Bank of America Nat'l. Trust & Savings Assn. v. United States
459 F.2d 513 (1972)
United States Court of Claims

BACKGROUND AND FACTS

Plaintiff Bank of America conducted a general banking business in the Kingdom of Thailand, the Republic of the Philippines, and the Republic of Argentina. With respect to this business, Bank of America paid the three jurisdictions various types of taxes. Bank of America demanded a credit for most of these assessments either on its federal income tax returns or by refund claim.

The Internal Revenue Service disallowed a number of the credits claimed and Bank of America appealed to a trial commissioner. The trial commissioner held for the Bank of America with respect to the Thailand Business Tax, Type 1 and Type 2; the Philippine Tax of Banks; and the City of Buenos Aires Tax on Profit-Making Activities. The matter was appealed to the Court of Claims.

JUDGE DAVIS

For a domestic corporation, §901(a) and (b)(1) of the Internal Revenue Code . . . allows a credit against federal income taxes of "the amount of any income, profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States." It is now settled that the question of whether a foreign tax is an "income tax" within §901(b)(1) must be decided under criteria established by our revenue laws and court decisions, and that the foreign tax must be the substantial equivalent of an income tax as the term is understood in the United States. . . .

[T]he Thailand Business Tax . . . states that . . . persons engaged in business have the duty to pay business tax on the "gross takings" for each tax month at [rates ranging from 2.5 percent to 10.5 percent]. "[G]ross takings" from the business of banking [are] (a) interest, discounts, fees, or service charges, and (b) profit, before the deduction of any expense, from the exchange, purchase, or sale of currency, issuance, purchase, or sale of notes or foreign remittances.

The City of Buenos Aires Tax on Profit-Making Activities . . . imposes a tax on the gross receipts of banks, insurance, savings and loan, and security and investment companies, and . . . provides that, in the case of banks and other lending institutions, "the taxable amount shall be composed of interest, discounts, profits from nonexempt taxable securities, and other revenue, resulting from profits and remuneration for service received in the course of the last business year."

The Philippines Tax on Banks provides . . . that there shall be collected a tax of 5 percent on the gross receipts derived by all banks doing business in the Philippines from interest, discounts, dividends, commission, profits from exchange, royalties, rentals of property, real and personal, and all other items treated as gross. . . . For none of the three taxes was the taxpayer permitted to deduct from gross income the costs or expenses of its banking business or of producing its net income.

The problem, then, is whether such imposts on gross banking income . . . are "income taxes" under the foreign tax credit—"income taxes" as we use that

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term in the federal system under our own revenue laws.

There is consensus on certain basic principles, in addition to the rule that the United States notion of income taxes furnishes the controlling guide. All are agreed that an income tax is a direct tax on gain or profits, and that gain is a necessary ingredient of income. . . . Income, including gross income, must be distinguished from gross receipts which can cover returns of capital. . . . Only an "income tax," not a tax which is truly on gross receipts, is creditable.

[W]e cannot accept the position that all foreign gross income taxes, no matter whether or not they tax or seek to tax profit or net gain, are covered by that provision. [F]rom 1913 on, Congress has always directed the domestic levy at some net gain or profit, and for almost sixty years the concept that the income tax seeks out net gain has been inherent in our system of taxation. That is the "well-understood meaning to be derived from an examination of the [United States] statutes which provide for the laying and collection of income taxes"—the basic test . . . for determining whether a foreign tax is an "income tax" under the foreign tax credit. . . . Where the gross income levy may not, and is not intended to, reach profit (net gain), allowance of the credit would serve only haphazardly to avoid double taxation of net income, since only the United States tax—under the concept followed since 1913—would necessarily fall upon such net gain. There would not then be any significant measure of commensurability between the two imposts (except by chance).

We do not, however, consider it all-decisive whether the foreign income tax is labeled a gross income or a net income tax, or whether it specifically allows the deduction or exclusion of the costs or expenses of realizing the profit. The important thing is whether the other country is attempting to reach some net gain, not the form in which it shapes the income tax or the name it gives. In certain situations a levy can in reality be directed at net gain even though it is imposed squarely on gross income.

For instance, it is almost universally true that a wage or salary employee does not spend more on expenses incident to his job than he earns in pay. A foreign tax upon the gross income of an employee from his work should therefore be creditable by the employee under 901(b)(1) despite the refusal of the other jurisdiction to permit deduction of job-related expenses. The reason is, of course, that in those circumstances the employee would always (or almost always) have some net gain and, accordingly, the tax, though on gross income, would be designed to pinch net gain in the end—and would in fact have that effect. In those circumstances, a loss (excess of expenses over profit) is so improbable, and some net gain is so sure, that the tax can be placed on gross income without any real fear or expectation that there will be no net gain or profit to tax.

Our review of the [law] persuades us that the term "income tax" in 901(b)(1) covers all foreign income taxes designed to fall on some net gain or profit, and includes a gross income tax if, but only if, that impost is almost sure, or very likely, to reach some net gain because costs or expenses will not be so high as to offset the net profit. . . .

Do the three foreign taxes we are now discussing . . . meet this test? Each of the taxes is levied on gross income from the banking business and allows no deductions for the costs or expenses of producing the income. Any taxpayer could be liable whether or not it operated at a profit during the year. The only question is whether it is very unlikely or highly improbable that taxpayers subject to the impost would make no profit or would suffer a loss. Obviously, plaintiff and the other institutions subject to the taxes had substantial costs in their banking business, salaries and rent being the major items. The covered banks must also have had bad debts and defaults, and these would have to be taken into account in calculating annual net gain. . . .

Nor can one say on this record that the three governments felt that net gain would always (or nearly so) be reached by these special banking levies, or that they designed these particular taxes to nip such net profit. Each of the three jurisdictions had a general net income tax (comparable to ours, and admittedly creditable) which the Bank of America and other banks had to pay. That was the impost intended to reach net gain.

We cannot say, therefore, that there was only a minimal risk that the combination of a bank's expenses plus its debt experience (and other losses) would outbalance its net gain or profits in any particular year—or that the foreign countries so considered. . . .

Decision. The United States Court of Claims dismissed Bank of America's petitions for a tax credit.