Textron Inc. & Subsidiary Companies v. Commissioner of Internal Revenue, 117 T. C. 67, 2001 U. S. Tax Ct. LEXIS 37 (U. S. Tax Court 2001)

In a landmark ruling, the U. S. Tax Court decided that Textron Inc. must include in its income the subpart F income of Avdel PLC, a foreign subsidiary, despite not directly owning its shares. The court held that a voting trust, established to comply with FTC regulations, was a grantor trust under U. S. tax law, thus attributing Avdel's income to Textron as the grantor. This decision clarifies the application of subpart F and grantor trust rules, impacting how U. S. corporations structure foreign acquisitions.

Parties

Textron Inc. and Subsidiary Companies (Petitioner) v. Commissioner of Internal Revenue (Respondent). Textron was the plaintiff at the trial level and remained the petitioner in the appeal to the U. S. Tax Court. The Commissioner of Internal Revenue was the defendant at the trial level and the respondent in the appeal.

Facts

In early 1989, Textron Inc. , a domestic corporation, acquired over 95% of the stock of Avdel PLC, a UK-based public limited company. Concurrently, the Federal Trade Commission (FTC) filed a complaint in U. S. District Court, seeking to enjoin Textron's acquisition and control over Avdel due to potential antitrust issues. The District Court issued a temporary restraining order (TRO) and later a preliminary injunction, mandating that Textron transfer its Avdel shares to a voting trust. The trust was managed by an independent trustee, Patricia P. Bailey, who was tasked with ensuring Avdel's independent operation and competition with Textron. Textron was the sole beneficiary of the voting trust, but had no control over Avdel's management or voting rights during the trust's term.

Procedural History

Textron filed a petition in the U. S. Tax Court to redetermine deficiencies determined by the Commissioner of Internal Revenue for the tax years 1988 through 1993. Both parties filed cross-motions for partial summary judgment regarding the inclusion of Avdel's subpart F income in Textron's income. The Tax Court previously decided another issue in the case (Textron Inc. v. Commissioner, 115 T. C. 104 (2000)), and the current motion focused on the subpart F income issue. The court granted summary judgment, applying a de novo standard of review.

Issue(s)

Whether Textron Inc. 's income includes the subpart F income of Avdel PLC, despite Textron not directly owning Avdel's shares due to the voting trust arrangement?

Rule(s) of Law

Subpart F of the Internal Revenue Code (IRC), sections 951 through 963, requires U. S. shareholders to include in their gross income their pro rata share of a controlled foreign corporation's (CFC) subpart F income. A U. S. shareholder is defined as a U. S. person owning, directly or indirectly, 10% or more of the total combined voting power of a foreign corporation. Subpart E of the IRC, sections 671 through 679, treats the grantor of a trust as the owner of any portion of the trust's income that can be distributed to the grantor without the approval of an adverse party.

Holding

The U. S. Tax Court held that Textron Inc. must include Avdel PLC's subpart F income in its gross income. Although Textron did not directly own Avdel's shares, the voting trust was classified as a grantor trust under IRC section 677(a), with Textron as its grantor. Consequently, the trust's subpart F income was attributed to Textron under the grantor trust rules of IRC section 671.

Reasoning

The court reasoned that Textron did not directly own Avdel's shares due to the voting trust arrangement, thus not meeting the direct or indirect ownership requirement under IRC section 951(a) for subpart F income inclusion. However, the court found that the voting trust itself was a U. S. shareholder under IRC section 951(b) because it owned more than 10% of Avdel's voting power and was considered a domestic trust under IRC section 7701(a)(30). The court then applied the grantor trust rules under IRC section 677(a), concluding that Textron was the grantor of the voting trust since it was entitled to the trust's income without the approval of an adverse party. The court rejected Textron's argument that the grantor trust rules should not apply, emphasizing that the statutory language did not provide for such an exception. The court also considered policy considerations, noting that the grantor trust rules were designed to tax income to the person with dominion and control over the trust property, which in this case was Textron.

Disposition

The U. S. Tax Court granted the Commissioner's motion for partial summary judgment and denied Textron's motion for partial summary judgment. The court ordered that decision be entered under Rule 155, requiring Textron to include Avdel's subpart F income in its gross income.

Significance/Impact

This case significantly impacts the tax treatment of foreign subsidiaries held in voting trusts by U. S. corporations. It clarifies that the grantor trust rules can apply to voting trusts established for regulatory compliance, potentially affecting how U. S. companies structure their acquisitions of foreign entities. The decision underscores the broad reach of subpart F and the grantor trust rules, emphasizing that even indirect control through a trust can result in income inclusion for U. S. tax purposes. Subsequent cases have cited Textron for its interpretation of the interaction between subpart F and grantor trust rules, and it remains a key precedent in the area of international tax law.