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Tax Court: Intercompany loan balance, guaranty by CFC constitute "United States property"

The U.S. Tax Court today, on summary judgment motions, found that the U.S. taxpayer must include various amounts in gross income under section 951(a)(1)(B) because the following constituted "United States property" within the meaning of section 956(c)(1)(C):

- An outstanding intercompany loan balance owed by a subsidiary to a controlled foreign corporation (CFC)
- A CFC's guaranty of the loan and direct or indirect pledge of assets as security for the loan
- A trade receivable held by a CFC

The case is: *Crestek, Inc. v. Commissioner,* 149 T.C. No. 5 (July 27, 2017). Read the Tax Court's **opinion** [PDF 128 KB]

Background

The taxpayer is the parent of a group of companies that includes a number of controlled foreign corporations (CFCs).

Before FY 2008, one of the taxpayer's domestic subsidiaries (S1) borrowed money from the CFCs, and those loans remained outstanding throughout FY 2008 and 2009. That subsidiary (before FY 2008) also borrowed money from a Malaysian bank. A CFC (the taxpayer's Malaysian subsidiary) guaranteed this loan.

Before mid-2005, the Malaysian CFC sold completed products to a second domestic subsidiary (S2), for which S2 incurred payment obligations in the form of trade receivables. The Malaysian CFC ceased manufacturing operations in mid-2005. The net trade receivable balance owed by S2 to the Malaysian CFC remained constant at $7.92 million from mid-2005 through the end of FY 2009.

After mid-2005, a second CFC (CFC-2) assumed the manufacturing activities of the Malaysian CFC and sold completed products to S2. The net trade receivable balance owed by S2 to CFC-2 rose from $8.87 million in the first quarter of FY 2007 to $18.41 million in the last quarter of FY 2009.

The IRS determined that all of these transactions gave rise to investments in "United States property" under section 956(c)(1)(C). Thus, it was determined that the taxpayer had to include various amounts in gross income under section 951(a)(1)(B).

Tax Court's opinion

The Tax Court's opinion sets out the following holdings on motions for partial summary judgment:

- The outstanding intercompany loan balance owed by the U.S> subsidiary to the CFCs constituted "United States property" held by the CFCs, pursuant to section 956(c)(1)(C), during FY 2008 and 2009.

- The Malaysian CFC's guaranty of the subsidiary's loan and direct or indirect pledge of assets as security for that loan constituted "United States property" held by the Malaysian CFC, within the meaning of section 956(c)(1)(C) and (d), during FY 2008 and 2009.

- The $7.92 million trade receivable balance owed by S2 to the Malaysian CFC (a receivable that had been outstanding for at least three years and bore no interest) was in excess of the amount that "would be ordinary and necessary" in a transaction between unrelated parties, within the meaning of section 956(c)(2)(C), to carry on their respective trades or businesses. The trade receivable constituted "United States property" held by the Malaysian CFC within the meaning of section 956(c)(1)(C), during FY 2008 and 2009.

Given these findings, the court held that the taxpayer must include various amounts in gross income under section 951(a)(1)(B).

The Tax Court, however, found there was a material dispute of fact as to whether the trade receivable balances owed by S2 to CFC-2, incurred in an ongoing trade or business between those entities, were "ordinary and necessary" within the meaning of section 956(c)(2)(C), to carry on their respective trades or businesses. Thus, the court did not grant summary judgment with respect to this issue.

accurate in the future. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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