

§ 1.532-1 Corporations subject to accumulated earnings tax.

(a) *General rule.* (1) The tax imposed by section 531 applies to any domestic or foreign corporation (not specifically excepted under section 532(b) and paragraph (b) of this section) formed or availed of to avoid or prevent the imposition of the individual income tax on its shareholders, or on the shareholders of any other corporation, by permitting earnings and profits to accumulate instead of dividing or distributing them. See section 533 and § 1.533-1, relating to evidence of purpose to avoid income tax with respect to shareholders.

(2) The tax imposed by section 531 may apply if the avoidance is accomplished through the formation or use of one corporation or a chain of corporations. For example, if the capital stock of the M Corporation is held by the N Corporation, the earnings and profits of the M Corporation would not be returned as income subject to the individual income tax until such earnings and profits of the M Corporation were distributed to the N Corporation and distributed in turn by the N Corporation to its shareholders. If either the M Corporation or the N Corporation was formed or is availed of for the purpose of avoiding or preventing the imposition of the individual income tax upon the shareholders of the N Corporation, the accumulated taxable income of the corporation so formed or availed of (M or N, as the case may be) is subject to the tax imposed by section 531.

(b) *Exceptions.* The accumulated earnings tax imposed by section 531 does not apply to a personal holding company (as defined in section 542), to a foreign personal holding company (as defined in section 552), or to a corporation exempt from tax under subchapter F, chapter 1 of the Code.

(c) *Foreign corporations.* Section 531 is applicable to any foreign corporation, whether resident or nonresident, with respect to any income derived from sources, within the United States, if any of its shareholders are subject to income tax on the distributions of the corporation by reason of being (1) citizens or residents of the United States, or (2) nonresident alien individuals to whom section 871 is applicable, or (3)

foreign corporations if a beneficial interest therein is owned directly or indirectly by any shareholder specified in subparagraph (1) or (2) of this paragraph.

§ 1.533-1 Evidence of purpose to avoid income tax.

(a) *In general.* (1) The Commissioner's determination that a corporation was formed or availed of for the purpose of avoiding income tax with respect to shareholders is subject to disproof by competent evidence. Section 533(a) provides that the fact that earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders unless the corporation, by the preponderance of the evidence, shall prove to the contrary. The burden of proving that earnings and profits have been permitted to accumulate beyond the reasonable needs of the business may be shifted to the Commissioner under section 534. See §§ 1.534-1 through 1.534-4. Section 533(b) provides that the fact that the taxpayer is a mere holding or investment company shall be prima facie evidence of the purpose to avoid income tax with respect to shareholders.

(2) The existence or nonexistence of the purpose to avoid income tax with respect to shareholders may be indicated by circumstances other than the conditions specified in section 533. Whether or not such purpose was present depends upon the particular circumstances of each case. All circumstances which might be construed as evidence of the purpose to avoid income tax with respect to shareholders cannot be outlined, but among other things, the following will be considered:

(i) 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,

(ii) The investment by the corporation of undistributed earnings in assets having no reasonable connection with the business of the corporation (see § 1.537-3), and

(iii) The extent to which the corporation has distributed its earnings and profits.

The fact that a corporation is a mere holding or investment company or has an accumulation of earnings and profits in excess of the reasonable needs of the business is not absolutely conclusive against it if the taxpayer satisfies the Commissioner that the corporation was neither formed nor availed of for the purpose of avoiding income tax with respect to shareholders.

(b) *General burden of proof and statutory presumptions.* The Commissioner may determine that the taxpayer was formed or availed of to avoid income tax with respect to shareholders through the medium of permitting earnings and profits to accumulate. In the case of litigation involving any such determination (except where the burden of proof is on the Commissioner under section 534), the burden of proving such determination wrong by a preponderance of the evidence, together with the corresponding burden of first going forward with the evidence, is on the taxpayer under principles applicable to income tax cases generally. For the burden of proof in a proceeding before the Tax Court with respect to the allegation that earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, see section 534 and §§ 1.534-2 through 1.534-4. For a definition of a holding or investment company, see paragraph (c) of this section. For determination of the reasonable needs of the business, see section 537 and §§ 1.537-1 through 1.537-3. If the taxpayer is a mere holding or investment company, and the Commissioner therefore determines that the corporation was formed or availed of for the purpose of avoiding income tax with respect to shareholders, then section 533(b) gives further weight to the presumption of correctness already arising from the Commissioner's determination by expressly providing an additional presumption of the existence of a purpose to avoid income tax with respect to shareholders. Further, if it is established (after complying with section 534 where applicable) that earnings and profits were permitted to accumulate beyond the reasonable needs of the

business and the Commissioner has therefore determined that the corporation was formed or availed of for the purpose of avoiding income tax with respect to shareholders, then section 533(a) adds still more weight to the Commissioner's determination. Under such circumstances, the existence of such an accumulation is made determinative of the purpose to avoid income tax with respect to shareholders unless the taxpayer proves to the contrary by the preponderance of the evidence.

(c) *Holding or investment company.* A corporation having practically no activities except holding property and collecting the income therefrom or investing therein shall be considered a holding company within the meaning of section 533(b). If the activities further include, or consist substantially of, buying and selling stocks, securities, real estate, or other investment property (whether upon an outright or marginal basis) so that the income is derived not only from the investment yield but also from profits upon market fluctuations, the corporation shall be considered an investment company within the meaning of section 533(b).

(d) *Small business investment companies.* A corporation which is licensed to operate as a small business investment company under the Small Business Investment Act of 1958 (15 U.S.C. ch. 14B) and the regulations thereunder (13 CFR part 107) will generally be considered to be a *mere holding or investment company* within the meaning of section 533(b). However, the presumption of the existence of the purpose to avoid income tax with respect to shareholders which results from the fact that such a company is a *mere holding or investment company* will be considered overcome so long as such company:

(1) Complies with all the provisions of the Small Business Investment Act of 1958 and the regulations thereunder; and

(2) Actively engages in the business of providing funds to small business concerns through investment in the equity capital of, or through the disbursement of long-term loans to, such concerns in such manner and under such terms as the company may fix in

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accordance with regulations promulgated by the Small Business Administration (see secs. 304 and 305 of the Small Business Investment Act of 1958, as amended (15 U.S.C. 684, 685)).

On the other hand, if such a company violates or fails to comply with any of the provisions of the Small Business Investment Act of 1958, as amended, or the regulations thereunder, or ceases to be actively engaged in the business of providing funds to small business concerns in the manner provided in subparagraph (2) of this paragraph, it will not be considered to have overcome the presumption by reason of any rules provided in this paragraph.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6652, 28 FR 4786, May 14, 1963]

§ 1.533-2 Statement required.

The corporation may be required to furnish a statement of its accumulated earnings and profits, the payment of dividends, the name and address of, and number of shares held by, each of its shareholders, the amounts that would be payable to each of the shareholders if the income of the corporation were distributed and other information required under section 6042.

§ 1.534-1 Burden of proof as to unreasonable accumulations generally.

For purposes of applying the presumption provided for in section 533(a) and in determining the extent of the accumulated earnings credit under section 535(c)(1), the burden of proof with respect to an allegation by the Commissioner that all or any part of the earnings and profits of the corporation have been permitted to accumulate beyond the reasonable needs of the business may vary under section 534 as between litigation in the Tax Court and that in any other court. In case of a proceeding in a court other than the Tax Court, see paragraph (b) of § 1.533-1.

§ 1.534-2 Burden of proof as to unreasonable accumulations in cases before the Tax Court.

(a) *Burden of proof on Commissioner.* Under the general rule provided in section 534(a), in any proceeding before the Tax Court involving a notice of de-

ficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation is upon the Commissioner if:

(1) A notification, as provided for in section 534(b) and paragraph (c) of this section, has not been sent to the taxpayer; or

(2) A notification, as provided for in section 534(b) and paragraph (c) of this section, has been sent to the taxpayer and, in response to such notification, the taxpayer has submitted a statement, as provided in section 534(c) and paragraph (d) of this section, setting forth the ground or grounds (together with facts sufficient to show the basis thereof) on which it relies to establish that all or any part of its earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business. However, the burden of proof in the latter case is upon the Commissioner only with respect to the relevant ground or grounds set forth in the statement submitted by the taxpayer, and only if such ground or grounds are supported by facts (contained in the statement) sufficient to show the basis thereof.

(b) *Burden of proof on the taxpayer.* The burden of proof in a Tax Court proceeding with respect to an allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business is upon the taxpayer if:

(1) A notification, as provided for in section 534(b) and paragraph (c) of this section, has been sent to the taxpayer and the taxpayer has not submitted a statement, in response to such notification, as provided in section 534(c) and paragraph (d) of this section; or

(2) A statement has been submitted by the taxpayer in response to such notification, but the ground or grounds on which the taxpayer relies are not relevant to the allegation or, if relevant, the statement does not contain facts sufficient to show the basis thereof.

(c) *Notification to the taxpayer.* Under section 534(b) a notification informing the taxpayer that the proposed notice of deficiency includes an amount with