***34 T.C. 89 (1960)***

A corporation is subject to the accumulated earnings tax if it accumulates earnings beyond the reasonable needs of its business to avoid shareholder surtax, and the burden of proof shifts to the IRS if the taxpayer provides a sufficient statement.

**Summary**

The U.S. Tax Court addressed whether American Metal Products Corporation and Adler Metal Products Corporation were liable for the accumulated earnings tax under the 1939 and 1954 Internal Revenue Codes. The IRS alleged that the corporations accumulated earnings beyond their reasonable business needs to avoid surtaxes on their shareholders. The court examined the corporations' financial statements, dividend history, and stated justifications for accumulating earnings. The court held that both corporations were liable for the accumulated earnings tax for specific years, finding their stated needs for accumulation were not sufficiently supported by concrete plans or facts. The court also addressed the burden of proof and the requirements for a taxpayer's statement to shift the burden to the IRS. Finally, the court addressed the deductibility of rental payments.

**Facts**

American Metal Products Corporation and Adler Metal Products Corporation, both Missouri corporations, were owned primarily by Jack Adler. Adler was the president and chief executive officer of both companies. Adler Corporation manufactured and sold filing cabinets. American Corporation purchased all of its products from Adler Corporation and primarily acted as a retailer. Both corporations filed income tax returns for 1952, 1953, and 1954. The IRS issued notices of deficiency, alleging that the companies were improperly accumulating earnings to avoid surtaxes on their shareholders. The corporations claimed their accumulations were justified for inventory, machinery and equipment, repairs and additions, and other business needs. The corporations also paid Jack Adler salary and rent. The IRS determined that the rental payments made to Jack Adler were excessive and also challenged the accumulated earnings. The corporations submitted statements of the grounds for their accumulation to the IRS, claiming they complied with section 534 of the 1954 Code to shift the burden of proof.

**Procedural History**

The IRS issued notices of deficiency to both corporations, alleging underpayment of taxes for 1952, 1953, and 1954. The corporations responded to the notices, asserting their positions. The IRS then issued statutory notices of deficiency. The cases were consolidated in the U.S. Tax Court, and the court reviewed the corporations' financial records, business plans, and justifications for accumulating earnings. The Tax Court ruled in favor of the IRS, finding that the corporations accumulated earnings beyond their reasonable business needs.

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## Issue(s)

1. Whether American Metal Products Corporation and Adler Metal Products Corporation were availed of during the years 1952, 1953, and 1954, for the purpose of preventing the imposition of surtax on their shareholders by accumulating earnings beyond the reasonable needs of their businesses.

2. Whether the corporations' rental payments made to Jack Adler were deductible as ordinary and necessary business expenses.

## Holding

1. Yes, because the corporations accumulated earnings beyond their reasonable needs with the intent to avoid surtax on their shareholders in 1952 and 1954. Adler Corporation was not liable for 1953.

2. Yes, because the rental payments were reasonable, supported by expert testimony, and were required for the continued use of the property.

## Court's Reasoning

The court applied the relevant provisions of the Internal Revenue Code of 1939 and 1954 regarding the accumulated earnings tax. It found that the primary focus of the inquiry was whether the corporations were formed or availed of for the purpose of avoiding surtax on shareholders by accumulating earnings rather than distributing them. The court examined the companies' accumulation of earnings, their investment in government bonds, and the lack of dividend payments. The court determined that the corporations' justifications for accumulating earnings, such as inventory needs, repairs, and expansion, were not supported by specific plans or concrete facts. The court found the claims were not supported by sufficient documentation, which indicated an indefinite postponement of any purported plans, thus precluding a finding of a reasonable business need. The court noted that the burden of proof generally rests on the taxpayer to disprove the IRS's determination, but the law allows for a shift in the burden. However, the court found that the corporations did not provide a statement under section 534(c) that contained sufficient facts to show the basis for their claims. In regard to the rental payments, the court held that the payments of 40 cents per square foot per year were reasonable, supported by expert testimony, and were required for the continued use of the property.

## Practical Implications

This case emphasizes the importance of businesses having specific, well-documented plans for the use of accumulated earnings to avoid the accumulated earnings tax. It underscores the need for detailed documentation, such as expansion plans, cost estimates, and timelines, to demonstrate the reasonableness of accumulations. The case highlights that vague intentions or statements are insufficient to justify

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earnings accumulation. The court’s ruling also means that when closely held companies pay rent to shareholders, they need to justify the reasonableness of the rent. Later cases reference this case when discussing the burden of proof in accumulated earnings tax cases and the need for specific and concrete evidence to support a taxpayer’s claim. This case is a useful reference for tax attorneys who are advising businesses on how to avoid the accumulated earnings tax by proper planning and record keeping, and when contesting IRS assessments.

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