

Foreign Tax Credit Developments

Recent Cases and Rulings

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Bank of New York Mellon Corp. v. Commissioner 2d Cir. September 9, 2015

- Taxpayers entered into foreign tax credit generating transactions, including Structured Trust Advantaged Repackaged Securities (STARS), that raised two issues:
 - Does the economic substance doctrine apply to the foreign tax credit regime.
 - If so, how are foreign taxes taken into account in determining pre-tax profitability.
- *Salem Financial Inc.* (Fed. Cir. May 14, 2015) also involved STARS:
 - Foreign taxes are economic costs deductible in determining profits, so
 - Profit (Loss) = Income – Expenses (including foreign taxes).
- *Compaq Computer Corp.* (5th Cir. 2001) and *IES Industries, Inc.* (8th Cir. 2001):
 - Foreign taxes are not economic costs and are not deductible, so
 - Profit (Loss) = Income – Expenses (excluding foreign taxes).

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- Alternate approach suggested by *Compaq Computer Corp.*:
 - Include the effects of both foreign taxes and the foreign tax credit, so
 - Profit (Loss) = Income – Expenses (including foreign taxes) + Foreign tax credit.
- *BNY Mellon* agrees with *Salem Financial*
 - Foreign taxes are an economic cost; foreign tax credit is not part of Profit.
 - “The purpose of calculating pre-tax profit in this context is not to perform mere financial accounting, subtracting costs from revenue on a spreadsheet: It is to discern, as a matter of law, whether a transaction meaningfully alters a taxpayer’s economic position other than with respect to tax consequences.”

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- The Second Circuit in *BNY Mellon* holds that:
 - The economic substance doctrine can be applied to disallow a claim for foreign tax credits.
 - Foreign taxes are economic costs that should be deducted when calculating pre-tax profit.
 - It is appropriate, in calculating pre-tax profit, for a court to include foreign taxes paid and to exclude the foreign tax credits claimed.
 - In determining whether a transaction lacks economic substance, we consider whether the taxpayer had an objectively reasonable expectation of profit, apart from tax consequences, from the transaction, and whether the taxpayer had a subjective non-tax business purpose in entering the transaction.
 - Note that the codification of the economic substance doctrine in Code § 7701(o) did not apply to this case.

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- Thus, there is a split between the 5th and 8th Circuits, on the one hand, and the Federal and 2nd Circuits, on the other hand.
- On September 29, 2015, Salem Financial filed a petition asking the Supreme Court to address the circuit split.
 - “The Federal Circuit employs the economic substance doctrine not to inform the application of the extensive regulatory framework governing foreign tax credits, but as an amorphous threshold inquiry that threatens to render the entire foreign tax credit regulatory framework irrelevant.”
 - Even if the Supreme Court grants *certiorari*, its potential decision could be limited to the narrow question of whether to treat foreign taxes as a cost in determining profitability, and not the larger question of the applicability of the economic substance doctrine.

Albamarle Corporation & Subsidiaries v. United States
Fed. Cir. August 13, 2015

- This case involved the timeliness of a claim for refund under the 10-year statute of limitations in Section 6511(d)(3)(A) of the Code.
 - Under Section 6511(d)(3)(A), the period for claiming a credit or refund relating to any taxes paid or accrued to any foreign country for which credit is allowed against U.S. tax “shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were **actually paid or accrued**”.
 - At issue was whether the 10-year period starts (i) on the date for filing the return for the year in which the foreign taxes were imposed or (ii) on the date for filing the return for the year in which the foreign tax liability was finally determined with the foreign tax authorities.

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