier of foreign corporations owned by EW LLC, despite no distributions being made by EW LLC to its partners in 2007 and 2008?

Rule(s) of Law

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Sections 902 and 960 of the Internal Revenue Code govern the availability of deemed-paid foreign tax credits. Section 902 allows a domestic corporation to claim a credit for foreign income taxes deemed paid on dividends received from a foreign corporation. Section 960 extends this rule to include section 951 inclusions as if they were dividends, provided the inclusions are in the gross income of a domestic corporation. The court must strictly construe these statutory provisions.

Holding

The U. S. Tax Court held that Eaton Corporation is not entitled to foreign tax credits under sections 902 and 960 for taxes paid by the lower tier of foreign corporations, as no dividends were received from these corporations and the section 951 inclusions were not included in the gross income of a domestic corporation.

Reasoning

The court's reasoning focused on the plain text of sections 902 and 960. Section 902 requires the receipt of dividends to trigger the deemed-paid credit, which did not occur in this case. Section 960 allows for the treatment of section 951 inclusions as dividends for the purpose of section 902, but only if the inclusions are in the gross income of a domestic corporation. Here, the inclusions were in the gross income of EW LLC, a domestic partnership, not a domestic corporation. The court rejected Eaton's argument that the upper tier CFCs should be treated as domestic corporations for the purpose of section 960, emphasizing that different statutory rules govern the calculation of gross income and E&P. The court also noted that Eaton's corporate structuring choice, by interposing a partnership between the tiers of CFCs, led to this outcome, underscoring the principle that taxpayers must accept the tax consequences of their chosen structures.

Disposition

The court granted summary judgment in favor of the Commissioner, denying Eaton's claim for deemed-paid foreign tax credits for the taxes paid by the lower tier CFCs.

Significance/Impact

This decision reaffirms the strict interpretation of the statutory provisions governing foreign tax credits and underscores the importance of corporate structuring in tax planning. It highlights that the interposition of a domestic partnership between tiers of foreign corporations can significantly impact the availability of foreign tax credits. The ruling may influence how multinational corporations structure their ownership of foreign subsidiaries to optimize their tax positions under the Internal Revenue Code.

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