Crestek, Inc. & Subsidiaries v. Commissioner, 149 T. C. No. 5 (2017)

The U. S. Tax Court ruled that loans and a guaranty extended by Crestek's foreign subsidiaries to its U. S. affiliates constituted investments in U. S. property under I. R. C. § 956, requiring the parent company to include these amounts in its gross income. However, the court found a factual dispute regarding trade receivables between related parties, necessitating a trial to determine their ordinary and necessary status.

Parties

Crestek, Inc. & Subsidiaries, the Petitioner, was represented by Richard Joseph Sapinski, Robert Alan Stern, Jefferson H. Read, Matthew T. Noll, and John H. Dies. The Respondent, the Commissioner of Internal Revenue, was represented by Lisa M. Rodriguez, Paul N. Schneiderman, and Carmen N. Presinal-Roberts.

Facts

Crestek, Inc. , a Delaware corporation, was the parent of a group of companies that included several controlled foreign corporations (CFCs). Before fiscal year 2008 (FY 2008), one of its domestic subsidiaries, CGI, borrowed money from four CFCs: Crest Ultrasonics Malaysia (CUM), KLN Mecasonic BV (Mecasonic), Crest Europe ApS (Crest Europe), and Crest Europe GmbH (Crest Germany). These loans remained outstanding throughout FY 2008 and 2009. Additionally, CGI borrowed from the Bank of Islam, with CUM providing a guaranty for this loan. CUM ceased manufacturing operations in mid-2005, after which it held a constant trade receivable of $7. 92 million from Crest Ultrasonics Corp. (Ultrasonics). Another CFC, Advanced Ceramics Technology Malaysia (ACTM), took over CUM's manufacturing operations and had increasing trade receivables from Ultrasonics during FY 2008 and 2009.

Procedural History

The IRS determined that these transactions resulted in investments in U. S. property under I. R. C. § 956(c)(1)(C), requiring Crestek to include these amounts in gross income under I. R. C. § 951(a)(1)(B). The IRS issued a notice of deficiency, and Crestek timely petitioned the Tax Court. The Commissioner moved for partial summary judgment, seeking a ruling that the intercompany loans, the guaranty, and the trade receivables constituted investments in U. S. property.

Issue(s)

1. Whether the outstanding intercompany loan balances owed by CGI to CUM, Crest Europe, Mecasonic, and Crest Germany constituted investments in U. S. property under I. R. C. § 956(c)(1)(C) during FY 2008 and 2009?
2. Whether CUM's guaranty of CGI's loan from the Bank of Islam constituted an investment in U. S. property under I. R. C. § 956(c)(1)(C) and § 956(d) during FY

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2008 and 2009?
3. Whether the $7. 92 million trade receivable balance owed by Ultrasonics to CUM was in excess of the amount that would be ordinary and necessary under I. R. C. § 956(c)(2)(C) to carry on their respective trades or businesses, thus constituting an investment in U. S. property under I. R. C. § 956(c)(1)(C) during FY 2008 and 2009?
4. Whether the trade receivable balances owed by Ultrasonics to ACTM were ordinary and necessary under I. R. C. § 956(c)(2)(C) to carry on their respective trades or businesses?

Rule(s) of Law

I. R. C. § 956(c)(1)(C) defines U. S. property to include an obligation of a U. S. person. I. R. C. § 956(d) provides that a CFC is considered to hold an obligation of a U. S. person if it is a pledgor or guarantor of such obligation. I. R. C. § 956(c)(2)(C) excludes from U. S. property any obligation of a U. S. person arising in connection with the sale or processing of property if the amount does not exceed what would be ordinary and necessary between unrelated parties to carry on their trades or businesses.

Holding

1. The court held that the outstanding intercompany loan balances owed by CGI to the CFCs constituted investments in U. S. property under I. R. C. § 956(c)(1)(C) during FY 2008 and 2009.
2. The court held that CUM's guaranty of CGI's loan and any direct or indirect pledge of assets as security for that loan constituted an investment in U. S. property under I. R. C. § 956(c)(1)(C) and § 956(d) during FY 2008 and 2009.
3. The court held that the $7. 92 million trade receivable balance owed by Ultrasonics to CUM, which had been outstanding for at least three years and bore no interest, was in excess of the amount that would be ordinary and necessary under I. R. C. § 956(c)(2)(C) to carry on their respective trades or businesses, thus constituting an investment in U. S. property under I. R. C. § 956(c)(1)(C) during FY 2008 and 2009.
4. The court held that there remains a material dispute of fact as to whether the trade receivable balances owed by Ultrasonics to ACTM were ordinary and necessary under I. R. C. § 956(c)(2)(C) to carry on their respective trades or businesses.

Reasoning

The court's reasoning involved analyzing the statutory framework of I. R. C. § 956 and the relevant regulations. For the intercompany loans, the court found no dispute that the loans were outstanding and constituted obligations of a U. S. person. Regarding the guaranty, the court noted that I. R. C. § 956(d) categorically treats a CFC as holding an obligation if it is a guarantor, without regard to the guarantor's financial strength. The court rejected Crestek's arguments about the guaranty's

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value, emphasizing that the statute and regulations do not consider such factors. For CUM's trade receivable, the court found it was not ordinary and necessary because it was a legacy of a terminated business activity and had been outstanding without interest for over three years. However, for ACTM's trade receivables, the court found a genuine dispute of fact requiring trial, as these receivables were part of ongoing business transactions.

Disposition

The court granted in part and denied in part the Commissioner's motion for partial summary judgment. The court ordered Crestek to include in gross income the amounts related to the intercompany loans, the guaranty, and CUM's trade receivable, subject to any applicable earnings and profits limitations and a reduction for previously taxed income.

Significance/Impact

This case clarifies the scope of I. R. C. § 956, particularly regarding what constitutes an investment in U. S. property by CFCs. It underscores the broad application of § 956 to include not only direct loans but also guaranties and certain trade receivables. The decision highlights the importance of the ordinary and necessary exception under § 956(c)(2)(C) and the factual determination required to apply this exception. The ruling impacts multinational corporations with CFCs, emphasizing the need to carefully manage intercompany transactions to avoid unintended tax consequences under the subpart F regime.

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