Crow-Burlingame Co. of Pine Bluff, et al. v. Commissioner of Internal Revenue, 65 T. C. 785 (1976)

Stock owned by employees and subject to a repurchase option can be considered "excluded stock" if the option indirectly favors the parent corporation, even if a third corporation holds the option.

Summary

Crow-Burlingame Co. sought to retain multiple surtax exemptions for its subsidiaries by selling stock to employees with a repurchase option held by C. B. Investment Co. (CBI). The Tax Court ruled that the subsidiaries formed a controlled group under IRC § 1563 because the stock was "excluded stock" due to the indirect control Crow-Burlingame exerted through CBI. The decision hinged on the repurchase option's substantial restriction on the employees' stock disposal rights, which indirectly favored Crow-Burlingame, requiring the application of a single surtax exemption across the group.

Facts

Crow-Burlingame Co. established subsidiaries to operate local automotive parts stores, retaining about 78% of each subsidiary's stock and selling the rest to employees through CBI, which held a repurchase option on the sold shares. CBI was controlled by Crow-Burlingame, sharing the same office space and key officers. The repurchase option was triggered by events like the employee's termination or death, ensuring the stock would not pass to outsiders and allowing Crow-Burlingame to maintain control over the subsidiaries.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the subsidiaries' income taxes for 1970, treating them as a controlled group under IRC § 1563. Crow-Burlingame contested this, leading to the case being heard by the U. S. Tax Court, which ruled in favor of the Commissioner.

Issue(s)

1. Whether the stock sold to employees of the subsidiaries and subject to a repurchase option held by CBI was "excluded stock" under IRC § 1563(c)(2)(A)(iii)?

2. Did the repurchase option run in favor of Crow-Burlingame or its subsidiaries, indirectly or otherwise?

Holding

1. Yes, because the stock was subject to conditions that indirectly favored Crow-Burlingame, fulfilling the requirements of "excluded stock" under IRC §

1563(c)(2)(A)(iii).

2. Yes, because Crow-Burlingame indirectly controlled CBI, and the repurchase option thus indirectly favored Crow-Burlingame, meeting the statutory criteria for excluded stock.

Court's Reasoning

The court applied IRC § 1563, which defines a controlled group and specifies "excluded stock" as stock subject to conditions favoring the parent or subsidiary corporation. The court found that the repurchase option held by CBI was a substantial restriction on the employees' disposal rights. Despite CBI being the nominal holder of the option, Crow-Burlingame's control over CBI meant the option indirectly favored Crow-Burlingame. The court cited the Eighth Circuit's decision in *Mid-America Industries, Inc. v. United States*, which supported the view that indirect benefits to the parent corporation from a repurchase option are sufficient to classify stock as excluded. The court emphasized that Crow-Burlingame's dominance over CBI's operations and the shared personnel and office space demonstrated this indirect control. The court also rejected the argument that CBI was an unrelated corporation, pointing to the substantial ownership of CBI's stock by Crow-Burlingame's employees, further solidifying the indirect control argument.

Practical Implications

This decision establishes that for tax purposes, indirect control through a third party can be as significant as direct control in determining the status of a controlled group. Companies must carefully structure employee stock ownership plans to avoid unintended tax consequences, especially when using options or restrictions that might be seen as favoring the parent corporation. This case has influenced how similar arrangements are analyzed, prompting businesses to ensure that any control mechanisms, whether direct or indirect, are structured in a way that does not trigger the controlled group provisions. Subsequent cases have referenced Crow-Burlingame to evaluate the indirect control aspect of excluded stock provisions, reinforcing the need for clear and separate corporate governance in such arrangements.