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STUDENT COMMENT

THE I.R.S. AND THE FOREIGN TAX CREDIT: THE RESTRICTIVE VIEW OF REVENUE RULING 78-61.

JAMES J. DUFFICY*

I. INTRODUCTION

In 1978 the Internal Revenue Service issued two rulings[1] that clarify its position with respect to the creditability of foreign income, war profits, or excess profits taxes.[2] This comment will examine the position taken by the I.R.S. in one of those rulings.[3]

In Rev. Rul. 78-61, the Ontario Mining tax was held to be neither an income tax nor a tax in lieu of an income tax within the meaning of sections 901 and 903 of the Internal Revenue Code, and the credit for the tax was denied.[4]

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1. Rev. Rul. 78-61, I.R. Bull. No. 1978-8 11; Rev. Rul. 78-62, I.R. Bull. No. 1978-8 16.

2. The foreign tax credit provision is contained in I.R.C. § 901. Pertinent provisions include:

> (a) Allowance of Credit - If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) . . .
>
> (b) Amount Allowed - Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):
>
> (1) Citizens and domestic corporations - In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; . . . .

3. While dealing *directly only* with Rev. Rul. 78-61, this comment will, *in effect*, deal also with Rev. Rul. 78-62, since the latter revolves around the same principles of creditability as the former.

4. I.R.C. § 903 grants an alternative credit for any taxes paid to a foreign country in lieu of an income tax. Under Treas. Reg. 1.903-1(a)(3), 1957-2 C.B. 419, the credit can be claimed only: (a) if the country has in force a general income tax law; (b) if the taxpayer would be subject to the tax in the absence of a specific exemption; and (c) if the income tax is not imposed upon the taxpayer subject to the substitute tax.

In the instance case the I.R.S., after denying the § 901 credit, also properly denied a credit under § 903 because the taxpayer in question was also subject to a general income tax from which he had not been exempted by the operation of the mining tax. This part of the decision will not be considered further, as it was amply justified in light of relevant case authority. On the creditability of "in lieu of" taxes, *see generally* Northwestern Mut. Fire Ass'n v. Commissioner, 181 F.2d 133 (9th Cir. 1950); Abbot Laboratories Int'l Co. v. United States, 160 F. Supp. 321 (N.D. Ill. 1958), *aff'd per*

The tax was levied on all profit of any mine in the Canadian province of Ontario if the profit from the mining function exceeded $50,000 for the taxable year. "Profit" under the act was defined as the sum of the gross receipts from the sale of ore, plus the actual market value of unsold ore that had been extracted during the year, less a narrow group of deductions.

The I.R.S. disallowed the credit under these circumstances. The mining tax was held to be levied not on income actually received from extracting and selling the ore, but on the value of the extraction. The tax was due on the value of the output whether or not it was sold (and in the case of output that had been incorporated into the owner's manufacturing process, in spite of the fact that it never would be sold). Furthermore, the Ontario tax did not allow the deduction of significant operating expenses that are deductible under the Internal Revenue Code of the United States. Some of the more important nondeductible expenses were interest, initial exploration and development expenses, taxes and royalties paid, depletion allowances, salaries and other expenses not directly connected to the mining function (in a typical mining enterprise, there are also manufacturing and treatment functions). Since this tax was levied on the market value of the extracted ore and not on an actual income base, the I.R.S. classified it as "a production or severance tax on the mining privilege," a noncreditable tax.[5]

II. BACKGROUND

The United States Government taxes its nationals on their worldwide income. This method of taxation could lead to double taxation, *i.e.*, paying income taxes on the same income to the United States and to the country where the income

curiam, 267 F.2d 940 (7th Cir. 1959); Compania Embotelladora Coca-Cola v. United States, 139 F. Supp. 953 (Ct. Cl. 1956); F.W. Woolworth Co. v. Commissioner, 54 T.C. 1233 (1970), *nonacq. on another issue*, 1971-2 C.B. 4.

5. The I.R.S. also properly ruled that this tax should be considered in its entirety, as it is an indivisible tax. As a general rule, when a tax is imposed upon more than one base, one of which would qualify as a proper base for the credit and one or more of which would not, that part of the tax levied upon a qualifying base will be creditable provided it is computed separately from the tax that is imposed upon a nonqualifying base. In the instant case, all of the various bases (output sold, output incorporated in a manufacturing process, and output sold after treatment) were combined, the allowable deductions were expensed against the entire base, and the tax was then computed upon the single base. *Cf.* Lanman & Kemp-Barclay & Co. of Columbia v. Commissioner, 26 T.C. (1956); Rev. Rul. 74-435, 1974-2 C.B. 204.

has been earned.[6] To prevent double taxation, Congress granted a tax credit.[7] Generally, section 901 allows a credit (a dollar-for-dollar reduction from overall tax liability)[8] for any income, war profits, or excess profits taxes paid to a foreign country.[9] The major source of contention within section 901 has been over the meaning of the words "income tax"; that is, when is a particular foreign tax an income tax within the meaning of section 901?

For nearly twenty years after the original enactment of the foreign tax credit provision in 1918, the Supreme Court allowed the foreign characterization of the tax as an income tax to control creditability.[10] However, with the landmark case of *Biddle v. Commissioner,*[11] the courts now refuse to allow a foreign characterization of a tax to control. Since *Biddle,* the courts have consistently applied the American conception of "income tax":[12] the foreign tax must be the substantial equiva-

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6. For a general discussion of the problems of double taxation, *see generally* H.R. REP. No. 94-658, 94th Cong., 1st Sess. (1975), 1976-3 C.B. 695, 904; *Characterization of an Income Tax for the Purpose of the Foreign Tax Credit,* 14 VAND. L. REV. 1469 (1961).

7. "The primary objective . . . [of § 901] is to prevent double taxation and a secondary objective is to encourage American foreign trade." American Metal Co. v. Commissioner, 221 F.2d 134, 137 (2d Cir. 1955).

8. I.R.C. § 164(a) allows a deduction of such taxes even if the credit is denied. This is generally less favorable to the taxpayer because the deduction merely reduces the tax base upon which U.S. income tax is levied, while a credit directly reduces the amount of the tax liability by the amount of the credit.

9. Taxes which are paid to a political subdivision of a foreign country are also creditable if they qualify. *See* Burnet v. Chicago Portrait Co., 285 U.S. 1 (1931); Havana Electric Railway, Light & Power Co. v. Commissioner, 34 B.T.A. 782 (1936) (an income tax imposed by the municipality of Havana was creditable under § 901).

10. Eitington Schild Co. & Subsidiaries v. Commissioner, 21 B.T.A. 1163 (1931) (a turnover tax imposed upon all business activity in France was not a qualifying income tax for purposes of the foreign tax credit, largely because France had imposed this tax apart from its income tax).

11. 302 U.S. 573 (1938).

12. *See* New York & Honduras Rosario Mining Co. v. Commissioner, 168 F.2d 745 (2d Cir. 1948) (Houduran tax imposed upon liquid profits derived from the mining enterprise was credited because of its similarity to the United States income tax); Keasbey & Mattison Co. v. Rothensies, 133 F.2d 894 (3rd Cir. 1943), *cert. denied,* 320 U.S. 739 (1943) (Quebec mining tax was noncreditable because the tax base, the value of ore extracted, did not constitute an income base in the United States sense); *accord,* Motland v. United States, 192 F. Supp. 358 (N.D. Iowa 1961); St. Paul Fire & Marine Ins. Co. v. Reynolds, 44 F. Supp. 863 (D. Minn. 1942); Bank of America Nat'l Trust & Sav. Ass'n v. United States, 459 F.2d 513 (Ct. Cl. 1972), *cert. denied,* 409 U.S. 949 (1972); F.W. Woolworth Co. v. Commissioner, 54 T.C. 1233 (1970), *nonacq. on another issue,* 1971-2, C.B. 4; Lanman & Kemp-Barclay & Co. of Colombia v. Commissioner, 26 T.C. 582 (1956).

lent of an income tax as defined by United States law.[13] The scant legislative history on the issue of creditability gives implicit approval to this test.[14]

To determine whether a particular tax is the substantial equivalent of the United States income tax, the courts look primarily to the tax base. To qualify for a credit, the foreign tax must be levied on a base that corresponds closely to income as understood in the United States. This conclusion indicates that the tax must be imposed on either a gain realized or a profit derived from capital, labor, or both,[15] since this is the traditional United States definition of income.[16]

In Rev. Rul. 78-61, the I.R.S. established three requirements that a foreign tax must meet to qualify as a creditable income tax on a proper tax base:[17]

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13. *See* Seatrain Lines, Inc. v. Commissioner, 46 B.T.A. 1076 (1942) (Cuban tax levied upon gross income was credited); Santa Eulalia Mining Co. v. Commissioner, 2 T.C. 241 (1943), *appeal dismissed,* 142 F.2d 450 (9th Cir. 1944) (Mexican tax upon gross royalties received was credited because the significant expenses incurred in producing the income were already deducted by the party paying the royalty).

14. *See* S. REP. No. 1631, 77th Cong., 2d Sess. (1942), 1942-2 C.B. 602. This report concerned the initial enactment of § 903, the "in lieu of" credit, which was considered necessary by the committee because of the narrow reading given § 901 by the courts and the I.R.S.

> In the interpretation of the term "income tax," the Commissioner, the Board [B.T.A.], and the courts have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit. . . . Your committee has deemed it desirable to extend the scope of this section.

The fact that the extension of the credit provision took the form of the "in lieu of" provision rather than an actual enlargement of § 901, gives implicit approval to the narrow construction of this section. *See* Motland v. United States, 192 F. Supp. 358 (N.D. Iowa 1961).

15. *E.g.*, Bank of America Trust & Sav. Ass'n v. United States, 459 F.2d 513 (Ct. Cl. 1972), *cert. denied,* 409 U.S. 949 (1972).

16. *Accord,* Keasbey & Mattison Co. v. Rothensies, 133 F.2d 894, 897 (3rd Cir. 1943), *cert. denied,* 320 U.S. 739 (1943); Abbot Laboratories Int'l Co. v. United States, 160 F. Supp. 321, 331 (N.D. Ill. 1958), *aff'd per curiam,* 267 F.2d 940 (7th Cir. 1959); Allstate Ins. Co. v. United States, 419 F.2d 409, 414 (Ct. Cl. 1969); Lanman & Kemp-Barclay & Co. of Columbia v. Commissioner, 26 T.C. 582, 587 (1956); Rev. Rul. 69-653, 1969-2 C.B. 152.

17. The I.R.S. held that it would determine whether the requirements were met by referring to the *entire class* of taxpayers subject to the foreign tax, rather than on a taxpayer-by-taxpayer or transaction-by-transaction basis. However, in Schering Corp. & Subsidiaries v. Commissioner, /1978/ Fed. Taxes (P-H) ¶ 69.46, at 57,471 (a decision issued contemporaneously with this Revenue Ruling), the I.R.S. attempted to persuade the Tax Court to make a determination of the noncreditability of a Swiss withholding tax by referring solely to the taxpayer, Schering Corp., while at the same

(1) The foreign tax must be levied on gain actually realized, since our own income tax is limited to realized as opposed to constructive gain. The I.R.S. requires a "substantially equivalent degree of realization with respect to foreign taxes."[18]

(2) The tax will be creditable only if "its purpose is to reach net gain and it is so structured so as to be almost certain of doing so." It is properly structured if, in the computation of the tax base, it is very unlikely that taxpayers will have to pay the tax if they have no net gain.[19]

(3) A credit is denied if the tax is not levied on the receipt of income but rather on "transactions such as sales or the exercise of a privilege or franchise." A tax that is imposed upon a transaction or a privilege is denied credit even if measured by net income.[20]

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time conceding that the tax in question was creditable when the entire class of taxpayers subject to the tax was considered. The court rejected this argument and granted the credit. This inconsistency on the part of the I.R.S. may be explained, at least in part, by the particular facts in the *Schering* case.

18. No authority directly supports this "three-pronged" test, but the I.R.S. does seem to be generally true to the judicial interpretation of § 901 in each of the criteria. The first prong (the tax must be levied upon gain actually realized) is clearly a proper application of § 901; *see* Motland v. United States, 192 F. Supp. 358 (N.D. Iowa 1961) (credit denied for a Cuban tax levied upon all capital exported from Cuba regardless of whether or not the capital represented actually realized gain); F.W. Woolworth Co. v. Commissioner, 54 T.C. 1233 (1970), *nonacq. on another issue,* 1971-2 C.B. 4 (credit denied for a British tax imposed upon the rental value of all property owned by the taxpayer, because this tax was imposed even if no rental income was realized from the property); Lanman & Kemp-Barclay & Co. of Colombia v. Commissioner, 26 T.C. 582 (1956) (credit denied for a Colombian patrimony tax imposed upon the appreciation of all property located in Colombia irrespective of actual realization by the taxpayer through sale); *accord,* Abbot Laboratories Int'l Co. v. United States, 160 F. Supp. 321 (N.D. Ill. 1958), *aff'd per curiam,* 267 F.2d 940 (7th Cir. 1959).

19. This second criterion (the tax must be designed to reach net gain), while generally true, seems somewhat restrictive considering Seatrain Lines, Inc. v. Commissioner, 46 B.T.A. 1076 (1942) (discussed *infra*). The I.R.S. seems to be attempting to restrict the credit to taxes that are structurally identical to our own in this test, an idea that runs counter to the *Seatrain* doctrine.

20. This third "test" (a privilege or excise tax is not creditable) actually seems to be little more than a conclusion to be drawn from the application of the first two tests. The courts uniformly deny a credit to taxes classified as "privilege" taxes, but the primary reasons for so classifying a tax are either because the tax is not imposed upon gain actually realized, or because the tax is not designed or intended to reach gain. Thus, while this "test" might be helpful in an overall consideration of a tax under § 901, it cannot truly stand independently. For decisions in this area, *see* Keasbey & Mattison Co. v. Rothensies, 133 F.2d 894 (3rd Cir. 1943), *cert. denied,* 320 U.S. 739 (1943) (discussed *infra*) (provincial Canadian tax imposed upon the value of extracted ore was classified as a privilege tax because the value of the extraction taxed included ore used by the operator, and thus represented gain never actually realized); American

When the above criteria are applied to the Ontario Mining severance tax, two principal issues emerge concerning the creditability of taxes that are imposed on only one facet of an operation:

(1) Must a taxpayer be granted all of the "normal" deductions before a tax will be considered an income tax?

(2) Can a tax be limited to income earned from a particular operation, *e.g.*, mining, and still qualify as an income tax?

III. ANALYSIS

A. *Must a taxpayer be granted all of the "normal" deductions before a tax will be considered an income tax for purposes of section 901?*

In the Ontario ruling, the mining severance tax was classified as a noncreditable privilege tax largely because the act disallowed the deduction of "significant operating expenses" that are deductible in the United States. The issue narrows to this: When are deductions that are not allowed by the foreign statute so significant as to deprive the tax of its characterization as an income tax?

The courts uniformly deny credit for any tax imposed upon gross receipts.[21] The area that is less clear is the amount between gross receipts and net income (as defined by United States law); this troublesome amount is gross income.[22]

While there are indications that some courts will categorically deny credit for a tax based on gross income,[23] the weight of authority is to the contrary. The leading case, *Seatrain*

Metal Co. v. Commissioner, 19 T.C. 879 (1953), *aff'd*, 221 F.2d 134 (2d Cir. 1955) (Mexican tax on mining output was classified as a privilege tax because it was levied upon the total value of output without any deductions, and was thus not aimed at gain or profit actually realized); Mallouck v. Commissioner, 34 B.T.A. 269 (1936) (Phillipine tax upon the value of exported goods was a noncreditable privilege tax both because it has no relation to gain realized through sale of the goods, and because nonpayment meant forfeiture of the privilege of doing business in the Phillipines).

21. *See* St. Paul Fire & Marine Ins. Co. v. Reynolds, 44 F. Supp. 863 (D. Minn. 1942); Allstate Ins. Co. v. United States, 419 F.2d 409 (Ct. Cl. 1969); Continental Ins. Co. v. Commissioner, 40 B.T.A. 540 (1939); I.T. 3429, 1940-2 C.B. 136.

22. Gross income may be defined as gross sales less the direct cost of making the sales. It is thus distinct from gross receipts which consist of all income including that which represents direct costs, while gross income excludes only the indirect costs of generating income (such as fixed and administrative expense). 1 MERTEN, LAW OF FEDERAL INCOME TAXATION § 5.10.

23. *E.g.*, St. Paul Fire & Marine Ins. Co. v. Reynolds, 44 F. Supp. 863 (D. Minn. 1942).

Lines, Inc. v. Commissioner,[24] indicates that under the proper circumstances a credit for a gross income tax will be allowed. *Seatrain* involved a Cuban tax on the gross income of shipping businesses. The tax was a flat 3% duty on gross income and was considered an income tax by Cuba. Furthermore, this 3% duty had replaced a 6% tax that had clearly been imposed on net income. The change in rates occurred because of administrative difficulties in determining the amount of expense that had actually been experienced by the taxpayers. Cuba cut the rate by 3% as an estimated allowance for the average amount of gross income consumed by operating expense. The tax was still intended to reach net income even though it was imposed on gross income, and the credit was allowed. In this case, the critical fact was the intent of the Cuban Government in levying the tax to reach net income. *Bank of America Trust & Sav. Ass'n v. United States*[25] clarified this perspective. There, the tax was imposed on the gross income of branch banks in Thailand, the Philippines, and Argentina, but the statutes did not allow for the deduction of significant operating expenses, such as indirect bank expenses, rental, or bad debt expense, so the court denied the credit. The court in *Bank of America* held that a direct income tax is creditable even though imposed on gross income, if it is highly likely, or was reasonably intended, always to reach some net gain in the normal circumstances in which it applies. The tax failed this test because the court could not say that the tax would reach, in all probability, net gain.[26]

These cases[27] make clear that a tax may be creditable even if it does not allow for the deduction of all the "normal" expenses that are allowed under the Internal Revenue Code. The

24. 46 B.T.A. 1076 (1942).

25. 459 F.2d 513 (Ct. Cl. 1972), *cert. denied*, 409 U.S. 949 (1972).

26. *Accord,* Bank of America Trust & Sav. Ass'n v. Commissioner, 61 T.C. 752 (1974).

27. *See also* Santa Eulalia Mining Co. v. Commissioner, 2 T.C. 241 (1943), *appeal dismissed,* 142 F.2d 450 (9th Cir. 1944), where a credit was allowed for a Mexican tax imposed upon the gross revenue derived from mining operations in Mexico. The tax in question was withheld from a royalty payment. The court was willing to grant the credit because the subcontractor, in determining the royalty, had already deducted the significant direct operating expenses incurred in mining, and the court was certain that the expenses connected with receiving the royalty were highly unlikely to exceed the amount of the royalty. Thus, the tax in effect was certain to fall on net gain in the United States sense.

courts look beyond the label of a tax to its nature and purpose in making a determination on its creditability. If the court finds that the *purpose* and *effect* of a tax are to reach net income, it will allow a credit despite the fact that the foreign statute does not allow for the deduction of every expense that is normally deductible in this country.

B. *Can a tax be limited to a particular operation, e.g., mining, and still qualify as an income tax?*

In the abstract, nothing prevents a tax on a particular operation, in this case mining, from qualifying for a credit as long as it meets the judicial criteria of an income tax.[28] This conclusion is especially true in cases involving severance taxes on mining output where the activity taxed, the extraction of minerals, results in marketable ore, a thing of value to the operator which was not usable before the mining operation took place. Extracting the ore is somewhat removed from the receipt of income from the sale of that output, but as long as a tax on the extraction is designed to, and does, reach the gain attributable to the mining function resulting in the sale of the ore, the tax on the single operation of mining should be creditable.

Keasbey & Mattison Co. v. Rothensies,[29] one of the leading decisions on the creditability of severable mining taxes, concerned a 4% mining duty imposed by the province of Quebec on all "profits" derived from mining ore in Quebec. The tax was levied on the market value of all output that left the pit's mouth, including both ore sold and ore used by the operator, and thus never resulted in actual profit. The profit was determined by deducting any expense directly related to the mining operation, including the direct salary and material expenses, as well as indirect costs, such as insurance, depreciation and utilities costs, from the aggregate market value of the output. The court disallowed the credit because this tax was not intended or structured to reach any gain from the mining operation, but

28. *See, e.g.*, Havana Electric Railway, Light & Power Co. v. Commissioner, 34 B.T.A. 782 (1936). The Board allowed a credit for a tax imposed by the muncipality of Havana upon the income earned by the utility within the city, even though the company's operations included other functions outside of Havana, and even though the company was also subject to a national income tax. This seems to justify the proposition that as long as the tax in question is an income tax, it makes no difference how the statute limits its operation, either geographically or functionally.

29. 133 F.2d (3rd Cir. 1943), *cert. denied,* 320 U.S. 739 (1943).

was rather intended as a tax on the privilege of removing the minerals from the earth.[30]

American Metal Co. v. Commissioner[31] also involved a tax imposed on the mining operation. The tax was imposed by Mexico on the market value of all output whether the ore was sold or utilized by the operator. Further, the tax allowed no deductions from this total. Under these circumstances (including the fact that the taxpayer had suffered an actual loss for several years but was still subject to the tax in those years), the court denied a credit because this tax was independent of any realized gain that might result from the sale of the minerals.

These cases clarify the creditability of taxes imposed on a particular operation. To be creditable, the tax on the mining operation must conform closely to an income tax as the concept is understood in this country, and cannot be based on the constructive receipt of income fixed at an artificial level such as the market value of the product, apart from the sale of the ore.[32]

This concept is developed further by *New York & Honduras Rosario Mining Co. v. Commissioner*,[33] where a tax on mining operations in Honduras was allowed a section 901 credit. The tax was imposed on "liquid profits" derived from the sale of iron ore extracted from mines in Honduras. The act allowed the deduction of every meaningful expense related to the mining operation, including indirect administrative costs; thus, the tax was intended to reach the gain resulting from the sale

30. Placing a tax on the privilege of removing natural resources from the earth is common, especially in the area of mining. This can only serve to increase the difficulty of classifying an output tax as an income tax within § 901, since the natural place to impose a mining privilege tax is at the point of the privileged activity, *i.e.*, the extraction of the ore.

31. 19 T.C. 879 (1953), *aff'd*, 221 F.2d 134 (2d Cir. 1955).

32. *See also* Rev. Rul. 69-653, 1969-2 C.B. 152, where the I.R.S. reviewed a mining tax imposed by Quebec that was much like the tax disallowed in *Keasbey*. The I.R.S. denied a credit for this tax because the tax was not properly laid upon income (gain derived from labor, capital, or from both combined) but rather included in the tax base nonincome items, such as the market value of ore shipped or consumed by the operator. Nor did it matter that all expenses directly related to the mining function were deductible, since an income tax cannot be levied on items that do not represent gain. It is obvious that any attempt to distinguish *Keasbey* and Rev. Rul. 69-653 from the Ontario tax will fail, since they involved the same features that identify the noncreditable nature of the Quebec mining taxes (they also were levied upon nonincome items such as the value of ore consumed by the operator, and allowed for the deduction of even fewer expenses than were allowed in *Keasbey*).

33. 168 F.2d 745 (2d Cir. 1948); *see also* Rev. Rul. 57-62, 1957-1 C.B. 241.

of the ore. Furthermore, the court recognized that the Honduran tax was distinguishable from the one disallowed in *Keasbey* in that the tax in *Keasbey* was levied on the gross value of output less direct mining expenses, while the Honduran tax included as its base only income actually received through sales, less the total expense needed to generate the sales.[34]

New York & Honduras Rosario Co. indicates that a tax upon the separate mining operation will be creditable only if the tax is imposed on gain actually realized through sale of the output and only if the foreign statute allows for the deduction of every significant expense incurred in producing the mining income. This highlights the importance of the concept of realized gain in section 901. The courts uniformly require that a tax be levied on a base that represents a gain that the taxpayer has received in the form of income.[35] When this principle is applied to the severable mining taxes reviewed here, it becomes clear that section 901 will only extend to taxes imposed on the mining function if the tax is designed to reach only realized gain that is attributable to the mining function, and when the statute is restricted in its base to ore that is intended for sale and not for the operator's use.

IV. CONCLUSION

In Rev. Rul. 78-61, the Internal Revenue Service adopted a restrictive view of section 901 of the Internal Revenue Code. When this ruling is applied to the Ontario Mining tax, the I.R.S. position seems justified, since this tax is nothing more

34. *See also* Santa Eulalia Mining Co. v. Commissioner, 2 T.C. 241 (1943), *appeal dismissed*, 142 F.2d 450 (9th Cir. 1944), where a tax withheld from a royalty payment was allowed as a § 901 credit. The tax withheld was levied upon the gross income derived from the mining operation of the company paying the royalty, and the court allowed the credit because the significant expenses incurred in mining the ore had already been deducted from the income base on which the royalty was paid.

35. *See* Lanman & Kemp-Barclay & Co. of Columbia v. Commissioner, 26 T.C. 582 (1956), where the tax in question was a patrimony tax imposed on the value of a taxpayer's assets, regardless of whether or not the taxpayer actually realized any gain from the use or sale of the assets. The tax, in effect, was levied on appreciation of all property in Colombia even if the appreciation had not been realized through sale. The credit was denied under these circumstances, because

> [t]he doctrine that only those increases in value of property which are actually realized by the owner constitute taxable income is basic to the income tax system of the United States . . . (citations ommitted). "The defined concept of income has been uniformly restricted to a gain realized or a profit derived from capital, labor, or both." (Citing *Keasby.*)

26 T.C. 582, at 587. *See also* Motland v. United States, 192 F. Supp. 358 (N.D. Iowa 1961).

than a tax on the privilege of extracting ore from the mines of Ontario. However, the three strict criteria set forth by the I.R.S. in Rev. Rul. 78-61 may exceed the standards set forth in some of the decisions reviewed here. For instance, the I.R.S. would seem to deny creditability to any tax that fails to provide for the major "normal" expenses that are allowed under the Internal Revenue Code,[36] while *Seatrain, Bank of America,* and *Santa Eulalia* all indicate that the courts are willing to grant a credit to such taxes if they are net income taxes in purpose and effect. Also, the I.R.S. would certainly classify any tax imposed on a separate operation as a privilege or excise tax, while *New York & Honduras Rosario Co.* and *Santa Eulalia* indicate that such a tax should be credited despite its functional limitation if it fulfills the traditional criteria of an income tax.

Looking to the future development of the foreign tax credit after Rev. Rul. 78-61, the restrictive view of the I.R.S. will certainly be the cause of litigation by taxpayers seeking a more generous interpretation of section 901. It is also probable that as the tax considerations of foreign investment decisions increase in importance, lobbying pressure by U.S. nationals in foreign legislatures may cause some countries to restructure their tax laws to conform with this country's Internal Revenue Code. This result will stimulate investment in such countries by allowing U.S. nationals to take full advantage of section 901 in their tax considerations. Thus, in the long run, Rev. Rul. 78-61 may well be an important force in lessening the strife over the proper interpretation of section 901, as it will be a strong impetus toward structural conformity in revenue laws.

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36. *E.g.*, in Rev. Rul. 78-61, I.R. Bull. No. 1978-8 11 at 14, the I.R.S. holds that expenses incurred in producing gross income are not inherently so slight as to insure that they will never exceed the gross income, and for this reason, a tax on gross income should not be creditable.