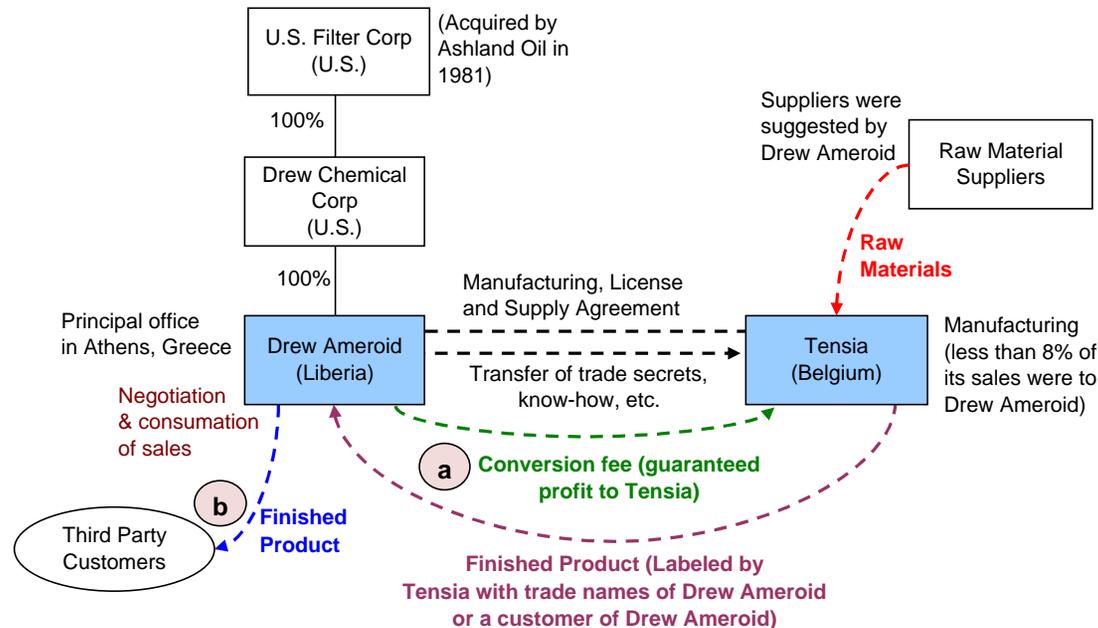


Ashland Oil, Inc. v. Commissioner
95 T.C. 348 (1990)

No Branch Created From A Contract with A Third Party

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The IRS had three principal arguments, in various overlapping combinations, in asserting that Tensia was a "branch or similar establishment." The arguments were congressional intent, the tax rate disparity between Belgium and Liberia, and the business relationship between Drew Ameroid and Tensia. The IRS argued that Congress, in enacting the branch rule of section 954(d)(2), intended it to be a broad "loophole closing" provision. The purported loophole was any arrangement that separates the manufacturing and sales functions so as to avoid or limit tax on the sales. The Tax Court held "[r]egardless of the precise ordinary meaning of 'branch', we are confident that such meaning does not encompass Tensia, an unrelated corporation operating under an arm's-length contractual arrangement with Drew Ameroid." The Tax Court held that the IRS's position on congressional intent would be more persuasive if Congress had granted specific regulatory authority to the Secretary of the Treasury to define "branch or similar establishment." Section 954(d)(2) does grant specific regulatory authority, but the authority becomes operative only if a branch or similar establishment is a given. In other words, the Secretary has a specific grant of authority to address certain consequences flowing from the existence of a branch or similar establishment, but does not have such authority to determine what a branch or similar establishment is.

The Tax Court found that the IRS's emphasis on tax rate disparities was misplaced. If an establishment is not in the nature of a branch in the first instance, it cannot become so as a result of a tax rate disparity. Under the third argument, the IRS asserted that the nature of the business relationship between Drew Ameroid and Tensia made the latter a branch or similar establishment. The IRS likened Tensia to an agent of Drew Ameroid, based on factors that include Drew Ameroid's control over Tensia's manufacturing operations under the Agreement, the allocation of risk between the two, and the anticipated lengthy term of the relationship. The Tax Court held that the degree of control exercised by Drew Ameroid over a part of Tensia's manufacturing operations, any disproportionate risk borne by Drew Ameroid relative to Tensia, and the anticipated length of the relationship were irrelevant considerations. The Tax Court rationalized that it was not unjustifiably permissive to conclude that Drew Ameroid did not have a branch, primarily because neither Drew Ameroid nor its United States shareholder, Drew Chemical, had a claim to any of Tensia's manufacturing income derived under the arm's-length Agreement or otherwise.