



# A Guide to Better Understanding Controlled Groups

Presented By  
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# Background

The Revenue Act of 1964 established the controlled group provisions as part of the Internal Revenue Code. Originally, these provisions were part of a tax reform package intended to encourage small businesses which operated in a corporate form.

Over time, some medium and large enterprises began taking advantage of lower tax rates afforded small businesses by organizing their structure into multiple corporations.

Specifically, multiple forms of corporate organization were used to secure the benefit of a deduction, credit, or other allowance to which a single corporation would not be entitled to in multiple amounts.

Amendments were promulgated to specifically prevent taxpayers from using the multiple form of corporate organization to avoid taxes. These amendments were designed to apply higher tax rates to corporations which were members of an affiliated group of corporations.

Once a corporation was determined to be part of one of the defined “controlled groups,” the group could elect to allocate one of the benefits (a “surtax exemption”), among the members of the group or one member could take the entire benefit, but then the benefit would be denied to all of the rest of the members of the group. ***In other words, the controlled group was treated as one complete entity and not as several small ones.***

Controlled group relates to the principal of controlled groups of corporations that is of general application within the Internal Revenue Code.

26 U.S.C. 1563,  
26 CFR 1.1563 — 1.1563-4

The importance of controlled groups is to determine whether separate related companies can be treated as one company for the purpose of the application of the following provisions of the IRC that TTB administers:

# Electronic Funds Transfer (EFT) in the Law

- Any person who in any 12-month period (ending on December 31) is liable for a gross amount equal to or exceeding \$5 million in taxes imposed on distilled spirits, wine, beer, tobacco products, cigarette papers and tubes are required to pay their taxes via EFT.
- All corporations that are component members of a controlled group shall be treated as one taxpayer for purposes of computing the application of this statute.

26 U.S.C. 5061(e)(1)  
and 5703(b)(3)

- Distilled spirits – 27 CFR 19.524(a)(2)
- Wine – 27 CFR 24.272(a)(3)
- Beer – 27 CFR 25.165(a)(2)
- Tobacco Products, cigarette papers and tubes – 27 CFR 40.357(a)(2)

# Small Winery Tax Credit

Any person who produce less than 250,000 wine gallons of wine during any calendar year shall be allowed a credit against any tax of 90 cents per wine gallon on the first 100,000 wine gallons of wine which are removed for consumption or sale and which have been produced in qualified facilities in the United States.

26 U.S.C. 5041(c)(1),  
27 CFR 24.278(a)

# Small Winery Tax Credit (Continued)

- “Person” means any controlled group of corporations. 

26 U.S.C. 5041(c)(1),  
27 CFR 24.278(a)
- Wineries that are members of controlled groups are treated as one winery for purposes of the 250,000 wine gallon threshold.

# Small Brewery Tax Credit

Brewers who produce not more than 2 million barrels of beer during the calendar year shall pay the tax at a barrel rate of \$7.00 for the first 60,000 barrels of beer which are removed in such year for consumption or sale and which have been brewed or produced by such brewer at qualified breweries in the United States.

26 U.S.C. 5051(a)(2)(A),  
27 CFR 25.152(a)

# Small Brewery Tax Credit (Continued)

- Brewers who are members of controlled groups are treated as one brewery for purposes of the 2 million barrel of beer threshold.

27 CFR 25.152(a)(3)

- The 2 million barrel quantity shall be applied to the controlled group and the 60,000 barrel quantity shall be apportioned among the brewers who are component members of such group.

26 U.S.C. 5051(a)(2)(B),  
27 CFR 25.152(d)

# Special Occupational Tax (SOT)

A manufacturer of tobacco products, cigarette papers and tubes and export warehouse proprietors shall pay a tax of \$1,000 per year in respect of each premises at which such business is carried on.

26 U.S.C. 5731(a),  
27 CFR 40.32(a) and 44.32(a)

# SOT (Continued)

- Any taxpayer whose gross receipts for a taxable year (July 1 – June 30) are less than \$500,000 shall pay at a reduced rate of \$500.00.

26 U.S.C. 5731(b)(1),  
27 CFR 40.32(b) and 44.32(b)

- Component members of a controlled group shall be treated as one taxpayer for purposes of this reduced rate.

26 U.S.C. 5731(b)(2),  
27 CFR 40.32(c) and 44.32(c)

# Tobacco Floor Stocks Tax (SCHIP)

- The existence of a controlled group has also been important in determining a taxpayer's eligibility for a credit against the tobacco floors stocks tax.
- Rules that apply for EFT also apply.

# **Types of Controlled Groups**

**26 U.S.C. 1563(a)(1)-(3)**

# Types of Controlled Groups

- 26 U.S.C. 1563(a)(1) – (3) recognize following main types of controlled groups of corporations:
  - Parent/Subsidiary – 26 U.S.C. 1563(a)(1)
  - Brother/Sister – 26 U.S.C. 1563(a)(2)
  - Combined Groups – 26 U.S.C. 1563(a)(3)

# **Unincorporated Entities as Members of Controlled Groups**

# Unincorporated Entities as Controlled Groups

Under TTB statutes and regulations controlled group principles are applicable to groups of persons under common control where one or more persons are not a corporation relative to the following provisions of the IRC that are administered by TTB. ***A controlled groups exists where unincorporated entities are subject to common management and financial control.***

# Unincorporated Entities as Controlled Groups

Unincorporated entities include, but are not limited to, sole proprietorships, partnerships, limited liability companies, as well as any other type of state recognized business structure.

# Parent-Subsidiary Controlled Groups

26 U.S.C. 1563(a)(1)

# Parent-Subsidiary

- One or more chains of corporations connected through stock ownership with a common parent corporation if:

26 U.S.C. 1563(a)(1)

# Parent-Subsidiary (Continued)

- Stock possessing at least **80 percent** of the total combined voting power of all classes of stock entitled to vote or at least **80 percent** of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; **and**

26 U.S.C. 1563(a)(1)

# Parent-Subsidiary (Continued)

- The common parent corporation owns (within the meaning of subsection (d)(1)) stock possessing at least **80 percent** of the total combined voting power of all classes of stock entitled to vote or at least **80 percent** of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such corporations.

26 U.S.C. 1563(a)(1)

# Parent-Subsidiary (Continued)

- 26 U.S.C. 1563(a)(1):
  - Provides that the existence of a parent-subsubsidiary controlled group requires “at least 80% ownership” of the voting stock (or total value of shares)
- TTB laws and regulations only require “more than 50%” ownership of the voting stock (or total value of shares).

# Parent-Subsidiary (Continued)

- Parent-subsubsidiary controlled group exists if following elements are met:
  - Existence of one or more chains of corporations
  - Chains of corporations are connected through stock ownership
  - Existence of common parent corporation
  - More than 50% of stock (voting or total value) of each subsidiary corporation is owned by other corporations in group
  - Parent corporation must own more than 50% of stock (voting or total value) of one of subsidiary corporations

26 U.S.C. 1563(a)(1)

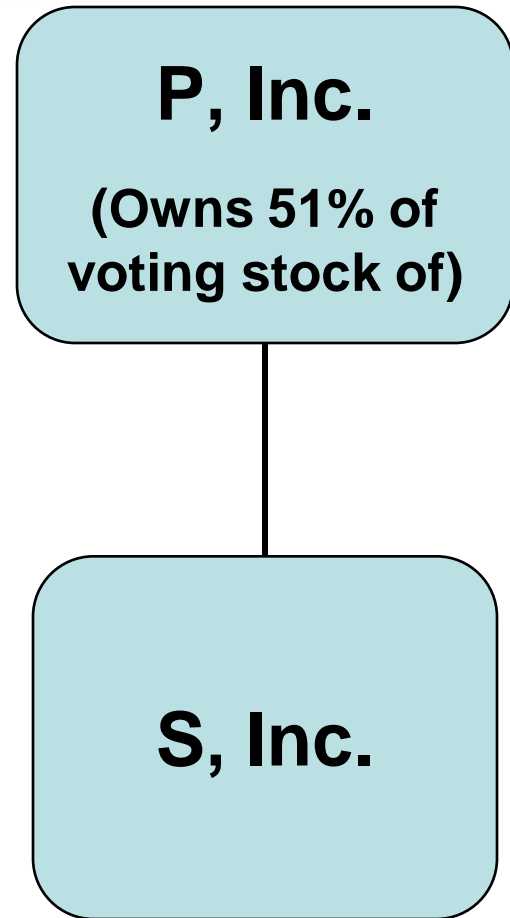
# Parent-Subsidiary Controlled Groups

Examples

# Example 1

P, Inc. and S, Inc. are both distilled spirits plants. Both corporations have gross receipts of \$3 million during the calendar year.

The question has arisen as to whether both P and S must start to pay their taxes through electronic fund transfers.



# Example 1 (Continued)

- |  |  |
|--|--|
| 1. Do one or more chains of corporations exist?  | 1. Yes. P, Inc. and S, Inc.  |
| 2. Are they connected by common stock ownership? | 2. Yes. P, Inc. owns more than 50% of the voting stock of S, Inc.                    |
| 3. Is there a common parent corporation?         | 3. Yes. P, Inc. is the parent of S., Inc. by virtue of its majority stock ownership. |

# Example 1 (Continued)

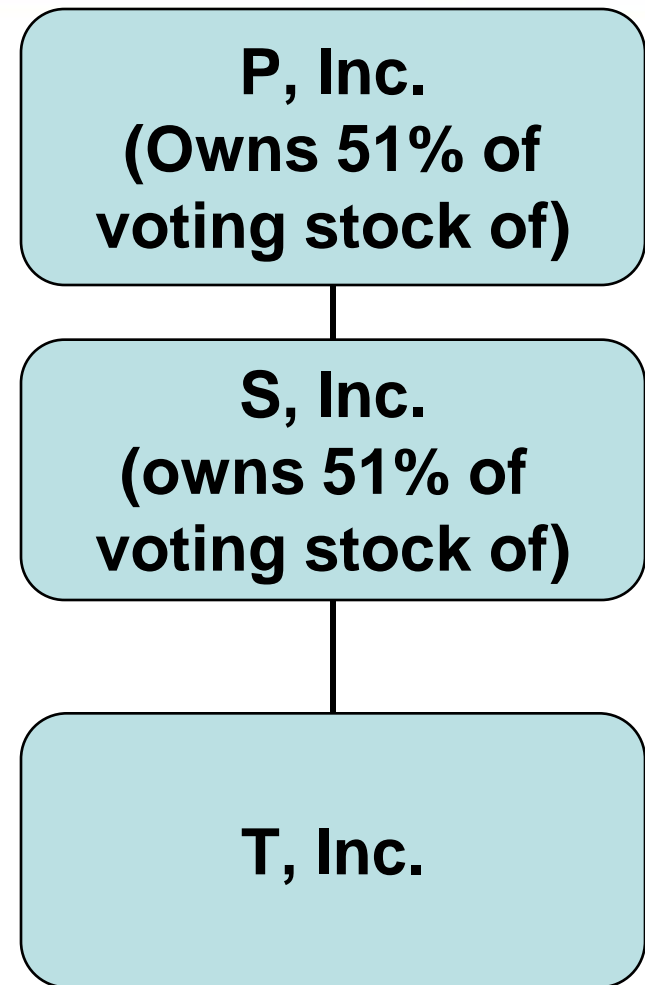
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| <p>4. Is more than 50% of the stock (voting or total value) of each subsidiary corporation owned by other corporations in group?</p> | <p>4. Yes. P, Inc. owns more than 50% of the voting stock in S, Inc.</p> |
| <p>5. Does the parent corporation own more than 50% of the stock (voting or total value) of one of the subsidiary corporations?</p>  | <p>5. Yes. P, Inc. owns more than 50% of the voting stock of S, Inc.</p> |

## Example 1 (Continued)

- A parent-subsubsidiary controlled group exists between P, Inc. and S, Inc. and are treated as one taxpayer for purposes of the EFT requirement.
- Since the gross receipts of both corporations exceed \$5 million dollars, both corporations are required to submit their tax payments via EFT.

## Example 2

P, Inc., S, Inc. and T, Inc. are related corporations that are also wineries. They each produced 100,000 wine gallons of wine during the past calendar year. Each winery alleges that it can avail itself of the small winery tax credit under 26 U.S.C. § 5041.



## Example 2 (Continued)

- |  |   |
|--|---|
| 1. Do one or more chains of corporations exist?  | 1. Yes. P, Inc., S, Inc., and T, Inc.   |
| 2. Are they connected by common stock ownership? | 2. Yes. P, Inc. owns more than 50% of the voting stock of S, Inc. and S, Inc. owns more than 50% of the voting stock of T, Inc. |
| 3. Is there a common parent corporation?         | 3. Yes. P, Inc. is the “common parent” of S, Inc. and T, Inc. by virtue of its stock ownership in S, Inc.                       |

## Example 2 (Continued)

4. Is more than 50% of the stock (voting or total value) of each subsidiary corporation owned by other corporations in group?
5. Does the parent corporation own more than 50% of the stock (voting or total value) of one of the subsidiary corporations?
4. Yes. P, Inc. owns more than 50% of the voting stock in S, Inc and S, Inc. owns more than 50% of the voting stock in T, Inc.
5. Yes. P, Inc. owns more than 50% of the voting stock of S, Inc.

## Example 2 (Continued)

- A parent-subsidary controlled group exists between P, Inc. and S, Inc. P, Inc. is the common parent of a parent-subsidary controlled group consisting of P, Inc., S, Inc. and T, Inc. S & T are the subsidiaries to P, Inc.
- These three corporations are treated as one person for purposes of the eligibility for the small winery producer's credit. The three wineries produced a combined 300,000 wine gallons of wine during the past calendar year. Consequently, they are not entitled to the small winery tax credit.

- Additional examples of parent-subsidiary controlled groups can be found in the appendix to this presentation, which will be posted on the TTB Web site with the appendix.

# **Brother-Sister Controlled Groups**

**26 U.S.C. 1563(a)(2)**

# Brother-Sister Controlled Group

Two or more corporations if 5 or fewer persons who are individuals, estates or trusts own (within the meaning of subsection (d)(2)) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each person only to the extent such stock ownership is identical with respect to each such corporation.

26 U.S.C. 1563(a)(2)

# Brother-Sister Controlled Group (Continued)

- Based on the statute, a brother-sister controlled group exists if following elements are met:
  - Must have two or more corporations
  - Five or fewer persons who are individuals, estates or trusts own stock possessing (voting power or total value) more than 50% of each corporation
  - The individuals who own more than 50% of the stock in each corporations own more than a 50% identical interest in each corporation.

26 U.S.C. 1563(a)(2)

# **Brother-Sister Controlled Groups**

## **Examples**

## Example 1

- Five related corporations (P, Q, R, S, and T) are each wineries. They each had gross tax liability in the last calendar year of \$1.5 million dollars
- The question has been raised as to whether these corporations are required to pay their taxes via EFT
- Each corporation has the same five shareholders (A, B, C, D, and E)

# Example 1 (Continued)

Corp. "P"	Corp. "Q"	Corp. "R"	Corp. "S"	Corp. "T"
Shareholder A 55% voting stock	Shareholder A 51% voting stock	Shareholder A 55% voting stock	Shareholder A 55% voting stock	Shareholder A 55% voting stock
Shareholder B 45% voting stock	Shareholder B 49% voting stock			
		Shareholder C 45% voting stock		
			Shareholder D 45% voting stock	
				Shareholder E 45% voting stock

# Example 1 (Continued)

1. Are there two or more corporations?
  1. Yes. There are 5 total corporations (P, Q, R, S, and T).
2. Do five or fewer persons own stock possessing (voting power or total value) more than 50% of each corporation?
  2. Yes. To meet this element the same 5 or fewer persons must own more than 50% of the stock (or some interest in all members of the controlled group). In this example, Shareholder A owns more than 50% of all of the stock of all corporations, i.e. 55% of P, 51% of Q, 55% of R, 55% of S and 55% of T.

# Example 1 (Continued)

- 3. Does Shareholder A own more than a 50% identical stock ownership in each corporation?
- 3. Yes. Shareholder A has a 51% identical interest in each of the corporations.

Identity of ownership interest is measured by the proportion of stock ownership that a shareholder has in a group of corporations.

## Example 1 (Continued)

- The result in Example 1 is that Corporations P, Q, R, S, and T are members of a brother-sister controlled group. All corporations in the controlled group are treated as one taxpayer for purposes of the EFT requirement.
- The combined gross tax liability of all corporations in the controlled group was \$7.5 million dollars in the past calendar year. Accordingly, all corporations are required to pay their taxes via EFT.

- Additional examples of brother-sister controlled groups can be found in the appendix to this presentation, which will be posted on the TTB Web site with the appendix.

# **Combined Controlled Groups**

**26 U.S.C. 1563(b)(3)**

# Combined Groups

- Three or more corporations each of which is a member of a group of corporations described in paragraph (1) or (2), and one of which—
  - Is a common parent corporation included in a group of corporations described in paragraph (1), and also
  - Is included in a group of corporations described in paragraph (2).

26 U.S.C. 1563(b)(3)

# Combined Groups (Continued)

- Based on the statute, a parent-subsidary controlled group exists if the following elements are met:
  - Three or more corporations each of which is a member of a group of a parent-subsidary or brother-sister controlled group
  - One of the corporations is a common parent corporation which is included in a parent-subsidary controlled group and is also included in a brother-sister controlled group

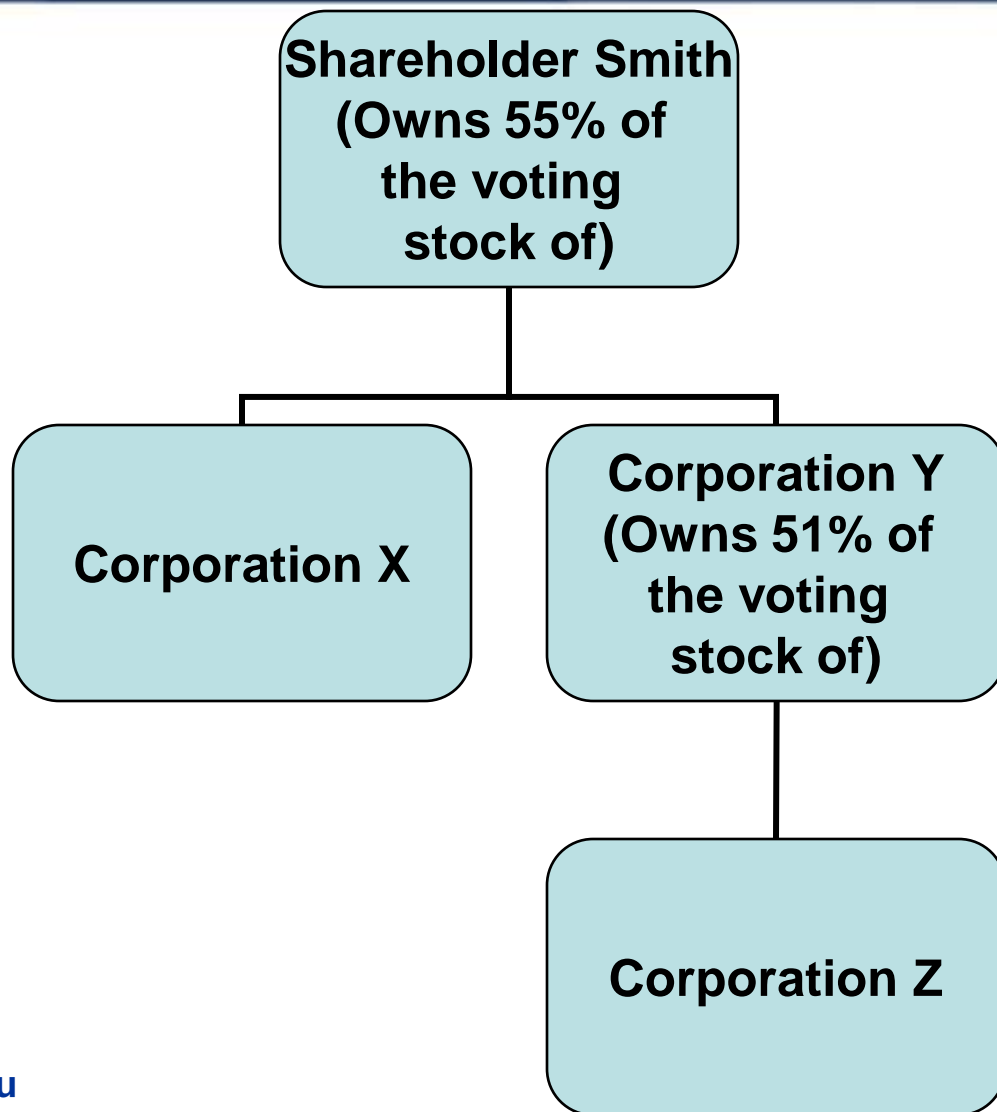
26 U.S.C. 1563(b)(3)

# Combined Controlled Groups

## Examples

# Example 1

Corporations X, Y and Z are related corporations that are breweries. The gross tax liability for each brew pub was \$2 million for the past calendar year. The question has arisen as to whether each brewery is required to pay its taxes via EFT.



# Example 1 (Continued)

1. Are there three or more corporations each of which is a member of a group of a parent-subsidary or brother-sister controlled group?
  2. Is one of the corporations a common parent corporation which is included in a parent-subsidary controlled group?
1. Yes. Corporations X, Y, and Z are members of either a parent subsidiary or brother-sister controlled group.
  2. Yes. Corporation Y is a parent corporation in a parent subsidiary controlled group (Corporation Z is the subsidiary).

# Example 1 (Continued)

3. If the answer to question 2 is yes, then is this common parent corporation also included in a brother-sister controlled group?
3. Yes. Corporation Y is included in a brother-sister controlled group with Corporation X.

## Example 1 (Continued)

- A combined group is the linking of 3 or more corporations that are individually members of parent-subsidary and brother-sister controlled groups.
- The key to linking these groups together is whether there is one corporation that is a member of both the parent-subsidary controlled group and the brother-sister controlled group.

## Example 1 (Continued)

- The result in Example 1 is that combined group exists between Corporations X, Y and Z.
- For purposes of determining the proper method of payment of taxes, all corporations in the combined group are treated as one taxpayer. The combined gross tax liability for all of the corporations in the combined group was \$6 million dollars during the past year. Consequently, all corporations are required to pay their taxes via EFT.

- An additional example of a combined controlled group can be found in the appendix to this presentation, which will be posted on the TTB Web site with the appendix.

# **Stock Ownership Controlled Groups**

**26 U.S.C. 1563(d)**

26 U.S.C. 1563(d) sets forth the rules for stock ownership in determining whether a corporation is a member of either a parent-subsidary and brother-sister controlled group.

## Parent-subsidary controlled groups:

- 26 U.S.C. 1563(d)(1) provides that for determining whether a corporation is a member of a parent-subsidary controlled group, stock owned by a corporation means:  
(a) stock owned directly by such corporation;  
and (b) stock owned pursuant to 26 U.S.C. 1563(e)(1), (2), and (3).

## Brother-sister controlled groups:

- 26 U.S.C. 1563(d)(2) provides that for determining whether a corporation is a member of a brother-sister controlled group, stock owned by a person who is an individual, estate or trust means (a) stock owned directly such person; and (b) stock owned pursuant to 26 U.S.C. 1563(e)(1) – (6).

# Constructive Stock Ownership

- Indirect ownership of stock in following situations:
  - Options
  - Attribution from partnerships
  - Attribution from estates or trusts
  - Attribution from corporations
  - Spouse
  - Children, grandchildren, parents and grandparents

26 U.S.C. 1563(e)

# **Component Members and Related Principles**



# Component Members

**Component Members:** 26 U.S.C. 1563(b)(1)

**Excluded Members:** 26 U.S.C. 1563(b)(2)

**Additional Members:** 26 U.S.C. 1563(b)(3)

**Overlapping Groups:** 26 U.S.C. 1563(b)(4)

# Component Members (Continued)

A corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if such corporation:

26 U.S.C. 1563(b)(1)

# Component Members (Continued)

- Is a member of such controlled group of corporations on the December 31 included in such year and is not treated as an excluded member (as defined under section 1563(b)(2); or
- Is not a member of such controlled group of corporations on the December 31 included in such year but is treated as an additional member (as defined under section 1563(b)(3).

26 U.S.C. 1563(b)(1)

# Excluded Members

A corporation which is a member of a controlled group of corporations on December 31 of any taxable year shall be treated as an excluded member of such group for the taxable year including such December 31 if such corporation:

26 U.S.C. 1563(b)(2)

# Excluded Members (Continued)

- Is a member of such group for less than one-half the number of days in such taxable year which precede such December 31;
- Is exempt from taxation under section 501(a) (except a corporation which is subject to tax on its unrelated business taxable income under section 511) for such taxable year;

26 U.S.C. 1563(b)(2)

# Excluded Members (Continued)

- Is a foreign corporation subject to tax under section 881 for such taxable year;
- Is an insurance company subject to taxation under section 801 (other than an insurance company which is a member of a controlled group described in subsection (a)(4)), or
- Is a franchised corporation, as defined in subsection (f)(4).

26 U.S.C. 1563(b)(2)

# Additional Members

A corporation which:

- Was a member of a controlled group of corporations at any time during calendar year,
- Is not a member of such group on December 31 of such calendar year, and
- Is not described, with respect to each group, in subparagraph (B), (C), (D), or E of section 1563(b)(2) (excluded members),

26 U.S.C. 1563(b)(3)

# Additional Members (Continued)

- Shall be treated as an additional member of such group on December 31 for its taxable year including such December 31 if it was a member of such group for one-half (or more) of the number of days in such taxable year which precede such December 31.

26 U.S.C. 1563(b)(3)

# Overlapping Groups

- A corporation is a component member of more than one controlled group of corporations with respect to any taxable year, such corporation shall be treated as a component member of only one controlled group.
- The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary which are consistent with the purposes of this part.

26 U.S.C. 1563(b)(4)

# Evidence of Controlled Groups

- Formation Documents:
  - These include articles of incorporation (corporations); articles of organization (limited liability companies); partnership agreements
- Included are any documents that evidence the ownership interest of the following persons:

# Evidence of Controlled Groups (Continued)

- Trust and estate interests (e.g., trust agreements, wills)
- Sole proprietor/individual ownership interests
- Spousal interests
- Children/grandchildren/parents/gandparents interests
- Any other group or individuals holding an interest in the business subject to tax



# Contact Information

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# **Appendix**

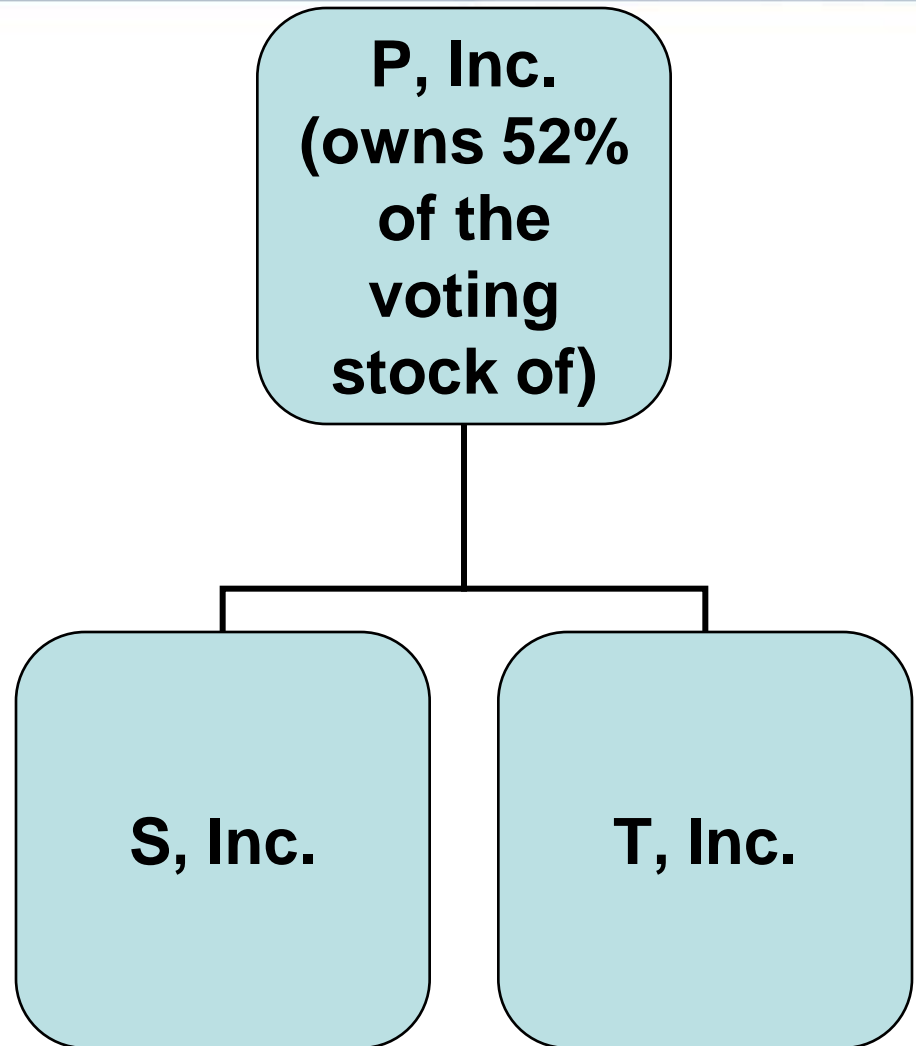
## **Additional Examples**

# **Additional Examples of Parent-Subsidiary Controlled Groups**

# Additional Example 1

P, Inc., S, Inc., and T, Inc. are related corporations that are also breweries. They each produced 700,000 barrels of beer during the past calendar year.

Each alleges that it can avail itself of the small brewery tax credit under 26 U.S.C. 5051(a)(2).



# Additional Example 1 (Continued)

1. Do one or more chains of corporations exist?  
1. Yes. P, Inc., S, Inc., and T, Inc.
2. Are they connected by common stock ownership?  
2. Yes. P, Inc. owns more than 50% of the voting stock of both S, Inc. and T, Inc.
3. Is there a common parent corporation?  
3. Yes. P, Inc. is the “common parent” of both S, Inc. and T., Inc.

# Additional Example 1 (Continued)

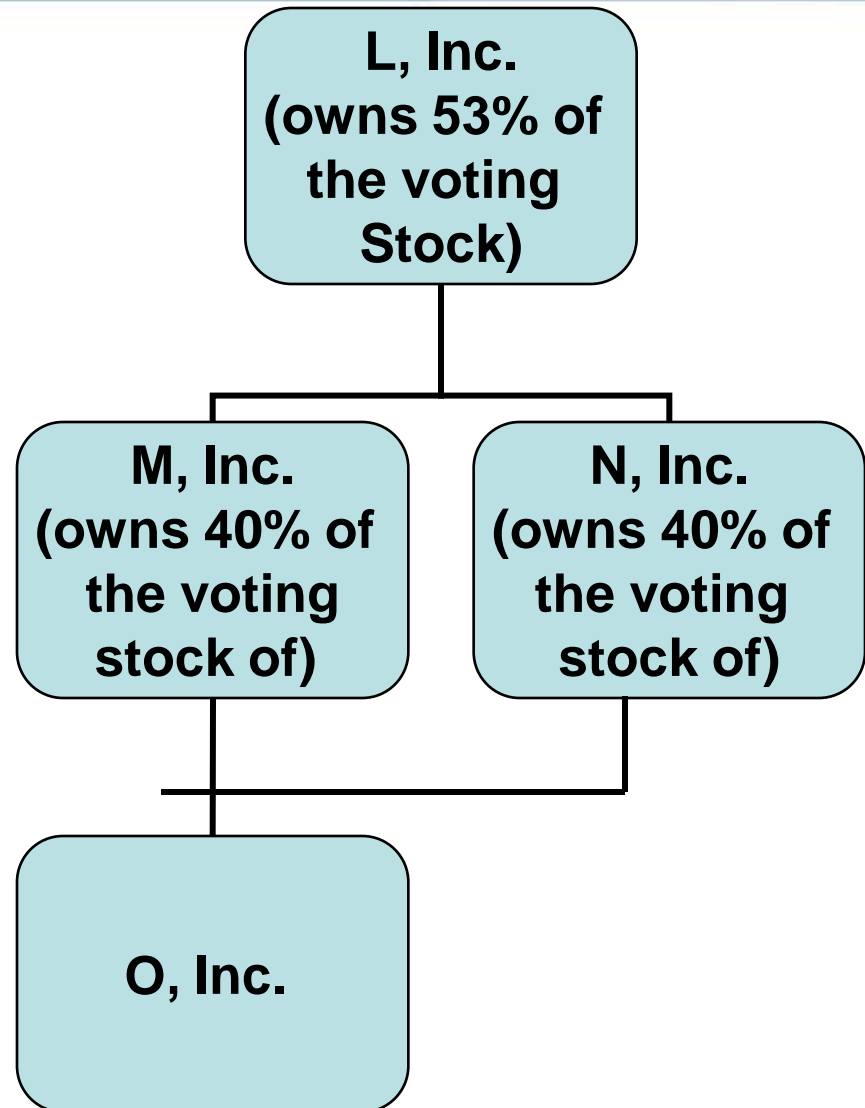
4. Is more than 50% of the stock (voting or total value) of each subsidiary corporation owned by other corporation in group?
4. Yes. P, Inc. owns more than 50% of the voting stock of both S, Inc and T, Inc.
5. Does the parent corporation own more than 50% of the stock (voting or total value) of one of the subsidiary corporations?
5. Yes. P, Inc. owns at least 50% of the voting stock of both S, Inc. and T, Inc.

# Additional Example 1 (Continued)

- P, Inc. is the common parent of a parent-subsidary controlled group that consists of P, Inc., S, Inc., and T, Inc. P, Inc. is the parent corporation. S, Inc. and T, Inc. subsidiary corporations of P, Inc.
- All breweries in the controlled group are considered one brewery for purposes of eligibility for the small brewery producer's credit. All breweries in the group produced a combined 2.1 million barrels of beer during the last calendar year. Accordingly, the breweries are not eligible for the small brewery tax credit.

## Additional Example 2

L, Inc., M, Inc, N, Inc. and O, Inc. are related corporations that are producers of cigars. From July 1, 2005, through June 30, 2006, each corporation had gross receipts of \$150,000. Each corporation maintains that it is eligible for the reduced SOT rate of \$500.00 for the year July 1, 2006, through June 30, 2007.



# Additional Example 2 (Continued)

1. Do we have the existence of one or more chains of corporations?
  1. Yes. L, Inc., M, Inc., and N, Inc., O, Inc.
2. Are they connected by common stock ownership?
  2. Yes. L, Inc. owns more than 50% of the voting stock of both M, Inc. and N, Inc. M, Inc. and N, Inc. each own 40% of the voting stock of O, Inc.
3. Is there a common parent corporation?
  3. Yes. L, Inc. is the “common parent” of M, Inc., N, Inc., and O, Inc.

# Additional Example 2 (Continued)

- |  |  |
|--|--|
| <p>4. Is more than 50% of the stock (voting or total value) of each subsidiary corporation owned by other corporations in group?</p> <p>5. Does the parent corporation own more than 50% of the stock (voting or total value) of one of the subsidiary corporations?</p> | <p>4. Yes. L, Inc. owns more than 50% of the voting stock of both M, Inc and N, Inc. Further, more than 50% of the voting stock of O, Inc. is owned in combination by M, Inc. and N, Inc. (M, Inc. and N, Inc. each own 40% of the voting stock of O, Inc. Their total combined ownership interest equals more than 50%).</p> <p>5. Yes. L, Inc. owns more than 50% of the voting stock of M, Inc. and N, Inc. Both M and N combined own more than 50% of the voting stock of both S, Inc. and T, Inc.</p> |
|--|--|

## Additional Example 2 (Continued)

- L, Inc. is the common parent of a parent-subsidary controlled group that consists of L, Inc., M, Inc., N, Inc. and O, Inc. L, Inc. is the parent corporation. M, Inc., N, Inc. and O, Inc. are the subsidiary corporations. All corporations in the controlled groups are considered one person for purposes of eligibility for the reduced SOT rate.
- The gross receipts of all four corporations combined was \$600,000 for the past tax year. Consequently, the corporations are not eligible for the reduced SOT rate.

**Additional Examples of  
Brother-Sister  
Controlled Groups**

# Additional Example 1

- Five related corporations (P, Q, R, S, and T) are wineries. They each produced 60,000 wine barrels of wine during the past calendar year. All of the wineries maintain that they are eligible for the small winery tax credit.
- Each corporation has the same common shareholders (A, B, C, D, and E). The stock ownership held by each shareholder in each corporation is as follows:

# Additional Example 1

Corp. "P"	Corp. "Q"	Corp. "R"	Corp. "S"	Corp. "T"
Shareholder A 35% voting stock	Shareholder A 31% voting stock	Shareholder A 35% voting stock	Shareholder A 35% voting stock	Shareholder A 35% voting stock
Shareholder B 16% voting stock	Shareholder B 20% voting stock			
		Shareholder C 16% voting stock		
			Shareholder D 16% voting stock	
				Shareholder E 16% voting stock

# Additional Example 1 (Continued)

1. Are there two or more corporations?

1. Yes. There are 5 total corporations (A, B, C, D, and E).

2. Do five or fewer persons own stock possessing (voting power or total value) more than 50% of two or more of the corporations?

2. Yes. Corporations P and Q have five or fewer persons that own more than 50% of their stock in each corporation. The following is how we arrive at that figure:

## Additional Example 1 (Continued)

- Shareholders A and B have a combined ownership interest of 51% of the stock of Corporation P (A owns 35% and B owns 16%) and Corporation Q (A owns 31% and B owns 20%).
- For purposes of this example, we are only looking at a brother-sister controlled group between Corporations P and Q.

# Additional Example 1 (Continued)

3. Do shareholders A and B own more than a 50% identical stock ownership in each corporation?

3. NO! The following is the breakdown of the identical ownership interest in each corporation:

- Shareholder A only has a 31% identical ownership interest in Corporations P and Q.
- Shareholder B only has a 16% identical interest in these same corporations.
- Shareholders A and B have a combined identical ownership interest of 47% of these two corporations.

# Additional Example 1 (Continued)

- As to Question 2: When calculating the “more than 50%,” you can combine the stock ownership of more than one shareholder.
- As to Question 3: The standard for this element is “proportion of identical stock ownership interest” and not “amount of actual stock owned.”

# Additional Example 1 (Continued)

- The result is that no “brother-sister” controlled group exists between Corporations P and Q.
- For purposes of the eligibility for the small winery producer’s credit, each corporation is treated individually. All of the corporations individually produced less than 250,000 wine gallons of wine during the last calendar year. Consequently, all of the corporations are eligible for the small winery tax credit.

## Additional Example 2

- Two related corporations (U and V) are breweries. They each produced 1.2 million barrels of beer during the last calendar year. Each brewery maintains that it is eligible for the small brewery tax credit.
- Each have the same eleven shareholders (A, B, C, D, E, F, G, H, I, J and K). The stock ownership held by each shareholder in each corporation is as follows:

# Additional Example 2 (Continued)

Corporation U	Corporation V
Shareholder A: 10% of voting stock	Shareholder A: 10% of voting stock
Shareholder B: 10% of voting stock	Shareholder B: 10% of voting stock
Shareholder C: 10% of voting stock	Shareholder C: 10% of voting stock
Shareholder D: 10% of voting stock	Shareholder D: 10% of voting stock
Shareholder E: 10% of voting stock	Shareholder E: 10% of voting stock
Shareholder F: 9% of voting stock	Shareholder F: 9% of voting stock
Shareholder G: 9% of voting stock	Shareholder G: 9% of voting stock
Shareholder H: 9% of voting stock	Shareholder H: 9% of voting stock
Shareholder I: 9% of voting stock	Shareholder I: 9% of voting stock
Shareholder J: 9% of voting stock	Shareholder J: 9% of voting stock
Shareholder K: 5% of voting stock	Shareholder K: 5% of voting stock

# Additional Example 2 (Continued)

1. Are there two or more corporations?
  1. Yes. There are 2 corporations (U & V).
2. Do five or fewer persons own stock possessing (voting power or total value) more than 50% of each corporation?
  2. NO! No group of 5 or fewer shareholders owns more than 50% of the stock in each corporation, nor does any such group meet the 50% test of identical ownership. The maximum amount of stock that is owned by any 5 persons is 50% (Shareholders A, B, C, D and E).

**NOTE:** The amount of stock owned must be more than 50%.

# Additional Example 2 (Continued)

3. Do five or fewer persons own more than a 50% identical stock ownership in each corporation?

3. NO! Again, the maximum amount of identical ownership interest of any 5 shareholders is 50% (Shareholders A, B, C, D and E).

**NOTE:** The amount of identical stock ownership or must be more than 50%.

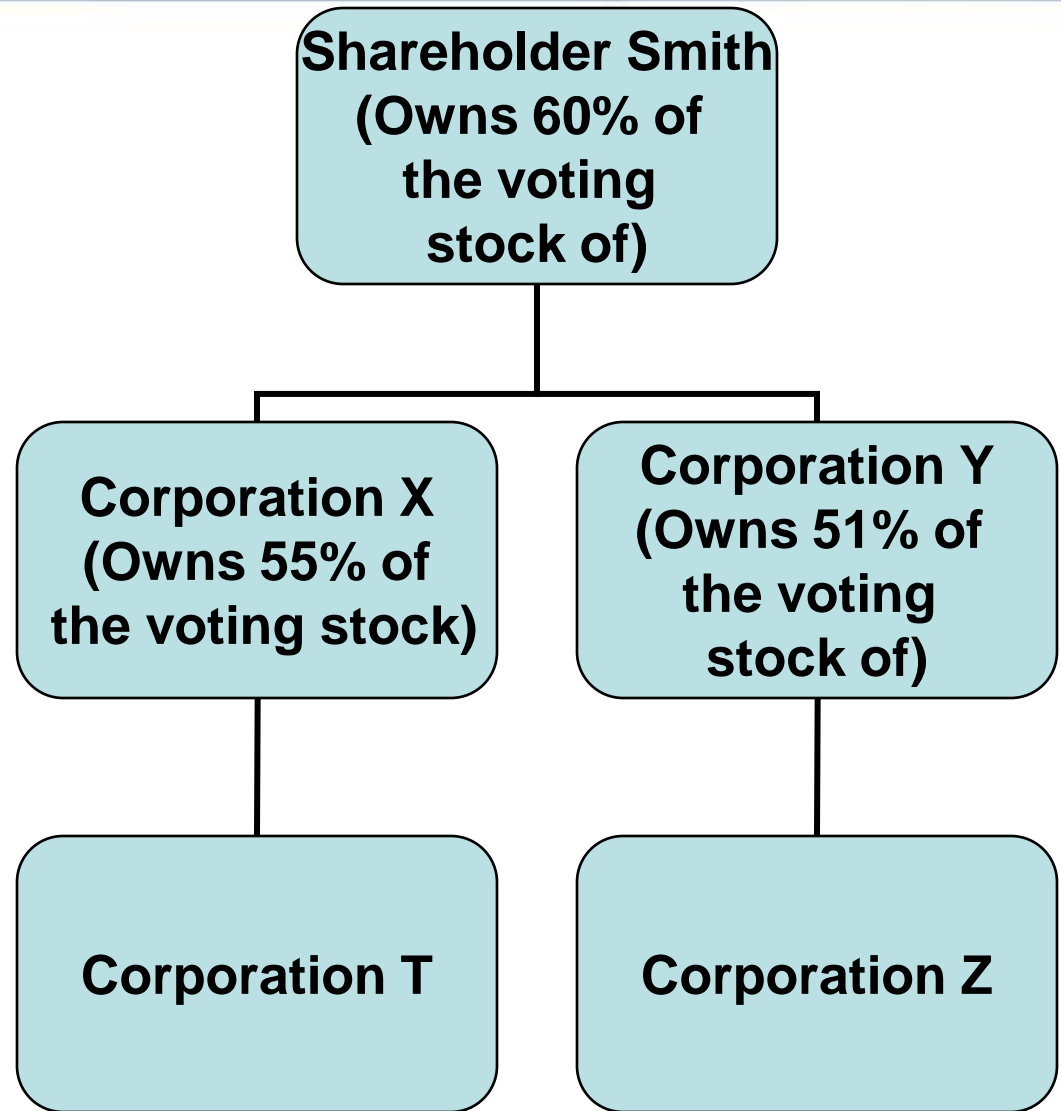
## Additional Example 2 (Continued)

- The result in Question 3 is that no “brother-sister” controlled group exists between Corporations U and V.
- For purposes of eligibility for the small brewery producer’s credit, each corporation is treated individually. Each brewery produced 1.2 million barrels of beer during the last calendar year. Consequently, each brewery is eligible for the small brewery tax credit.

# **Additional Example of a Combined Controlled Group**

# Additional Example

Corporations T, X, Y and Z are related corporations and are also wineries. They each produced 70,000 wine gallons of wine during the last calendar year. Each winery maintains that it is eligible for the small winery tax credit.



# Additional Example (Continued)

1. Are there three or more corporations each of which is a member of a group of a parent-sub subsidiary or brother-sister controlled group?

1. Yes. Corporations T, X, Y and Z are members of either a parent-sub subsidiary or brother-sister or are a brother-sister controlled group. The following is the basis for this conclusion:

# Additional Example (Continued)

- Corporations X and Y are members of a brother-sister controlled group.
- Corporations X and T are members of a parent-subsidary controlled group. Corporation X is the parent corporation. Corporation T is the subsidiary corporation.
- Corporations Y and Z are members of a parent-subsidary controlled group. Corporation Y is the parent corporation. Corporation Z is the subsidiary.

# Additional Example (Continued)

- |  |   |
|--|---|
| <p>2. Is one of the corporations a common parent corporation which is included in a parent-subsidary controlled group?</p>               | <p>2. Yes. Corporations X and Y are each parent corporations in a parent-subsidary controlled group.</p>    |
| <p>3. If the answer to question 2 is yes, then is this common parent corporation also included in a brother-sister controlled group?</p> | <p>3. Yes. Corporations X and Y are both included in a brother-sister controlled group with each other.</p> |

# Additional Example (Continued)

- The result in Question 2 is that combined group exists between Corporations T, X, Y and Z.
- For purposes of the eligibility for the small winery producer's credit, the wines produced by all corporations in the combined group are examined together. The combined production of all of the wineries in the combined group was 280,000 wine gallons. Consequently, the corporations in the group are not entitled to the small winery tax credit.