

32 T.C. 93 (1959)

A corporation is subject to accumulated earnings tax if it accumulates earnings and profits beyond the reasonable needs of its business, and the purpose of the accumulation is to avoid income tax on its shareholders.

Summary

The IRS determined a deficiency in I.A. Dress Co.'s 1949 income tax, asserting that the company was used to avoid surtax on its sole shareholder by accumulating earnings. The Tax Court agreed. The company, engaged in operating a leased commercial building, accumulated substantial earnings in U.S. bonds and cash. The court found the accumulation exceeded the reasonable needs of the business, particularly as the company had no concrete plans to purchase the leased property. The court emphasized the lack of dividend payments and the resulting tax avoidance, upholding the IRS's assessment under Section 102 of the 1939 Internal Revenue Code, which governed the tax year in question. The court also clarified the burden of proof rules regarding the accumulated earnings tax.

Facts

I. A. Dress Co., a New York corporation, operated a commercial building under lease. Its sole stockholder was Isaac Alper. The company's 1949 income tax return showed substantial net income, retained after tax. The corporation had a large cash balance and significant holdings of U.S. bonds. The company had extended its lease several times but, in 1949, it had no definite plans to acquire the leased premises, nor had the owner committed to a sale. The company's balance sheets showed a consistent increase in working capital over several years. The company did not pay dividends. The IRS issued a notice of deficiency, asserting that the company was accumulating earnings to avoid surtax on Alper, which was followed by I. A. Dress Co.'s submission of a statement claiming that the welfare of the corporation would have been jeopardized by the distribution of any part of its earnings, and the continued corporate existence could only be ensured by the full retention of all earnings.

Procedural History

The IRS determined a deficiency in I.A. Dress Co.'s 1949 income tax. I. A. Dress Co. petitioned the Tax Court to challenge this deficiency. The Tax Court considered the case and ultimately ruled in favor of the Commissioner of Internal Revenue.

Issue(s)

1. Whether I. A. Dress Co. was availed of in 1949 for the purpose of preventing the imposition of surtax on its sole shareholder by accumulating earnings and profits, as defined under Section 102 of the 1939 Internal Revenue Code.

2. Whether the accumulation of earnings and profits by I. A. Dress Co. in 1949 exceeded the reasonable needs of its business.
3. Whether the company's submitted statement shifted the burden of proof to the IRS.

Holding

1. Yes, because the court found that the company was availed of for the purpose of preventing the imposition of surtax upon its sole shareholder.
2. Yes, because the court concluded that the accumulation exceeded the reasonable needs of its business.
3. No, because the court determined that the statement submitted by the taxpayer did not contain sufficient facts to support the grounds for accumulation.

Court's Reasoning

The court addressed the 1939 Internal Revenue Code Section 102, which imposed a surtax on corporations improperly accumulating surplus to avoid shareholder tax. The court first considered the burden of proof. The court held that under the applicable statute, if the corporation had submitted a statement providing sufficient grounds and facts to support the reasonableness of the earnings accumulation, the burden would have shifted to the Commissioner to disprove those grounds and facts. However, the court determined that the statement submitted by I. A. Dress Co. was not sufficient to shift the burden of proof because its grounds were too broad and its supporting facts were insufficient. Therefore, the burden remained on the taxpayer to demonstrate that the earnings accumulation was reasonable.

The court then examined whether the accumulation was beyond the company's reasonable business needs. The court found the accumulation excessive, citing a lack of a definite plan to acquire the leased property or other property, despite the accumulation of large amounts of cash and U.S. bonds, with no dividends being paid. The court pointed out the lack of any immediate need for additional funds. Because there was no immediate business purpose for the accumulation and because the accumulation of earnings enabled Alper to avoid income tax, the court concluded the surtax was properly imposed.

The court cited Section 102(c), which states, "the fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary."