CCA, Inc. v. Commissioner, 64 T. C. 137 (1975)

A foreign corporation is not considered controlled if more than 50% of its voting power is held by non-U. S. shareholders who exercise their voting rights independently.

Summary

CCA, Inc. restructured its Swiss subsidiary, Control AG (AG), to avoid being classified as a controlled foreign corporation under the 1962 Revenue Act. AG issued preferred stock to non-U. S. shareholders, giving them 50% of the voting power. The Tax Court held that AG was not a controlled foreign corporation because the preferred shareholders actively participated in corporate governance and had significant powers, indicating a genuine shift of control away from CCA, Inc. This decision underscores the importance of substantive control in determining the status of foreign subsidiaries under U. S. tax law.

Facts

CCA, Inc. , an American corporation, established Control AG (AG) in Switzerland as a wholly owned subsidiary in 1958. After the passage of the Revenue Act of 1962, which introduced the concept of controlled foreign corporations, CCA, Inc. sought to avoid its application. In 1963, AG transferred its operating subsidiaries to another CCA, Inc. subsidiary and issued preferred stock to non-U. S. shareholders, giving them 50% of the voting power. The preferred shareholders actively participated in AG's governance, with no substantial restrictions on their stock or voting rights.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in CCA, Inc. 's tax returns, asserting that AG was a controlled foreign corporation. CCA, Inc. and The Singer Company, as successor to CCA, Inc. , petitioned the U. S. Tax Court for relief. The court heard the case and issued its decision in 1975, holding that AG was not a controlled foreign corporation.

Issue(s)

1. Whether Control AG (AG) was a controlled foreign corporation under Section 957(a) of the Internal Revenue Code during the years in question.

Holding

1. No, because the preferred shareholders held 50% of the voting power and exercised their voting rights independently, indicating a genuine shift of control away from CCA, Inc.

Court's Reasoning

The court analyzed the substance of the transaction to determine if AG was a controlled foreign corporation. It found that the preferred stock was issued without substantial restrictions, and the board of directors was evenly split between common and preferred shareholders with no deadlock-breaking provisions. The preferred shareholders had significant powers, including voting on dividends and transfers of common stock, and actively participated in corporate governance. The court distinguished this case from others where U. S. shareholders retained control through restrictive agreements or manipulation of the board. The court concluded that CCA, Inc. successfully divested itself of control over AG, as evidenced by the lack of significant strings attached to the preferred shareholders' voting rights and their active participation in AG's affairs.

Practical Implications

This decision provides guidance on the criteria for determining whether a foreign corporation is controlled under U. S. tax law. It emphasizes the importance of genuine divestment of control, as evidenced by the independence and active participation of non-U. S. shareholders in corporate governance. Practitioners should ensure that any restructuring to avoid controlled foreign corporation status is substantive, with non-U. S. shareholders exercising meaningful control. The ruling may influence how multinational corporations structure their foreign subsidiaries to minimize U. S. tax liabilities. Subsequent cases have cited CCA, Inc. v. Commissioner to clarify the application of Section 957(a) and the importance of substantive control.

