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PUB-120698-98

1999-007
August 30, 1999
Attachment 1

REVISED ACTION ON DECISION

CHIEF COUNSEL:

Re:	Vulcan Materials Company and Subsidiaries v. Commissioner
Venue:	11th Cir.
Docket No.:	11680-88
Decision:	April 2, 1992
Opinion:	96 T.C. 410 (1991), aff'd per curiam, 959 F.2d 973 (11th Cir. 1992).

Tax, Years, and Amounts

Income, 1984, $133,679

Issue:

Whether the term "accumulated profits" as used in the denominator of the section 902 deemed paid credit fraction before the Tax Reform Act of 1986 means all of a foreign corporation's accumulated profits for the taxable year. This revised action on decision clarifies the Service's position on this issue in cases appealable to the 11th Circuit.

Discussion:

Vulcan is a domestic corporation that was a shareholder of a Saudi Arabian corporation that also had a Saudi shareholder. Saudi Arabia imposes a religious tax on its corporate nationals based on a percentage of net equity less net fixed assets, and subjects non-Saudi Arabian nationals to an income tax. When a corporation is owned partly by Saudi Arabians and partly by non-Saudi Arabians, Saudi Arabia imposes its income tax only on the portion of the corporation's net profits attributable to the stockholdings of the non-Saudi Arabian shareholders. Vulcan and the other shareholders set up shareholder level accounts of accumulated profits and reduced each shareholder's account by the tax for which each was liable. Thus, only the United States shareholders' share of accumulated profits was reduced by the Saudi income tax.

Section 902(a) as in effect during 1984, the taxable year at issue in Vulcan, provided that a domestic corporation owning at least 10 percent of the voting stock of a foreign corporation from which it received dividends would be deemed to have paid the same proportion of the foreign corporation's income tax paid to a foreign country for a particular taxable year "on or with respect to the accumulated profits of such foreign

corporation from which such dividends were paid, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of [income taxes paid]." The section 902 credit was computed according to the following formula:

$$\text{Foreign income taxes deemed paid} = \text{Foreign income taxes paid} \times \frac{\text{Dividends received}}{\text{Accumulated profits less foreign income taxes paid}}$$

By including only accumulated profits attributable to non-Saudi shareholders in the denominator of the deemed paid credit fraction, and reducing those profits by the entire Saudi income tax imposed on the corporation, Vulcan was able to reduce the denominator and significantly increase its section 902 credit.

The Tax Court found the statutory language of section 902(a) and regulations interpreting that language to be unclear. In particular, the Court was not persuaded that the reference to "accumulated profits" necessarily meant all of the foreign corporation's accumulated profits for the year. The Court interpreted the language "on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid" in section 902(a) as linking the taxes to be credited to the particular profits on which they were paid and, based in part on this reading, concluded that it could look to the portion of the accumulated profits on which the foreign tax was imposed. Turning to the purpose of section 902, the Court decided that petitioner's position produced a more equitable result and interpreted the policy behind section 902 to reach that result. In doing so, however, the Tax Court ignored contrary policy and legal principles that would preclude the result it reached.

The Tax Court's reliance on the "on or with respect to" language in section 902 prior to 1986 was misplaced. The "on or with respect to" language simply reflects the annual nature of the section 902 credit calculation prior to 1986, and does not permit or require the computation of the deemed paid credit using less than all of the foreign corporation's accumulated profits. "Accumulated profits" for purposes of section 902 generally are equated with, and determined in accordance with United States tax principles relating to pre-tax earnings and profits. See United States v. Goodyear Tire and Rubber Company, 493 U.S. 132, 139 (1989); section 1.902-3(e), Income Tax Regulations. Earnings and profits generally are determined at the corporate level and include all income earned by the corporation, whether or not all or any portion of the income is subject to tax. Thus, Saudi Arabia's imposition of an income tax on only the portion of the corporation's net profits attributable to the stockholdings of non-Saudi shareholders should not have influenced the determination of accumulated profits for purposes of computing the section 902 credit.

In Goodyear, the Supreme Court stated that the statutory canon that tax provisions should be read to incorporate domestic tax principles wherever possible

"has particularly strong application * * * where a contrary interpretation would leave an important statutory goal * * * to the varying tax policies of foreign tax authorities." Goodyear, 493 U.S. at 145. The Tax Court in Vulcan claimed to be following Goodyear. By taking foreign law into account in computing accumulated profits for purposes of section 902, however, the Tax Court's decision conflicts with the rule clearly articulated in Goodyear that the denominator of the section 902 fraction is based on earnings and profits computed in accordance with United States tax principles, and not on foreign taxable income.

The Tax Reform Act of 1986 revised section 902 to change the method of determining the amount of foreign taxes deemed paid from the use of annual layers of accumulated profits and associated taxes to the use of single multi-year pools of undistributed earnings and associated taxes. See H.R. Rep. (Conf.) 841, 99th Cong., 2d Sess. II-589 (1986). The 1986 Act changes to section 902(a) eliminated the language "on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid" that the Tax Court relied on in Vulcan to link the taxes to be credited to the particular profits on which they were paid. See H.R. Rep. (Conf.) 841, 99th Cong., 2d Sess. II-589 (1986). As amended in 1986, section 902 simply defines the pool of creditable taxes as "any income, war profits, or excess profits taxes paid by the foreign corporation" to the foreign taxing authority. See section 902(c)(4).

Section 902(c)(6) as amended in the 1986 Act provides that foreign taxes deemed paid with respect to post-1986 distributions out of accumulated profits of pre-1987 years, and distributions out of earnings of post-1986 years in which the ownership requirements of section 902(c)(3) are not yet satisfied, must be computed under the rules of section 902 as in effect before the effective date of the Tax Reform Act of 1986. The regulations under section 902 define post-1986 distributions to which old law applies collectively as "pre-1987 accumulated profits". See section 1.902-1(a)(10), Income Tax Regulations.

The regulations under section 902 reverse the Tax Court's decision in Vulcan for distributions in taxable years beginning after December 31, 1986, out of pre-1987 accumulated profits. In addition, the regulations make clear that the decision in Vulcan is not applicable to distributions out of post-1986 undistributed earnings. The regulations state that both post-1986 undistributed earnings and pre-1987 accumulated profits are determined at the corporate level, and include all of the foreign corporation's earnings and profits. Unless otherwise provided, special allocations of corporate earnings and taxes, whether required or permitted by foreign law or a shareholder agreement, are not permitted under section 902 and will be disregarded in computing foreign taxes deemed paid. See section 1.902-1(a)(9)(iv) and (a)(10)(ii), Income Tax Regulations.

The Service, therefore, does not acquiesce in the Tax Court's decision with respect to distributions of pre-1987 accumulated profits made in taxable years

beginning before January 1, 1987. Although we disagree with the decision of the Court, we recognize the precedential effect of the decision to cases appealable to the 11th Circuit, and therefore will follow it with respect to cases within that circuit, if the opinion cannot be meaningfully distinguished. We do not, however, acquiesce to the opinion and will continue to litigate our position in cases in other circuits.

The Service also does not acquiesce in the Tax Court's decision with respect to distributions made in taxable years beginning after December 31, 1986, out of pre-1987 accumulated profits.

Recommendation:

Nonacquiescence, and that the action on decision approved on February 13, 1995 be withdrawn and that this action be substituted therefor.

Reviewers:

_____
Anne O'Connell Devereaux
Attorney

Approved:

STUART L. BROWN
Chief Counsel

By: _____
Michael Danilack III
Associate Chief Counsel
(International)