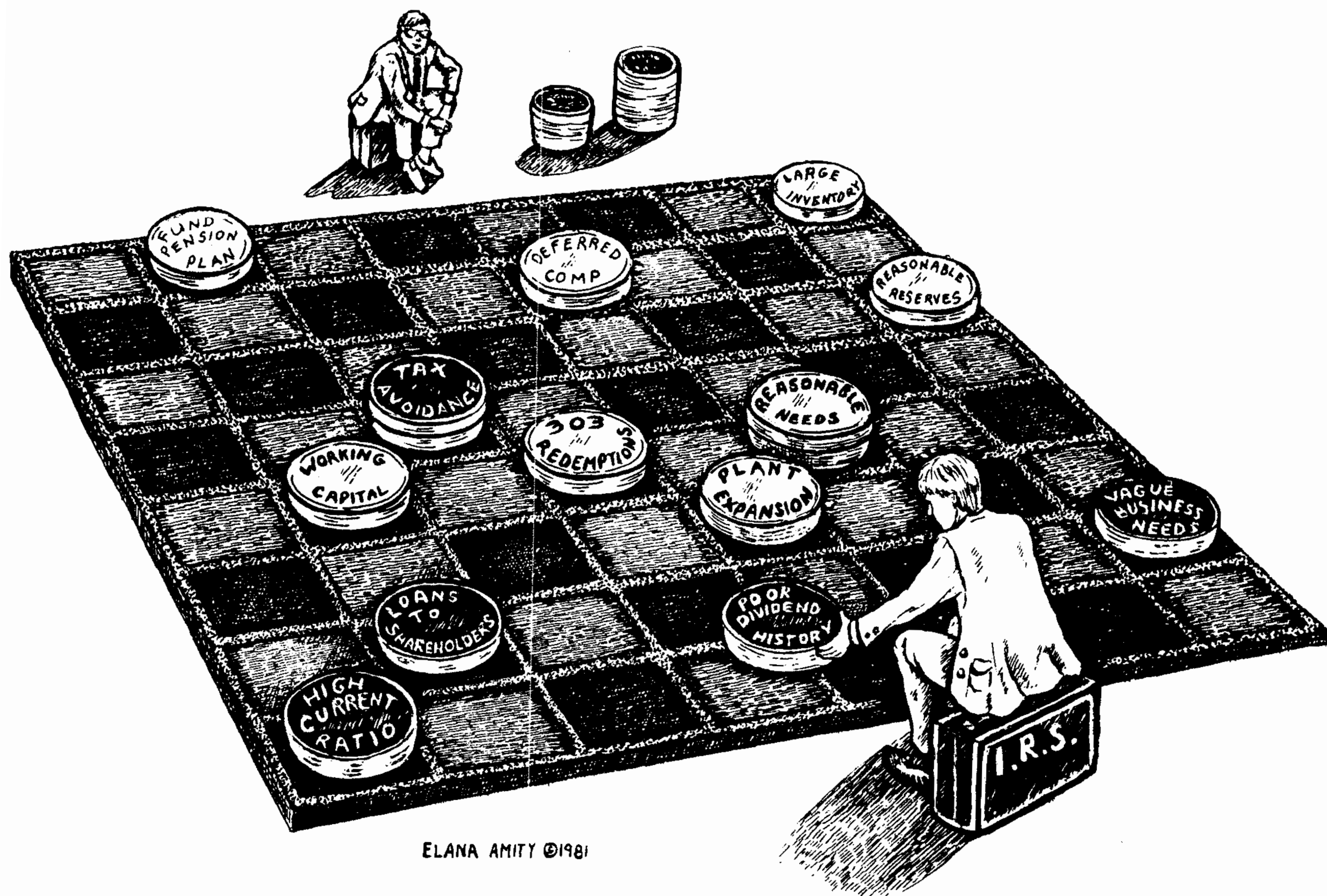

TAX PLANNING TO AVOID THE ACCUMULATED EARNINGS TAX

by Allan T. Cannon and Bruce S. Schaeffer

How can the risk of the accumulated earnings tax be minimized? What defenses are available to fight an IRS attempt to impose it? Does it pay to fight? This article explores these questions.

Corporations can accumulate substantial income, without having to distribute it to their shareholders as taxable dividends, if they know how to maneuver around the many pitfalls of the accumulated earnings tax and parry aggressive IRS enforcement. Advance planning and the keeping of corporate records are the keys to reducing exposure to this penalty tax.

To this end, this article will explore the mechanics of the tax, what constitutes the forbidden purpose, what constitutes reasonable needs of the corporation, the IRS' current attitude, and how—and whether it pays—to fight imposition of the tax.

THE THREE ELEMENTS

Three elements must be present for the accumulated earnings tax (which is in addition to the normal corporate tax) to be applicable:

1/ There must be accumulated taxable income,

2/ There must be an accumulation of earnings, and

3/ The accumulation must have been made with an intent to avoid tax at the shareholder level.[1]

There is some question as to whether the tax may be levied against publicly held corporations.[2] From a practical point of view, however, it is asserted almost exclusively against closely held corporations.

The accumulated earnings tax (AET) is a graduated tax levied against accumulated taxable income (ATI), which is specifically defined in Section 535. The rate is 27½% of the first $100,000 of ATI and 38 ½% of the ATI in excess of $100,000.

THE MECHANICS

The AET is an annual tax. It does not apply to all of the accumulated earnings and profits of the corporation but only to the ATI of the year or years as to which it is asserted. Corporations are subject to the AET if they permit earnings and profits to accumulate instead of being divided or distributed. The precise meaning of this phrase is the subject of much litigation and disagreement among the courts.

The application of the rules can yield anomalous results: The AET can be levied in a year when there is no current accumulation of earnings and profits[3] while, on the other hand, there can be large accumulations of earnings and profits that are not subject to the AET.[4]

ATI is the corporation's taxable income subject to certain adjustments, the purpose of which, theoretically, is to determine the amount actually available to be distributed as dividends. The major adjustments are as follows:

1/ Taxable income is *decreased* by federal taxes paid other than the AET, charitable contributions of the year (without regard to the 5-10%-of-adjusted-gross-income limitation), capital losses to the extent that they were disallowed under Section 1211, and capital gains (reduced by the federal taxes paid with respect to such gains).

2/ Taxable income is *increased* by the dividends-received deduction allowed, the NOL deductions under Section 172, and any carryback or carryover capital losses.

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The interplay of corporate taxable income, accumulated taxable income, and earnings and profits for various categories of income, coupled with the available means of getting money out of the corporation is illustrated by the box on page 47.

In arriving at ATI, taxable income (as adjusted) is further reduced by (1) the accumulated earnings credit and (2) the dividends-paid deduction.

The accumulated earnings credit is the part of earnings and profits for the taxable year that is retained for the reasonable needs of the business, less the capital gains adjustment noted above. The minimum credit—for taxable years beginning after 1981 is the amount by which $250,000 exceeds the accumulated earnings and profits of the corporation at the close of the preceding taxable year. For certain service-related corporations, primarily professional corporations, the minimum credit is $150,000. Mere holding or investment corporations are limited to the minimum credit because they are presumed to have no reasonable needs. For operating corporations, the major battleground is determining what constitutes the reasonable needs of the business (discussed below).

The dividends-paid deduction reduces the ATI base by distributions made during the taxable year or within two and one-half months thereafter. Dividends for this purpose are dividends out of earnings and profits within Section 316, certain liquidating dividends and consent dividends. However, to qualify, the dividends *must* be pro rata. If preferential in any respect, even if all the shareholders agree to it, the deduction will be barred.[5] Thus, excessive compensation that is treated as a dividend, if other than pro rata among all the shareholders, will not qualify.

Likewise, a non-pro rata redemption that is accorded dividend treatment under Section 302 will not qualify. Every shareholder in a class of shareholders must be treated the same as every other shareholder in that class, and no class of share-

holders may be treated otherwise than in accordance with its dividend rights as a class, as such rights are specified in the corporation's governing instrument.

The consent dividend procedure is a mechanical device whereby shareholders can consent to be treated as if they had received a dividend and concomitantly made a contribution to capital in such amount. They receive an appropriate basis increase in their stock and are treated as being in receipt of income for tax purposes. Consent dividends also cannot be preferential.

THE FORBIDDEN PURPOSE

The AET requires an intent to avoid taxation at the shareholder level. It does not have to be the *major* motivation. Even if the avoidance motive merely *contributed to* the decision to accumulate, it is sufficient to taint the shareholder's motives, no matter how pure they may otherwise be.[6] And, under Section 533, the burden of proof is on the taxpayer if the earnings and profits of the corporation are permitted to accumulate beyond the reasonable needs of the business.

It is usually held that this forbidden purpose must be present during the taxable year at issue. However, the Court of Claims has held that if the intent is present at any time *prior to the filing of the corporation's tax return,* the statute is satisfied.[7]

Certain objective factors have been held to evidence tax avoidance. Courts generally rely on these factors and do not give much credence to shareholder testimony with respect to their own intent. The regulations[8] list as evidence of the forbidden purpose:

1/ Dealings between the corporation and its shareholders, such as withdrawals by the shareholders as personal loans or the expenditure of funds by the corporation for the personal benefit of the shareholders;

2/ The investment by the corporation of undistributed earnings in assets having no reasonable connection with the business of the corporation; and

3/ The extent to which the corporation has distributed its earnings and profits.

The Effect of $100 of Income

A corporation, in the top corporate and AET tax brackets, has $100 of each of the following types of income:

1/ Ordinary income,

2/ Capital gain,

3/ Tax-exempt income, and

4/ Dividend income (subject to the 85% dividends-received deduction).

Let's examine the effect of each on taxable income, accumulated taxable income (ATI), and earnings and profits (E&P), along with the regular corporate tax (46%) and the AET (38½%). This is shown in the table below:

Category	*Taxable Income*	*Tax*	*ATI*	*AET*	*E&P*
Ordinary Income	100	46	54	21	33
Capital Gain	100	28	0	0	72
Tax-Exempt Income	0	0	0	0	100
Dividend Income	15	7	93	36	57

The ATI was determined by adding to taxable income the dividends-received deduction (for the dividend income) and subtracting from taxable income capital gains less the tax attributable thereto (for the capital gains income) and federal taxes (for the ordinary income and the dividend income).

The AET was determined by applying the 38½% rate to the ATI.

The E&P was determined by taking the income received (whether taxable or not) and subtracting both the regular tax and the AET.

Now let's see the net after-tax effect on the shareholders (in the 50% tax bracket) of a distribution, both as a dividend and as a liquidating capital gain distribution, of the net corporate assets (i.e., the E&P), stemming from each of the various types of income.

	Dividend Distribution			*Liquidating Capital Gain*		
Category	*Taxable Income*	*Tax*	*Net*	*Taxable Income**	*Tax*	*Net*
Ordinary Income	33	16.5	16.5	13	6.5	26.5
Capital Gain	72	36	36	29	14.5	57.5
Tax-Exempt Income	100	50	50	40	20	80
Dividend Income	57	27.5	27.5	23	11.5	45.5

* After 60% capital-gains deduction.

A good dividend or salary record tends to indicate that there is no tax avoidance motive present. Other factors having evidentiary weight are the tax bracket of the shareholders and the resultant increase in taxes that the shareholders would pay if there were dividends.

REASONABLE NEEDS

If earnings are retained for the reasonable needs, or reasonably anticipated needs, of the business, then the question of intent need not be addressed. The major bone of contention in the accumulated earnings tax area is what constitutes the reasonable needs of the business—and the taxpayer has the burden of proof on this issue.

The standard adopted in determining reasonableness is that of a prudent businessman. The courts are generally loath to replace a businessman's judgment with their own. Of course, if there have been sufficient accumulations in prior years to meet the present needs of the business, no current accumulations will be protected. However, in keeping with the statutory scheme (i.e., determining the amount available to be divided or distributed), the courts have focused not only on the accumulated earnings and profits of a corporation but also on the liquidity of its assets. One court reasoned that the "assumption that a retained earnings account (regardless of nomenclature) invariably represents a readily available source of liquid funds with which to satisfy existing and anticipated corporate obligations is unsound. As a practical matter, a retained earnings account may embody a cross section of the assets of the corporation."[9]

In the landmark case of *Smoot Sand and Gravel Corporation,*[10] the court noted that "to the extent that the surplus has been translated into plant expansion, increased receivables, enlarged inventories, or other assets related to its business, the corporation may accumulate surplus with immunity."

Both the courts and the Service (in its Audit Guidelines) focus on liquidity as expressed by the current or "quick" assets (i.e., current assets net of current liabilities). Before the *Bardahl* formula (discussed below) evolved, there was a rule of thumb that up to a 2.5:1 current assets to current liabilities ratio was acceptable.[11] Prior to that, it had been held that working capital sufficient to meet one year's operating expenses was a

Bardahl Formula Worksheet

1/ Operating expenses for full year including cost of goods sold $____

Less:

Depreciation included in *line 1* $____

Federal income taxes included in *line 1** $____

2/ Operating expenses for year as adjusted $____

3/ Operating business cycle:

a/ Cost of goods sold $____

b/ Average inventory (inventory at beginning of year plus inventory at end of year divided by 2) $____

c/ Inventory turnover (*line b* divided by *line a* multiplied by 365) $____

d/ Net sales for year $____

e/ Average accounts receivable (receivables at beginning of year plus receivables at end of year divided by 2) $____

f/ Accounts receivable turnover (*line e* divided by *line d* multiplied by 365) ____

g/ Days in operating cycle (add *lines c* and *f*) ____

h/ Operating cycle expressed as percentage of year (divide *line g* by 365) ____

4/ Amount of working capital needs for one cycle (multiply *line 2* by *line h*) $____

**Note:* In the original *Bardahl* case, 24 TCM 1030 (1965), the Tax Court did not consider anticipated federal income taxes for the following year as an operating expense for which cash is needed in advance. However, in *Empire Steel Castings*, 33 TCM 155 (1974), it treated estimated tax payments as operating expenses and indicated that it would not follow its original *Bardahl* position. In *Doug-Long, Inc.*, 72 TC 158 (1979) the Tax Court reaffirmed the position it took in *Empire Steel Castings*. Recently, the Service informed its Agents that "the Bardahl Formula is modified by the Empire Steel Castings decision .... [P]ayments of estimated federal income taxes should be included in operating expenses that are used to determine the working capital needs of one cycle. The Bardahl formula remains unchanged except for the inclusion of estimated federal income tax payments in the computation to determine working capital needs of one cycle." (Manual Transmittal, May 23, 1980; Audit Manual 777.4).

reasonable accumulation.[12] Since the advent of the more sophisticated *Bardahl* formula, such rules of thumb have been rarely used. However, for service businesses, where the *Bardahl* working capital formula has little application, they are still of some value.[13]

What Needs Are Reasonable?

Certain needs are specifically listed by Section 537 as reasonable:

1/ *The reasonably anticipated needs of the business.* This reflects legislative sanction for the business aptitude of foresight.

2/ *The need to make a Section 303 redemption.* Section 303 allows redemptions to be treated as capital gains, rather than dividends, where stock in the redeeming corporation composes a specified portion of the estate of a decedent. If the stock qualifies, then Section 303 treatment will be accorded to the extent that the value of the stock redeemed does not exceed the sum of the death taxes and the funeral and administrative expenses of the estate. There is nothing in the statute that sanctions such accumulations *prior* to the death of a shareholder. However, if a shareholder were in bad health or of advanced age, it would seem that a pre-death accumulation to the extent of the anticipated Section 303 redemption would be a reasonable need of the business.[14]

3/ *The need to redeem excess business holdings.* This allows for accumulations to redeem stock from certain private foundations. It applies primarily to pre-1969 taxpayers and is of little current application.

4/ *The need to maintain reserves for product liability losses.*

In addition to the needs recognized by statute, there are a number of judicially recognized needs: (1) business investment, (2) reserves for business risks and contingencies, (3) funding of nonqualified deferred compensation plans, (4) capital retirement and (5) working capital. These are discussed below (working capital, the major area, is discussed in the next section).

1/ *Business investment,* as opposed to unrelated investment, is generally recognized as a reasonable need of the business. Thus, stock purchases to assure sources of supply or loans to maintain the viability of a major account are generally acceptable. Likewise, accumulations to enable the corporation to enter a new field have been held reasonable. On the other hand, if the corporation invests its funds outside of its own existing or projected fields of business, such investments may be deemed evidence of the forbidden purpose. Such unrelated investments may be considered as current assets in determining the reasonableness of the corporation's current accumulations and, if so, will be valued at current market value rather than original cost.[15] This is an area of fine distinctions with cases decided on particular facts, but practitioners should be aware that the business of a controlled subsidiary will normally be deemed that of its parent while the business of a sister corporation will rarely be accorded such treatment.[16] Moreover, in the context of related corporations, it is the Service's position that a Section 482 reallocation[17] may increase the accumulated taxable income base.

2/ *Reserves for business risks and contingencies* are acceptable so long as they constitute reasonable expectations. Some activities that have justified accumulations are (1) potential labor disputes, (2) self-insurance reserves, (3) meeting competition, (4) potential litigation liabilities, (5) surety bond requirements and (6) pollution control requirements. In one case a small corporation that specialized in making automobile clutches was permitted accumulations to enter a new business when its old line was threatened by the advent of automatic transmissions. Additionally, a reserve set up to meet a potential, though contested, accumulated earnings tax liability was held to be reasonable.[18] And, in a recent case, the Tax Court, in upholding an accumulation, took the novel position that a company operating at full capacity can reasonably be expected to look to expanding its operations, even in the absence of a formal written plan.[19]

3/ *Reserves to meet deferred compensation liabilities* have been held to be reasonable business needs. There is authority for allowing such reserves to be invested to assure funding of the obligations while excluding such investments from the computation of current assets available for distributions to shareholders.[20] Of course, such accumulations would only be reasonable if the deferred compensation qualified as reasonable compensation; otherwise they would probably constitute evidence of the proscribed purpose.

4/ *Capital retirement* can take many forms, such as the repayment of debt or the redemption of preferred or common stock. While a corporation may generally accumulate to retire outstanding debt, retirement of shareholder debt is more vulnerable than that held by third parties. If the corporation is thinly capitalized, the debt might be considered equity and the retirement treated as a redemption. Whether or not accumulations to redeem stock are reasonable needs of the business is a confused and much litigated area.[21] However, the presence of a formal buy-sell agreement and the use of the accumulations to pay premiums on key man life insurance to fund the agreement, help to classify the accumulations as reasonable.[22]

"The IRS has used the accumulated earnings tax to gain other concessions."

As noted above, accumulations to meet the reasonably anticipated needs of the business have received legislative grace. Thus, accumulations for projected expansions and/or diversification are within the reasonable needs. However, to gain judicial acceptance, such plans must be specific, definite and feasible as opposed to vague, uncertain and indefinitely postponed. Although such plans need not be carried out (so long as they were reasonable at the time of the accumulation), a subsequent abandonment without acceptable justification will often taint the original accumulation.

The corporation's full spectrum of financial planners should be used in helping to memorialize the anticipated needs of the business. If an expansion or diversification is planned, the corporate minutes should so reflect with specificity. Projections from accountants, bankers, industry analysts, brokers and, where applicable, architects and engineers, all help to show the intent as something more than nebulous. This sort of documentation should be contemporaneously compiled; after-the-fact records often create hostile reactions from Service Agents and the courts.

Working Capital

The regulations clearly state that a corporation may retain sufficient earnings to meet its current operating needs.[23] Both the courts and the Internal Revenue Manual now use a statistical analysis known as the *Bardahl* formula to determine the working capital requirements. Under this formula, a corporation's working capital needs are the amount of working capital necessary for one operating cycle. In the case of a mercantile business, the operating cycle begins with the purchase of inventory and ends with the collection of the accounts receivable resulting from its sale. The cycle is reduced, however, by the time that the corporation's creditors allow for ceivable cycle minus (3) a credit cycle (which the IRS does not include in its *Bardahl* worksheet, but which some courts have recognized). This theory of applying the *Bardahl* formula might be summarized as follows:

Under *Bardahl,* the length of the operating cycle (i.e., the time needed to convert cash into raw materials, raw materials into finished goods, inventory into sales and accounts receivable into cash) is determined by three components: (a) the production cycle, or average inventory turnover period, which is computed by dividing the annual costs of goods sold for the year into the peak period (or average) inventory; (b) the collection cycle, or average accounts receivable turnover period, which is computed by dividing the annual sales for the year into the peak period (or average) accounts receivable; and (c) the credit cycle, or average accounts payable turnover period, which is computed by dividing annual purchases into average (or peak period) accounts payable. Each of these calculations yields a decimal figure representing part of the year. The first two are added together and the third is subtracted, the result being the average length of the operating cycle expressed as a decimal part of the year.

This figure is then multiplied by the corporation's cost of goods sold and its operating expenses (excluding non-cash expenses, such as depreciation, and federal income taxes) for the year in question, and the result is the amount of cash theoretically needed to cover the reasonably anticipated costs of operating the business for a single operating cycle.[24]

For seasonal businesses, the *Bardahl* formula is applied by using inventories and accounts receivable during a corporation's peak seasonal period instead of using average annualized figures.

Revenue Agents have been instructed to make the *Bardahl* computation as a matter of course. The box on page 48 sets forth the "Bardahl Formula Worksheet" contained in the Internal Revenue Manual.

Although the *Bardahl* formula gives the illusion of mathematical certainty, it is not meant to give the *precise* amount of capital needed. Rather, it is only meant to estimate *minimal* working capital needs. Since the formula gives only the minimal amount necessary, a strong argument can be made that the taxpayer should be able to retain somewhat more to take into account such things as growth, inflation and un-

known business risks. The test should be flexible and not applied rigidly.

IRS' AUDIT GUIDELINES

With reference to the *Bardahl* formula, the Internal Revenue Manual directs Agents to use the following audit techniques:

1/ Determine the amount of current and accumulated earnings.

2/ Require justification of current and accumulated earnings only to the extent represented by the excess of current assets over current liabilities, including federal income taxes due.

3/ Determine (a) the operating expenses for a full year, including the cost of goods but excluding depreciation . . . ,[25] and (b) the operating cycle in terms of percent of a year. Then, multiply (a) by (b) to get the amount of net liquid assets necessary to meet ordinary operating expenses. The operating cycle is the time required to convert cash into raw materials, raw materials to inventory, inventory into sales and accounts receivable and the period required to collect the outstanding accounts. In the *Bardahl* case this computation was based on the operating expenses of the succeeding year.

4/ Ascertain the amount needed to meet specific and definite plans for expansion, extraordinary expenses, etc.

5/ Compare the funds required or computed in (3) plus (4) with the funds available as computed in (2). If funds available exceed funds required, the excess is unreasonable accumulation.

6/ Check to see whether corporate funds were used for nonliquid investments which have no relationship to the business. Such investments are considered as additional working capital. If this amount when added to the funds available as computed in (2) exceeds the funds required as computed in (3) plus (4), the excess is an unreasonable accumulation.

The Internal Revenue Manual (Exhibit 700-5) also lists the following factors that Agents should consider in deciding whether to assert the accumulated earnings tax:

Factors against assertion:

1/ A history of paying good dividends.

2/ The payment of a substantial salary to the principal stockholder who is an employee of the corporation.

3/ The corporation being publicly owned.

4/ The existence of business indebtedness.

5/ The need to diversify as a result of:

a/ Being a one-customer business.

b/ The business obsolescence factor being high.

6/ Documentation of the needs of the business:

a/ In the corporate minutes.

b/ By the performance of actual work in fulfilling the needs.

7/ Low current-asset-to-current-liability ratio.

8/ Low current-asset-to-current-working-capital ratio.

9/ The need for expansion of plant and equipment.

10/ Actual entry into an unrelated business.

Factors favoring assertion:

1/ Vague and indefinite business needs for the accumulation.

2/ Working capital needs being able to be met from current operations.

3/ The existence of non-liquid passive investments.

4/ Diversification into an unrelated business is only contemplated [i.e., the taxpayer must do something more than "contemplate"—Ed.]

5/ The corporation being closely held.

6/ Stock redemptions.

7/ Loans to shareholders or to other businesses of the shareholders.

8/ An unfavorable dividend history, such as:

a/ No cash dividends.

b/ Cash dividends related to shareholders' tax status.

c/ Declaration of stock dividends.

9/ Inability to pay dividends due to:

a/ A restriction on dividend payments.

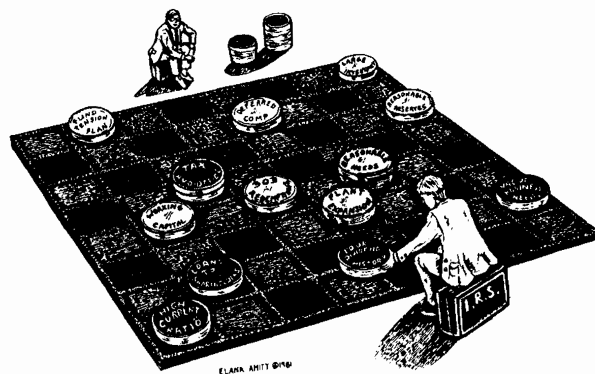
b/ The lack of liquid funds.

10/ Investments in uncontrolled subsidiaries.

11/ No outstanding debt obligations or debts being incurred for nonbusiness reasons.

12/ Shareholders in a high tax bracket.

13/ High current-asset-to-current-liability ratio.



14/ High current-asset-to-working-capital ratio.

15/ Corporation being aware of the tax and consciously attempting to avoid its application.

The normal statute of limitations for assessing the AET is three years after the income tax return is first filed. Interest on the AET liability runs from the date of notice and demand, and not from the due date of the income tax return for the year in question.

If liability for the tax is contested in the Tax Court, no assessment, and hence no notice and demand may be forthcoming until after the Tax Court decision becomes final. Thus, if the taxpayer elects to pay the cost of the contest, the years of AET deferral, if he should ultimately lose, will mean that he has had an interest-free loan until notice and demand (and thereafter at statutory rates).

The IRS takes the position that the 5% negligence penalty under Section 6653 is applicable to the AET while saying it will not be automatically asserted.[26] The authors are unable to find any case in which such a penalty was litigated. However, if a corporation is found liable for the AET, it will be particularly vulnerable in subsequent years, since many practitioners report that losing an AET issue at audit usually triggers audits for the open years. For example, losing on an AET issue in 1982 for the 1978 return could result in audits of the 1979 to 1981 returns for AET.

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DOES IT PAY TO FIGHT?

The Internal Revenue Manual takes what many practitioners feel is too strong a position in asserting liability for the AET. The Service has been known to use the AET as a wedge to gain concessions in other areas. Such "terror tactics" are often successful, with taxpayers giving in rather than facing the time and expense of a contest.

What are the stakes? The maximum federal tax on $100 of corporate earnings, if the AET does not apply and the corporation makes a distribution in liquidation at capital gains rates, is $57 (corporate tax = $46 and capital gains tax = $11). If the AET does apply, the corporation has two alternatives:

1/ It pays the AET and subsequently liquidates. The tax cost would be then be $74 consisting of $46 of the regular corporate tax ($100 @ 46%), $21 of AET ($54 @ 38 1/2%), and $7 of tax at the shareholder level ($33 @ 20%).

2/ It pays a full dividend to avoid the AET. The tax cost would then be $73 ($46 plus 50% of $54).

Consequently, the difference between paying the AET and paying a dividend to avoid the AET may be, and often is, minimal.

Perhaps the deciding factor is the lottery aspect. The AET is not a self-assessing tax; there is no form the taxpayer must file. It is possible that the corporation will not be audited and, even if audited, the issue may be overlooked. If the tax is asserted, the corporation may (after interminable discussion) make a settlement. If no favorable settlement can be reached, the corporation may go to court.

CONCLUSION

The payment of a dividend, painful as it may be, is probably more helpful than not paying anything. A nominal dividend, however, may highlight the issue and cause a Revenue Agent to investigate its adequacy. If all else fails, a tax-free

recapitalization under Section 368 (a)(1)(E) might be considered whereby dividend paying shares (usually nonparticipating preferred stock) are issued and gifts or bargain sales are made to low-bracket taxpayers (usually children or trusts) who will be taxed on the dividend income when paid. In terminal cases, a Subchapter S election could be made. However, while this will prevent the imposition of the AET, it can bring odious tax results to the shareholders in the absence of careful planning. However, now that the maximum rate on unearned income is 50%, when a corporation with an AET problem reaches the maximum level of officer-shareholder salaries, a Subchapter S election may be advantageous. Electing Subchapter S status eliminates both AET and reasonable compensation problems. In fact, if a dividend is paid within seventy-five days after year end it does "double duty." It will qualify as a dividend for the prior year, thus reducing the AET exposure for the prior year, and it will be considered a distribution of Subchapter S income in the year of payment (assuming a Subchapter S election is made), at no additional income tax cost. Furthermore, the Economic Recovery Tax Act of 1981 now allows certain trusts (which can be for the benefit of children) to be shareholders of Subchapter S corporations.[27]

Diligent investigation of facts to determine the extent of the problem, intelligent advance planning, and the keeping of meticulous and detailed records supporting any corporate action (or inaction) will help reduce corporate exposure to the accumulated earnings tax. PA

1. Under Section 532, the tax is levied against any corporation "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders or the shareholders of any other corporation." Thus, a subsidiary that accumulates to avoid the tax on shareholders of the parent may be liable for the tax.
2. *Golconda Mining Corp.*, 35 AFTR 2d 75-336, 74-2 USTC ¶ 9845 (CA-9, 1973), *rev'g.* 58 TC 139 (1972). Personal holding companies, foreign personal holding companies and exempt organizations are also not subject to the tax. Section 532(b). However, the AET was applied to a professional corporation in *Brumer, Moss & Cohen*, P.A., 37 AFTR 2d 76-802, 76-2 USTC ¶ 9533 (DC Fla., 1976).
3. *GPD, Inc.*, 508 F.2d 1076 (CA-6 1974), *rev'g* 60 TC 480 (1973).
4. See *Rev. Rul.* 70-497 (C.B. 1970-2, 128) (tax-exempt income is not included in ATI).
5. Section 562(c); Reg. 1.562-2(a).
6. *Donruss Co.*, 23 AFTR 2d 69-418, 69-1 USTC ¶ 9167 (Sup Ct., 1969).
7. *JJJ Corp.*, 42 AFTR 2d 78-5024, 78-1 USTC ¶ 9453 (Ct. Cls., 1978).
8. Reg. 1.533-1 (a)(2).
9. *Electric Regulator Corp.*, 14 AFTR 2d 5447, 64-2 USTC ¶ 9705 (CA-2, 1964).
10. 50 AFTR 1612, 57-1 USTC ¶ 9376, 9694 (CA-4, 1957), *rev'g. and rem'g.* 15 TCM 418 (1956).
11. *Remerton Sun Publishing Co.*, 44 TC 566 (1965).
12. *J.L. Goodman Furniture Co.*, 11 TC 530 (1948).
13. *Cadillac Textiles, Inc.*, 34 TCM 295 (1975).
14. *C.E. Hooper, Inc.*, 38 AFTR 2d 76-5417, 76-2 USTC ¶ 9538 (Ct. Cls. 1976).
15. *Ivan Allen Co.*, 36 AFTR 2d 75-5200, 75-2 USTC ¶ 9557 (Sup. Ct., 1975).
16. See, e.g., *Cataphote Corp. of Miss.*, (Ct. Cls., 1976); see also, Prop. Reg. 1.1502-43 (1979) for application of this principle in the consolidated returns area.
17. *Rev. Rul.* 78-430.
18. *Alma Piston Co.*, 35 TCM 464 (1976), *aff'd. per curiam*, 42 AFTR 2d 78 5320, 78-2 USTC ¶ 9591 (CA-6, 1978); *Rev. Rul.* 70-301.
19. *Brookfield Wire Co.*, TCM 1980-321.
20. *John P. Scripps Newspapers*, 44 TC 453 (1965).
21. See Rudolph, "Stock Redemptions and the Accumulated Earnings Tax—An Update," 4 J. Corp. Tax. 101 (1977).
22. *Emeloid Co.*, 40 AFTR 674, 51-1 USTC ¶ 66,013 (CA-3, 1951); *Motor Fuel Carriers, Inc.*, 40 AFTR 2d 77-5807, 77-2 USTC ¶ 9661 (CA-5, 1977).
23. Reg. 1.537-2 (b)(4).
24. Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, p. 8-19 (4th Ed. 1979).
25. The IRM was modified in 1980 to include federal income taxes in the formula. See the note to the *Bardahl* Formula Worksheet with this article.
26. *Rev. Rul.* 75-330.
27. See Section 1371(g) for rules covering Qualified Subchapter S Trusts.

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