United States Tax Court

158 T.C. No. 4

APTARGROUP INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 7218-20. Filed March 16, 2022.

P owns stock in a controlled foreign corporation (CFC) that apportioned interest expense under the modified gross income method. P claimed a foreign tax credit under I.R.C. § 904 with respect to tax imposed on its income from the CFC. To determine the amount of the foreign tax credit, P characterized its stock in the CFC using the asset method. Thus, P did not use the same method that the CFC used for interest expense apportionment. R issued a notice of deficiency to P denying the foreign tax credit. The parties have filed Cross-Motions for Partial Summary Judgment on the issue of whether P must use the modified gross income method to characterize the stock of its CFC for purposes of computing the foreign tax credit as it is the method that the CFC used to apportion interest expense.

Held, P's position is inconsistent with the proper application of Temp. Treas. Reg. § 1.861-9T(f)(3)(iv), which requires the U.S. shareholder of a CFC to characterize the stock of the CFC using the same method that the CFC used to apportion its interest expense and which is not limited by Temp. Treas. Reg. § 1.861-12T.

Served 03/16/22

Robert E. Dallman, John A Sikora, and *Courtney A. Hollander*, for petitioner.

Maha Sadek and *Naseem Jehan Khan,* for respondent.

OPINION

GOEKE, *Judge*: This case is before the Court on Cross-Motions for Partial Summary Judgment on the apportionment of interest expense with respect to petitioner's stock in a controlled foreign corporation (CFC) for purposes of the computation of a foreign tax credit. We will grant respondent's motion and deny petitioner's motion.

Background

There is no dispute as to the following facts, which are drawn from the Petition and the Stipulation of Facts. Petitioner is a U.S. corporation that filed a consolidated income tax return for 2014 and had its principal place of business in Illinois when it timely filed the Petition.

In December 2014 petitioner restructured its ownership of its foreign subsidiaries. Before the restructuring, petitioner directly owned 100% of AptarGroup Holdings, an entity organized under the laws of France (AGH France), which served as a global holding company for most of petitioner's foreign subsidiaries. Petitioner owned, directly or indirectly, 42 CFCs and also directly owned stock in other foreign corporations including noncontrolled foreign corporations as described in section 902.[1] As part of the restructuring, petitioner transferred ownership of substantially all of its foreign subsidiaries including AGH France to a Luxembourg holding company, AptarGroup Global Holding (AGH Lux). After the restructuring, petitioner wholly owned AGH Lux, which wholly owned, directly and indirectly, 32 CFCs. The CFCs held assets that generated foreign source income, and some also held assets that generated U.S. source income. Petitioner remained the direct owner of five CFCs.

[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code (Code), Title 26 U.S.C., in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

During 2014 petitioner paid or accrued interest expense or was deemed to have done so. On its 2014 return petitioner claimed a foreign tax credit of $3,539,543. On February 27, 2020, respondent issued a notice of deficiency to petitioner for 2014 disallowing the foreign tax credit in its entirety and determining a deficiency of $3,539,543 and a section 6662(a) accuracy-related penalty. The parties have filed Cross-Motions for Partial Summary Judgment with respect to the method that petitioner may use to apportion interest expense for purposes of calculating the foreign tax credit.

Discussion

The purpose of summary judgment is to expedite litigation and avoid costly, unnecessary, and time-consuming trials. *FPL Grp., Inc. & Subs. v. Commissioner*, 116 T.C. 73, 74 (2001). We may grant partial summary judgment when there is no genuine dispute of material fact and a decision may be rendered as a matter of law. Rule 121(b); *see Fla. Peach Corp v. Commissioner*, 90 T.C. 678, 681 (1988). The parties state that there is no genuine dispute of material fact affecting the method of interest expense apportionment, and we find no such dispute. The issue is solely a question of law. Accordingly, the issue may appropriately be adjudicated summarily.

I. *Foreign Tax Credit*

The United States taxes its citizens and domestic corporations on worldwide income. *See, e.g., Cook v. Tait*, 265 U.S. 47, 56 (1924); *Huff v. Commissioner*, 135 T.C. 222, 230 (2010). Because this policy creates the potential for double taxation, the Code allows U.S. citizens and domestic corporations a credit for income tax paid to a foreign country. § 901(a); *Am. Chicle Co. v. United States*, 316 U.S. 450 (1942); *Vento v. Commissioner,* 147 T.C. 198, 203–04 (2016), *supplemented by* 152 T.C. 1 (2019), *aff'd*, 836 F. App'x 607 (9th Cir. 2021). A domestic corporation may also claim a credit for tax that it is deemed to have paid or accrued. § 960. The extent to which a taxpayer is entitled to a foreign tax credit is determined by applying U.S. tax law; thus, the source of income depends on how U.S. tax law categorizes such income. *United States v. Goodyear Tire & Rubber Co.,* 493 U.S. 132 (1989); *Phillips Petroleum Co. v. Commissioner*, 104 T.C. 256, 295 (1995).

The Code limits the amount of a foreign tax credit to prevent taxpayers from using foreign tax to reduce U.S. tax on their U.S. source income. *Theo. H. Davies & Co. v. Commissioner*, 75 T.C. 443, 446 n.9

(1980), *aff'd per curiam*, 678 F.2d 1367 (9th Cir. 1982). The allowable foreign tax credit for a taxable year is the lesser of foreign tax paid or accrued (or so deemed) or the foreign tax credit limitation (FTC limitation). § 904(a). The foreign tax credit is limited to "the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States . . . bears to his entire taxable income for the same taxable year," and the FTC limitation is computed by multiplying total U.S. tax on worldwide income by a fraction with a numerator of foreign source taxable income and a denominator of worldwide taxable income. *Id.* Generally, in the case of an affiliated group of corporations, the foreign tax credit is determined on a consolidated basis. Treas. Reg. § 1.1502-4(c).

Where a taxpayer has more than one category of income as listed in section 904(d) (limitation category), the FTC limitation must be computed separately for each limitation category. § 904(d)(1). The FTC limitation is computed for the affiliated group, i.e, the totals for the affiliated group. Treas. Reg. § 1.1502-4(d). Petitioner earns income in more than one limitation category and must compute more than one FTC limitation. However, AGH Lux stock generates income from only one limitation category although it generates both foreign and U.S. source income.

II. *Sourcing Rules*

To compute the FTC limitation, the taxpayer must determine the source for its gross income. The sourcing rules are in the regulations under section 861, which are used in conjunction with operative sections of the Code, i.e., Code sections such as section 904 that require the taxpayer to determine taxable income from specific sources or activities. After determining the source of the gross income, the taxpayer must allocate each loss, expense, and other deduction (collectively, expense) to a class of gross income and then, if necessary, apportion the expense within the class of gross income between (or among) a statutory grouping and a residual grouping. *See* Treas. Reg. § 1.861-8(a)(2). A statutory grouping is gross income from the specific source or activity that is relevant for purposes of the operative section at issue, and the residual grouping is gross income from all other sources or activities. *Id.* subpara. (4). For purposes of the foreign tax credit, each limitation category is a statutory grouping, and a taxpayer claiming the credit must determine the foreign source taxable income in each limitation category in which it has income.

In general, expenses are allocated and apportioned on the basis of the factual relationship of the expense to gross income.[2] *Id.* subpara. (2). Expenses are allocated to the class of gross income to which they definitely relate. *Id.* para. (b)(1) and (2) (defining "definitely related"). Some expenses are not definitely related to a class of gross income or are related to all gross income and thus must be ratably allocated to all gross income. *Id.* Next, if necessary, expenses are apportioned between the statutory and residual groupings. *Id.* para. (c)(3).

III. *Special Rules for Interest Expense*

Special rules exist for allocation and apportionment of interest expense in Temporary Treasury Regulation § 1.861-9T (section -9T).[3] In general, interest expense is treated as related to all income-producing activities and assets regardless of the specific purpose for the borrowing, on the general principle that money is fungible, borrowing frees up other funds for other purposes, and management has flexibility as to the source and use of funds. *Id.* para. (a). Thus, interest expense must be ratably allocated to all gross income. Allocation is not at issue. Petitioner must allocate its interest expense to all its income-producing assets and activities. The parties disagree over the apportionment of the interest expense.

Section -9T sets out two methods for apportioning interest: the asset method and the modified gross income method, described at paragraphs (g) and (j), respectively. Domestic corporations must use the asset method. *Id.* para. (f)(1)(i). CFCs are permitted to choose either method subject to certain consistency requirements. *Id.* subpara. (3).

As a domestic corporation, petitioner apportioned its interest expense using the asset method. That method requires taxpayers to

---

[2] The gross income to which a specific deduction is factually related is referred to as a "class of gross income." Treas. Reg. § 1.861-8(b)(1). Classes of gross income are not predetermined; a taxpayer determines its classes of gross income on the basis of the deductions that it must allocate. *Id.* A class of gross income may consist of one or more items of gross income enumerated in section 61 such as compensation for services, gross income derived from business, interest, rents, royalties, dividends, or subdivisions of these items. Treas. Reg. § 1.861-8(a)(3). For allocation of interest expense, all the taxpayer's gross income is treated as one class.

[3] The relevant version of the temporary Regulation was effective from July 16, 2014, to December 7, 2016. The version of Temporary Treasury Regulation § 1.861-12T (section -12T) at issue was effective from August 4, 2009, to June 20, 2019.

apportion interest expense to the various statutory groupings on the basis of the average total value of assets assigned to each grouping for the year. *Id.* para. (g)(1). To apply the asset method, therefore, petitioner is required to divide the value of its assets among the relevant statutory groupings, a process the regulations define as "characterizing" the assets. *See id.* subparas. (1), (3). At issue is petitioner's method for characterizing its AGH Lux stock under these rules.

IV. *Asset Characterization*

Section -9T(g)(3) sets out general asset characterization rules for purposes of applying the asset method. However, the regulations also provide a special consistency rule regarding the characterization of CFC stock in the hands of any U.S. shareholder. Specifically, section -9T(f)(3)(iv) provides: "Pursuant to [section -12T(c)(2)], the stock of a controlled foreign corporation shall be characterized in the hands of any United States shareholder using the same method that the controlled foreign corporation uses to apportion its interest expense."[4]

Section -12T(c)(3) describes two methods for characterizing CFC stock, which are referred to as the asset method and the modified gross income method, and imposes the same consistency rule. That rule provides as follows:

> Stock in a controlled foreign corporation whose interest expense is apportioned on the basis of assets shall be characterized in the hands of its United States shareholders under the asset method described in paragraph (c)(3)(ii). Stock in a controlled foreign corporation whose interest expense is apportioned on the basis of gross income shall be characterized in the hands of its United States shareholders under the gross income method described in paragraph (c)(3)(iii).

Section -12T(c)(3)(i) (flush text).

AGH Lux elected to apportion interest expense using the gross income method, as it was entitled to do under section -9T(f)(3)(i). But in characterizing its AGH Lux stock, petitioner did not apply the special characterization rules of sections -9T(f)(3)(iv) and -12T(c)(3) that require consistency. Rather, petitioner relied on the general characterization

[4] The reference to paragraph (c)(2) appears to be a typo; section -12T(c)(3) describes the characterization of CFC stock.

rules of section -9T(g)(3). This choice allowed petitioner to reduce the amount of interest expense that it apportioned to foreign source income thereby increasing its foreign source taxable income and increasing its foreign tax credit.

Respondent argues that petitioner is not permitted to use the general characterization rules because sections -9T(f)(3)(iv) and -12T(c)(3)(i) required it to characterize its stock in AGH Lux using the modified gross income method described in section -12T(c)(3)(iii). Petitioner disagrees, arguing that sections -9T(f)(3)(iv) and -12T(c)(3)(i) do not apply on the facts of this case, and therefore, it was free to characterize its AGH Lux stock using the general asset characterization rules of section -9T(g)(3). For the reasons below, we agree with respondent.

We interpret regulations using canons of statutory construction, begin with the text of the regulation, and give effect to its plain meaning. *See Austin v. Commissioner,* 141 T.C. 551, 563 (2013). To determine the plain meaning, we must look to the text at issue as well as the text and design of the regulation as a whole. *K Mart Corp. v. Cartier, Inc.,* 486 U.S. 281, 291 (1988). "We interpret . . . regulations in toto rather than phrase by phrase." *Microsoft Corp. v. Commissioner*, 115 T.C. 228, 248–49 (2000) (citing *Norfolk Energy, Inc. v. Hodel,* 898 F.2d 1435, 1442 (9th Cir. 1990)), *rev'd and remanded*, 311 F.3d 1178 (9th Cir. 2002). A regulation should be interpreted so as to avoid conflict with the statute. *Phillips Petroleum Co. v. Commissioner*, 97 T.C. 30, 35 (1991), *aff'd without published opinion*, 70 F.3d 1282 (10th Cir. 1995). If a regulation is ambiguous, we must interpret the regulation in a manner that is "most harmonious with its scheme and with the general purposes." *NLRB v. Lion Oil Co.,* 352 U.S. 282, 297 (1957) (Frankfurter, J., concurring in part).

We begin by looking at the text of the relevant parts of the temporary regulations. Section -9T(f)(3) provides the CFC an election between the asset and the modified gross income methods, imposes the consistency requirement for purposes of interest expense apportionment in subdivision (iv), and refers to section -12T.

Section -9T(g)(1) describes the asset method and refers to paragraph (g)(3)(i) of that section and section -12T for asset characterization rules, providing as follows:

> Under the asset method, the taxpayer apportions interest expense to the various statutory groupings based on the average total value of assets within each such grouping for the taxable year, as determined under the asset valuation rules of this paragraph (g)(1) and paragraph (g)(2) of this section and the asset characterization rules of paragraph (g)(3) of this section and [section -12T]. . . .

Section -9T(f), after setting forth the asset method as the general rule, allows a CFC to elect to use the modified gross income method and expressly states the consequences of the election, that the U.S. shareholder of a CFC must characterize the CFC stock using the same method that the CFC used to apportion interest expense. Thus, under section -9T(f) the CFC's election of the modified gross income method binds the U.S. shareholder to that method. Petitioner argues that the modified gross income method is an exception to the consistency requirement. When we read section -9T(f)(3) in its entirety, it is clear that the election is not an exception. Rather, the consistency requirement is a condition of the election. The modified gross income method is an exception to the general rule of the asset method and is the reason for the consistency requirement. The consistency requirement is imposed because an election is provided.

Moreover, we disagree with petitioner that section -12T is determinative with respect to whether consistency is required on the facts here. Significantly, section -9T(f)(3)(iv) imposes the consistency requirement. That provision provides the rule, and section -12T is intended to supplement section -9T, including the consistency requirement that it imposes. We do not read the reference to section -12T in section -9T(f)(3)(iv) as limiting the application of the consistency requirement as petitioner suggests. Rather, it refers to section -12T as providing supplemental rules for the characterization of CFC stock. Section -9T(g)(1) and (3) also refers to section -12T as supplementing the rules contained therein. This conclusion is confirmed by section -9T(f)(4)(iii), which similarly cited section -12T(c) to establish a parallel rule for characterizing the stock of noncontrolled section 902 corporations. *See also* Treas. Reg. § 1.861-12(c)(4); section -12T(c)(4). Finally, section -9T(j), which describes the modified gross income method, states that it applies "[s]ubject to rules set forth in paragraph (f)(3)," reenforcing that use of the modified gross income method is subject to the consistency requirement.

Moreover, while petitioner argues that the introductory sentence of section -12T(a) excuses it from the consistency requirements of section -9T, section -12T(a) provides that "[t]hese rules are applicable to taxpayers in apportioning expenses under an asset method to income in various separate limitation categories under section 904(d), and supplement other rules provided in [sections -9T], 1.861-10T, and 1.861-11T." The concluding part of that sentence, "supplement other rules," establishes an additional purpose of the section -12T rules independent of section 904(d) apportionment. In 2019 the Secretary amended section -12T to clarify that it applies for all operative sections, not just section 904(d). *See* T.D. 9882, 84 Fed. Reg. 69022, 69070 (Dec. 17, 2019).

To summarize, we interpret the version of section -12T in effect for petitioner's 2014 taxable year. First and most significant, the consistency requirement of section -9T(f)(3)(iv) does not depend on whether section -12T applies. It imposes an independent consistency requirement for purposes of interest expense apportionment by a CFC that elected to use the modified gross income method. Furthermore, we do not agree that section -12T on its face provides the limitation that petitioner seeks. It is intended to supplement other rules including the section -9T provisions at issue here.

Petitioner's position is inconsistent with the proper application of section -9T. AGH Lux elected to use the modified gross income method to apportion interest expense; thus, petitioner must characterize its AGH Lux stock using the modified gross income method.

We have considered all other arguments made by the parties, and to the extent not discussed above find the arguments to be irrelevant, moot, or without merit. To reflect the foregoing,

An appropriate order will be issued.