Lion Clothing Co. v. Commissioner, 8 T.C. 1181 (1947)

A company cannot avoid accumulated earnings tax by claiming an investment business distinct from its primary business as an excuse for accumulating earnings; the reasonable business needs considered must relate to the primary operating business.

Summary

Lion Clothing Co., primarily a paper, paperboard, and twine jobber, argued its accumulated earnings were for a separate securities business, justifying the accumulation to avoid surtax on stockholders. The Tax Court rejected this, stating that a business cannot use a separate investment business as an excuse to avoid accumulated earnings tax related to its primary business. The court found the company's accumulation unreasonable, noting sufficient funds for its paper business and no concrete plans for expansion, thus upholding the Commissioner's deficiency determination.

Facts

Lion Clothing Co. operated as a jobber in paper, paperboard, and twine, with this business becoming less significant over time. The company also invested in securities, claiming this was a distinct business. The company accumulated earnings, arguing it needed the funds due to anticipated post-World War II economic downturns. Most goods were shipped directly from manufacturer to customer, requiring little investment in inventory. The company purchased government obligations, incurring debt, claiming paper manufacturers were interested in bond drives.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Lion Clothing Co. for accumulated earnings tax under Section 102 of the Internal Revenue Code and adjusted the excess profits credit. Lion Clothing Co. petitioned the Tax Court for a redetermination, contesting both the accumulated earnings tax and the excess profits credit calculation.

Issue(s)

1. Whether Lion Clothing Co. was availed of for the purpose of preventing the imposition of surtax upon its shareholders by accumulating earnings beyond the reasonable needs of its business, within the meaning of Section 102 of the Internal Revenue Code.
2. Whether the Commissioner erred in determining the excess profits credit based upon invested capital by failing to include 50 percent of the alleged borrowed capital under Section 719(a)(1) of the Internal Revenue Code.

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Holding

1. No, because the company's primary business (paper, paperboard, and twine) did not require such accumulation and the claimed

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