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U.S. Tax Court: Upper-tier CFC partners' E&P increased by partnership's section 951(a) income inclusions

The U.S. Tax Court today issued a "reviewed opinion" in which the majority concluded that the earnings and profits of upper-tier controlled foreign corporation partners of a U.S. domestic partnership must be increased as a result of the partnership's section 951(a) income inclusions.

The Tax Court granted the government's motion for summary judgment. The case is: *Eaton Corp. v. Commissioner*, 152 T.C. No. 2 (February 25, 2019)

Read the [Tax Court's opinion](#) [PDF 113 KB] that includes concurring and dissenting opinions.

Summary

A controlled foreign corporation (CFC) that is a partner in a domestic partnership must include in gross income its distributive share of that partnership's gross income—including amounts that the partnership included in income under section 951(a) with respect to any lower-tier CFCs. According to the IRS, the upper-tier CFC partners also must increase their earnings and profits (E&P) by that amount.

The amount of the upper-tier CFCs' E&P was relevant for purposes of applying section 956. The IRS and the taxpayer agreed that section 956 applied to the extent of the upper-tier CFC's applicable earnings, but disagreed on whether the CFC's distributive share of the domestic partnership's section 951(a) inclusion increased the CFC's E&P. The IRS argued that the CFC's E&P was increased, and thus, asserted that the correct amounts to be included in the taxpayer's gross income under sections 951 and 956 were approximately \$73 million and \$114 million for tax years 2007 and 2008, respectively.

The taxpayer countered that a domestic partnership's section 951(a) inclusions do not affect the E&P of its upper-tier CFC partners.

The Tax Court majority agreed with the IRS, holding that the E&P of the upper-tier CFC partners of the domestic partnership must be increased by their distributive share of the partnership's section 951(a) income inclusions.

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