Doug-Long, Inc. v. Commissioner, 73 T. C. 71 (1979)

Contested taxes do not accrue for purposes of calculating a corporation's accumulated taxable income subject to the accumulated earnings tax.

Summary

Doug-Long, Inc. challenged the Commissioner's calculation of its 1974 accumulated earnings tax, arguing that a contested income tax deficiency should be treated as an accrued tax. The Tax Court upheld the Commissioner's position, ruling that under the applicable regulation, contested taxes are not considered accrued until the contest is resolved. The court found that Doug-Long contested a portion of its tax deficiency, and thus, it could not deduct this amount in calculating its accumulated taxable income. The decision reinforces the principle that the accumulated earnings tax, a penalty to discourage tax avoidance through corporate retention of earnings, should not be mitigated by contested tax liabilities.

Facts

In 1974, Doug-Long, Inc. filed its tax return and later faced proposed adjustments from the IRS, including disallowance of a bad debt deduction and expenses for a lawnmower and plumbing. Doug-Long protested the bad debt and lawnmower deductions but conceded the plumbing expense. The IRS issued a statutory notice of deficiency for 1974, which Doug-Long conceded entirely in its petition to the Tax Court. The issue arose when calculating the accumulated earnings tax, where Doug-Long argued that the entire income tax deficiency should be treated as an accrued tax.

Procedural History

The IRS initially proposed adjustments to Doug-Long's 1974 tax return. Doug-Long protested part of these adjustments, leading to a statutory notice of deficiency. Doug-Long conceded the income tax deficiency in its petition to the Tax Court but disputed the accumulated earnings tax. The Tax Court had previously ruled Doug-Long liable for the accumulated earnings tax for 1974 in a prior opinion (72 T. C. 158). The current dispute centered on the calculation of accumulated taxable income, leading to the supplemental opinion in question.

Issue(s)

1. Whether a contested tax can be treated as an accrued tax for purposes of calculating a corporation's accumulated taxable income subject to the accumulated earnings tax.
2. Whether the regulation stating that a contested tax is not considered accrued until the contest is resolved is valid.

Holding

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1. No, because under the regulation, a contested tax is not considered accrued until the contest is resolved, and Doug-Long contested a portion of its tax deficiency.
2. Yes, because the regulation is consistent with the statutory language and judicial precedent, and it furthers the purpose of the accumulated earnings tax.

Court's Reasoning

The court relied on the regulation that defines accrued taxes and the principle from *Dixie Pine Products Co. v. Commissioner* that contested liabilities cannot be accrued until resolved. The court rejected Doug-Long's argument that the definition of a "contested tax" should differ for accumulated earnings tax purposes, noting that the term "accrued" should be interpreted consistently across tax contexts. The court also found support for the regulation's validity in *Estate of Goodall v. Commissioner* and emphasized that the accumulated earnings tax is a penalty designed to prevent tax avoidance through corporate retention of earnings. The court concluded that allowing contested taxes to reduce accumulated taxable income would undermine this purpose.

Practical Implications

This decision clarifies that corporations cannot reduce their accumulated taxable income by contested tax liabilities when calculating the accumulated earnings tax. Practitioners should advise clients to resolve tax disputes before the end of the tax year to potentially reduce their accumulated earnings tax liability. The ruling reinforces the IRS's ability to enforce the accumulated earnings tax as a penalty against corporations that retain earnings to avoid individual taxation. Future cases involving similar issues will likely cite this decision to support the non-accrual of contested taxes for accumulated earnings tax calculations. Businesses should be aware that challenging tax deficiencies may result in higher accumulated earnings tax liabilities if the challenge is not resolved in their favor by the end of the tax year.

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