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Income Tax--Accumulation of Earnings Tax

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ABSTRACTS

Income Tax—Accumulation of Earnings Tax

The Commissioner of Internal Revenue assessed accumulated earnings taxes against the defendant corporation by application of Internal Revenue Code of 1954, §§531-37. These sections impose a surtax on corporations “formed or availed of for the purpose of avoiding the income tax with respect to . . . [their] shareholders . . . by permitting earnings and profits to accumulate instead of being divided or distributed.” The IRC also provides that if corporate earnings accumulate beyond the reasonable needs of the business, this very fact is presumptive of the purpose to avoid income tax unless the corporation can prove the contrary by the preponderance of the evidence.

In a refund suit, the issue of “purpose to avoid income tax” was decided in favor of the defendant by the court of appeals. On review, the government contended that in order to rebut the presumption of purpose to avoid income tax, the taxpayer must establish by the preponderance of the evidence that tax avoidance was not “one of the purposes” for the accumulation of earnings beyond the reasonable needs of the business. The defendant argued that it may rebut this presumption by a demonstration that tax avoidance was not the “dominant, controlling, or impelling” reason for the accumulation. *Held*, reversed and remanded. Upon an examination of the language, purpose, and legislative history of the statute, the Court concluded that a corporation that accumulated earnings beyond the reasonable needs of the business must pay an accumulated earnings tax if one, though not the dominant, purpose of the accumulation was income tax avoidance. *United States v. Donruss Co.*, 89 S. Ct. 501 (1969).

The dissent concurred with much of the Court’s opinion. Nonetheless, the dissent observed that the guides approved by the Court failed to effectively provide the taxpayer a “last clear chance” to prove that the unreasonable accumulation of earnings was not due to the proscribed purpose. In lieu of the Court’s test, the dissent suggested a “but for” test, which would impose tax liability only if the jury finds that the taxpayer would not have accumulated excess earnings “but for” its knowledge that a tax saving would result.

Procedure—Scintilla Rule Affirmed

Plaintiff Davis was operating a motorcycle in a westerly direction on a city street. As he approached an intersection a municipal fire