12 T.C. 869 (1949)

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A corporation can be subject to accumulated earnings tax under Section 102 of the Internal Revenue Code if it accumulates earnings beyond the reasonable needs of its business, effectively preventing the imposition of surtax on its shareholders.

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Summary

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Eastern Railway & Lumber Company was assessed a deficiency for improperly accumulating surplus. The Tax Court upheld the Commissioner's determination, finding that the company had accumulated earnings beyond its reasonable business needs in 1943, with the purpose of preventing surtax on its shareholders. The company, primarily owned by S.A. Agnew, had become largely inactive after 1939 and was found to be using its retained earnings to finance Agnew's personal business ventures, rather than distributing them as dividends.

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Facts

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Eastern Railway & Lumber Company, incorporated in 1903, engaged in the logging and lumber business. S.A. Agnew became the majority shareholder over time. After a fire in 1939, the company became inactive, leasing its mill to Agnew. Agnew also purchased the company's timber. Instead of paying for the timber, Agnew used the funds to buy more timber for himself. The company paid no dividends after 1920 and accumulated significant cash and surplus in 1943.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Eastern Railway & Lumber Company's income tax and declared value excess profits tax for 1943,

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citing the improper accumulation of earnings to avoid surtax on shareholders under Section 102 of the Internal Revenue Code. The Tax Court upheld the Commissioner’s determination.

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Issue(s)

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Whether the petitioner was availed of during the taxable year 1943 for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its earnings or profits to accumulate instead of being divided or distributed.

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Holding

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Yes, because the company accumulated earnings beyond its reasonable business needs and was effectively used to prevent the imposition of surtax on its shareholders.

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Court’s Reasoning

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The court emphasized that whether a corporation permitted earnings to accumulate beyond reasonable business needs or was

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