



# TaxNewsFlash

United States



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## U.S. Tax Court: U.S. taxpayer realized subpart F income on sales of appliances manufactured in Mexico

The U.S. Tax Court today issued an opinion granting summary judgment for the government, upholding an IRS deficiency determination finding that sales income from manufacturing operations in Mexico and involving a Luxembourg controlled foreign corporation (CFC) was foreign base company sales income (FBCSI) of the taxpayer under section 954(d).

The case is: *Whirlpool Financial Corp. v. Commissioner*, 154 T.C. No. 9 (May 5, 2020). Read the [Tax Court opinion](#) [PDF 213 KB] (62 pages)

### Background

The taxpayer (a U.S. corporation) was engaged in the manufacture and distribution of household appliances (refrigerators and washing machines) through domestic and foreign subsidiaries. The foreign subsidiaries were controlled foreign corporations (CFCs) as defined by section 957(a).

During 2007-2009, the taxpayer restructured its Mexican manufacturing operations in a manner the Tax Court described as “driven largely by tax considerations.” Following the restructuring, the taxpayer’s Luxembourg CFC acted as the nominal manufacturer of appliances in Mexico, using a maquiladora structure through its disregarded Mexican subsidiary that qualified for Mexican tax and trade incentives.

The Luxembourg CFC, which had a single employee, then sold these appliances to the taxpayer and to the taxpayer’s Mexican distribution CFC, which distributed the appliances for sale to consumers. The Luxembourg CFC earned substantial income that was exempt from both Mexican and Luxembourg tax. The IRS determined that the income the Luxembourg CFC earned from sales of appliances to the taxpayer and to the taxpayer’s Mexican CFC constituted foreign base company sales income (FBCSI) under section 954(d). Thus, the IRS determined that the FBSCI was taxable to the taxpayer as subpart F income under section 951(a). The IRS increased the taxpayer’s taxable income for 2009 by approximately \$50 million (and that in turn decreased a consolidated net operating loss (NOL) carryback deduction).

The taxpayer filed a petition with the Tax Court and then filed a motion for partial summary judgment contending that the sales income was not FBCSI under section 954(d)(1) because the appliances sold by the Luxembourg CFC were substantially transformed by its Mexican branch from the component parts and raw materials it had purchased.

The government opposed the taxpayer's summary judgment motion, contending that genuine disputes of material fact existed as to whether the Luxembourg CFC actually manufactured the products.

Further, the parties filed cross-motions for partial summary judgment as to whether the sales income was FBCSI under section 954(d)(2)—the so-called "branch rule."

### **Tax Court's opinion**

The Tax Court today granted summary judgment for the government with regard to the application of the branch rule.

The Tax Court—while agreeing with the government that genuine disputes of material fact may exist with respect to the application of subsection (d)(1)—stated that it agreed with the government with respect to subsection (d)(2) of section 954. After analyzing both the statutory language of section 954(d)(2) and the extensive regulations that have been issued implementing those rules, the court concluded that whether or not the Luxembourg CFC is regarded as having manufactured the products, its Mexican branch under section 954(d)(2) is treated as a subsidiary of the Luxembourg CFC, and that the sales income the Luxembourg CFC earned constitutes FBCSI taxable to the taxpayer as subpart F income.

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