

TaxNewsFlash

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U.S. Tax Court: Foreign tax credits for “compulsory levies” paid by Mexican branch

The U.S. Tax Court today issued an opinion holding that Mexican taxes paid by the U.S. taxpayer's Mexican licensee for 2007-2009 were “compulsory levies” for which the U.S. taxpayer was entitled to claim foreign tax credits under section 901(a).

The case is: *The Coca-Cola Co. v. Commissioner*, 149 T.C. No. 21 (December 14, 2017). Read the Tax Court's 32-page [opinion](#) [PDF 121 KB]

Background

The taxpayer is a U.S. corporation doing business in Mexico through a branch (licensee). For tax years 2007-2009, the licensee paid royalties to the taxpayer for the use of the taxpayer's intangible property, and the licensee claimed deductions for these royalties on its Mexican corporate income tax returns. The taxpayer reported all of the licensee's income on its U.S. consolidated federal income tax returns, and claimed foreign tax credits under section 901 for the corporate income taxes that the licensee had paid to Mexico.

The IRS examined the taxpayer's 2007-2009 returns, and determined substantial deficiencies as a result of transfer pricing adjustments under section 482. The IRS found that the royalties that the licensee had paid to the taxpayer were not at arm's length. A related finding by the IRS was that the licensee had claimed insufficient deductions for royalty payments on its Mexican tax returns and, to that extent, had overpaid its Mexican corporate income tax. The IRS found that, to the extent of the overpaid Mexican corporate income tax, the taxes paid to Mexico were not “compulsory” and were as such not “taxes.”

The taxpayer filed a motion for partial summary judgment with respect its claim for foreign tax credits. The transfer pricing issues are not part of this action and are pending adjudication.

Tax Court's opinion

The Tax Court concluded that the Mexican taxes paid by the licensee were "compulsory" levies for which the taxpayer was entitled to claim foreign tax credits under section 901(a). The court observed that:

- The taxpayer had calculated its Mexican tax liabilities "in a manner that is consistent with a reasonable interpretation and application of the * * * provisions of foreign law (including applicable tax treaties) in such a way as to reduce, over time, * * * [its] reasonably expected liability under foreign law for tax" pursuant to Reg. section 1.901-2(e)(5)(i).
- The taxpayer had "exhaust[ed] all effective and practical remedies, including invocation of competent authority procedures available under applicable tax treaties, to reduce, over time, * * * [its] liability for foreign tax" pursuant to Reg. section 1.901-2(e)(5)(i).

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