Estate of Edwin C. Weiskopf v. Commissioner, 64 T. C. 789 (1975)

A foreign corporation is considered a controlled foreign corporation under Section 957(a) if U. S. shareholders retain effective control despite nominal foreign ownership of voting power.

Summary

In Estate of Edwin C. Weiskopf, the Tax Court held that Ininco, a foreign corporation, was a controlled foreign corporation under Section 957(a) despite Romney, a foreign entity, owning 50% of the voting shares. The court found that U. S. taxpayers Whitehead and Weiskopf retained effective control over Ininco through various arrangements, triggering Section 1248's dividend treatment upon the sale of their interest. The court rejected the form of the transaction as a sale, treating it as a liquidation in substance, and upheld the Commissioner's computation of taxable gain as a dividend, subject to certain adjustments for distributions to Romney.

Facts

Technicon Instruments Corp. , owned by Whitehead and Weiskopf, formed Intapco to hold stock in Ininco, a UK-based Overseas Trade Corp. (OTC) established to sell AutoAnalyzers globally. Romney, a UK corporation, owned 50% of Ininco's voting shares, while Intapco owned the rest. Ininco's operations were dependent on AutoAnalyzers supplied by Limited, a Technicon subsidiary controlled by Whitehead and Weiskopf. After the UK repealed OTC tax benefits, Ininco was sold to Hong Kong Holdings, which then liquidated it. Whitehead and Weiskopf reported the sale of their Intapco stock as long-term capital gain, while the Commissioner treated it as dividend income under Section 1248.

Procedural History

The Commissioner issued deficiency notices to Whitehead and Weiskopf, asserting that the sale of Intapco stock resulted in dividend income under Section 1248. The taxpayers petitioned the Tax Court, which held a trial and issued an opinion finding Ininco to be a controlled foreign corporation and treating the transaction as a liquidation in substance.

Issue(s)

1. Whether Ininco was a controlled foreign corporation under Section 957(a) despite Romney's 50% voting interest.
2. Whether the sale of Intapco stock to Hong Kong Holdings was in substance a liquidation of Ininco, triggering Section 1248.
3. Whether the Commissioner's computation of taxable gain as a dividend under Section 1248 was correct.

Holding

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1. Yes, because Whitehead and Weiskopf retained effective control over Ininco through various arrangements, despite Romney's nominal voting power.
2. Yes, because the transaction was structured to liquidate Ininco and avoid UK taxes, triggering Section 1248's dividend treatment.
3. Yes, subject to adjustments for distributions made to Romney, as the Commissioner's computation was generally correct.

Court's Reasoning

The court applied the substance-over-form doctrine, focusing on the actual control Whitehead and Weiskopf retained over Ininco. Despite Romney's 50% voting interest, the court found that Romney had little incentive to challenge the U. S. shareholders' control due to its limited stake in Ininco's profits and the dependence on Limited's AutoAnalyzer supply. The court relied on cases like Kraus and Garlock, emphasizing that arrangements shifting formal voting power away from U. S. shareholders would not be given effect if voting power was retained in reality. The court also considered the overall transaction, noting that Ininco was merely a vehicle for Technicon's global expansion, and its termination was orchestrated by Whitehead and Weiskopf. The court treated the sale to Hong Kong Holdings as a liquidation in substance, as it was designed to extract Ininco's earnings tax-free. Finally, the court upheld the Commissioner's computation under Section 1248, applying the holding period rules to attribute earnings to Weiskopf's common stock.

Practical Implications

This case demonstrates that U. S. taxpayers cannot avoid controlled foreign corporation status and Section 1248's dividend treatment by nominally shifting voting power to foreign entities while retaining effective control. Practitioners should carefully structure foreign corporate arrangements to ensure that foreign shareholders have a genuine interest in the corporation's operations and profits. The case also highlights the importance of the substance-over-form doctrine in tax cases, as the court looked beyond the form of the transaction to its true purpose. Future cases involving sales of foreign corporations may be analyzed to determine if they are liquidations in substance, triggering Section 1248. Additionally, this decision may impact how taxpayers structure the sale of foreign subsidiaries to minimize tax liability, particularly when dealing with accumulated earnings.

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