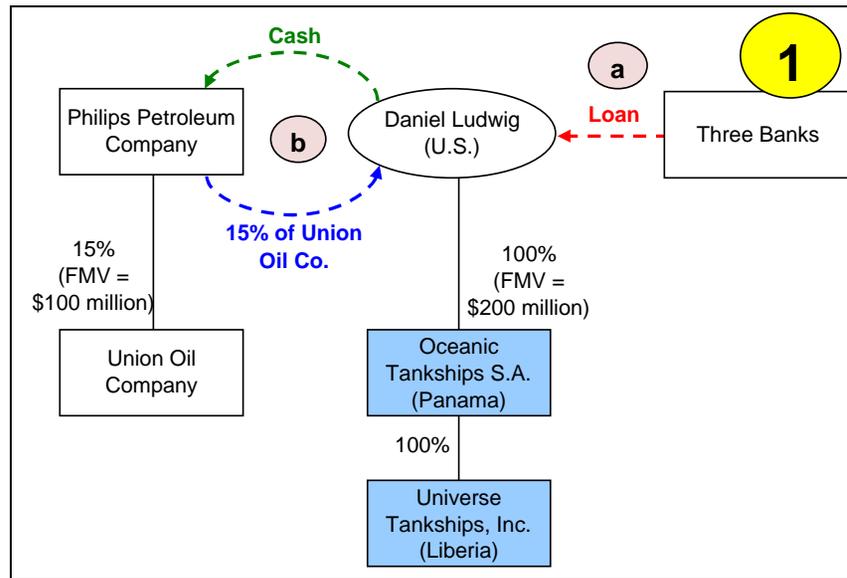


**Ludwig v. Commissioner  
68 T.C. 979 (1977)**

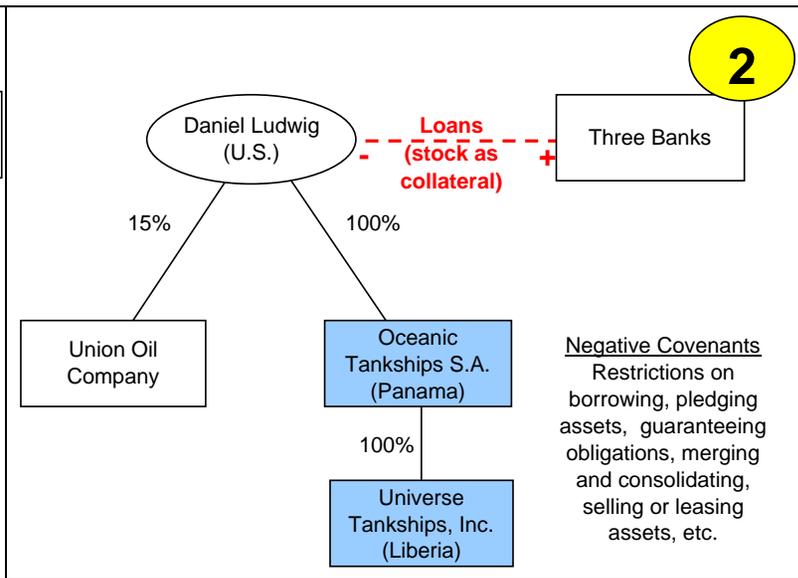
**Pledge of CFC Stock With  
Negative Covenants Was Not  
A Guarantee By The CFC**

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**Borrowing & Purchase**



**Oceanic Negative Covenants**



In June 1963, Ludwig entered into an agreement with Phillips Petroleum providing for the purchase by Ludwig from Phillips of 1,340,517 shares of stock of Union Oil Company. These shares amounted to approximately 15 percent of Union Oil's total outstanding stock. The purchase price was \$75 per share, or a total of \$100,538,775.

In order to pay for the 1,340,517 shares of Union Oil, Ludwig arranged to borrow the entire amount of the purchase price from three banks. Ludwig offered and the banks accepted as collateral the 1,340,517 shares of Union Oil stock to be acquired by Ludwig with the loan proceeds, plus 1,000 shares of Oceanic Tankships, S.A. (Oceanic). In order to protect the value of the Oceanic stock held as collateral, the banks required of Ludwig certain negative covenants restricting his absolute control over the assets and liabilities of Oceanic and Universe during the term of the loan.

The Tax Court held that section 956(c) is applicable only where the guarantor--the controlled foreign corporation ("CFC") --is a party to the transaction, not when its stock is merely pledged. At the time of this case, pledging the stock of a CFC did not create an investment in U.S. property. However, Treas Reg. 1.956-2(c) was amended in 1980 to provide that the CFC is considered an indirect pledgor or guarantor if two-thirds or more of all classes of stock entitled to vote is pledged and the pledge is accompanied by one or more negative covenants.

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