In the

Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

vs.

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of Ethel B. Bennett,

Respondent.

No. 71-1665

Washington, D. C.
January 16, 1973

Pages 1 thru 37

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Washington, D. C.
Tuesday, January 16, 1973

The above-entitled matter came on for argument at 1:04 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM O. DOUGLAS, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

ERWIN N. GRISWOLD, ESQ., Solicitor General of the United States, Department of Justice, Washington, D. C. 20530; for the Petitioner

RALPH J. GREGG, ESQ., 2110 Main Place Tower, Buffalo, New York 14202; for the Respondent

C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in No. 71-1665, United States against Cartwright.

Mr. Solicitor General.

ORAL ARGUMENT OF ERWIN N. GRISWOLD, ESQ.,

ON BEHALF OF THE PETITIONER

MR. GRISWOLD: Mr. Chief Justice, and may it please the Court:

This is a federal estate tax case. It is here on a writ of certiorari to review a decision of the United States Court of Appeals for the Second Circuit. It involves one of those narrow but recurring questions which have no place to come for final decision except here and which arrive here only after long continued litigation and multiple decisions in the lower court.

The question relates to the value to be assigned to mutual fund shares held by the estate of a decedent. Specifically it involves the validity of Section 20.1031-8(b) of the Treasury regulations on estate tax which is printed at pages 25 and 26 of our brief, beginning at the bottom of page 25. It provides, and I quote: "The fair market value of a share in an open-end investment company (commonly known as a 'mutual fund') is the public offering price of a share."

And then there is a final clause which is not relevant, "adjusted for any reduction in price available to

the public in acquiring the number of shares being valued."

But the significant part is that the regulation provides thatthe fair market value of a share in an open-end investment company is the public offering price of a share.

Q Mr. Solicitor General, prior to the issuance of that regulation however, the Department of Justice did not go off--

MR. GRISWOLD: Prior to the issuance of that regulation, there was confusion and uncertainty. There was no clear rule or practice. The Treasury repeatedly endeavored to use the public offering price. Very frequently the matter was settled out as one of the numerous things which came up in the final adjustment with the revenue agent. When suits were brought, the Department of Justice would not defend the public offering price as the value in the state of the law where there was no regulation and no officially stated rule. And I daresay that that is one of the reasons why this regulation upon which we rely here, which was issued on October 10, 1963, by final approval by the Commissioner of Internal Revenue and the Assistant Secretary of the Treasury and publication in the Federal Register as a Treasury decision--why it provides at the bottom of page 26 in our brief, "The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963."

Q The public offering price is--

MR. GRISWOLD: The public offering price is the price at which the distributor sells the shares. It is the price which is stated in a prospectus. Usually there is a close arrangement between the distributor and the investment company itself. The investment company receives the net asset value. The distributor receives the addition which, in this case, is usually about eight percent, often referred to as the load. And a way to look at it and one to which I shall return is that the public offering price is the retail price at which the shares are sold to the public.

Q Except when offered at any other price.

MR. GRISWOLD: They not only are never offered at any other price by the distributor, but the--

Q Or by the company.

MR. GRISWOLD: Or by the company. They could be offered by you or me, if we owned them, at another price. But the industry has a built-in resale price maintenance provision in the law from the beginning. Section 22 of the Investment Company Act provides that no principal underwriter of such security and no dealer, which means anybody who is a dealer, shall sell such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. So that the public offering price is a unilateral price at which it may be sold by a person who is subject to the

Investment Company Act, which means an underwriter or a dealer.

Q Mr. Solicitor General, if you and I made a deal for shares of IDS that I have, I take it that IDS would accept their transfer?

MR. GRISWOLD: Yes, Mr. Justice, I understand they not only would but they must. And apparently there are very rare sales by one individual to another; they are discouraged by the industry as much as possible, and they are impossible to dealers because a dealer cannot sell except at the public offering price.

Q As a practical matter, would not those transactions likely be limited to very large blocks where there would be a large saving?

MR. GRISWOLD: Not necessarily. They might be sold between members of a family or friends or in some special circumstance.

Q The real incentive is in the big blocks in the transaction, is it not?

MR. GRISWOLD: There would be a substantial amount involved in a big block, and a person who had a large block would be reluctant to have them redeemed at the net asset value if he could find some other way to do it.

Apparently it is still very difficult to sell them by a private individual at anything approaching the public

offering price. In this case, the decedent died on December 4, 1964, somewhat more than a year after the new regulation was put out so that the regulation was applicable. Her executor valued the shares on her estate tax return at the redemption price, the bid price or net asset value. The commissioner determined, in accordance with the regulations, that the shares should be valued at their public offering price, and he determined that a deficiency accordingly, that difference is the load, usually about eight percent in an open-end investment trust. The executor paid the additional tax, filed a claim for refund, filed suit to recover the tax, contending that the regulation is invalid. And the district court agreed, and the Court of Appeals affirmed.

The regulation has similarly been held invalid in the Ninth Circuit in Davis against the United States, with one dissent. That case involves $600, and we did not seek to bring it here because the question is here in this case.

On the other hand, the regulation has been upheld in the Sixth Circuit in Ruehlmann against the Commissioner, which affirmed a divided decision of the Tax Court of the United States, and this Court denied certiorari several years ago. And the companion gift tax regulation has been held valid by the Seventh Circuit in Howell against the United States. And similarly there has been some division in the decisions of the district courts and the question is now

pending before the Tenth Circuit and the Court of Claims.

Q In reference to the companion gift tax regulation, what does the Internal Revenue Service do in measuring, for instance, a gift of IDS stock to an eleemosynary donee? Do they give the value with the load charge or without?

MR. GRISWOLD: It is my position, Mr. Justice, that in determining the value of a gift of a mutual fund share to a charity that under the analogy to the regulation, because the regulation applies directly to estate tax and the gift tax, that the amount of the deduction is the public offering price, exactly the same figure for which we contend here.

I believe our opponents say that there is no evidence that that is actually applied. I cannot cite clear authorities. But it is our position that that is the valuation which should be applied in determining the amount of a gift tax deduction.

At first blush it may seem that the regulation goes a little far. It is contended vigorously that the most that the estate can realize from the shares is the bid price or what might be called the liquidating value. But further consideration, I think, shows that that argument is by no means conclusive. Property is not ordinarily valued in estates at what can be realized from it.

For example, if the decedent owned Blackacre at an

agreed value of $100,000, his estate could not ordinarily realize the $100,000 from it. It would be likely to have to pay a commission on sale of, say, $6000, six percent. Yet the value of Blackacre for estate tax purposes would undoubtedly be $100,000 and not the $94,000 that could be realized net on its sale.

And that I think on further reflection is right. If they continue to hold Blackacre, do not sell it, it is worth $100,000. On the other hand, if they sell Blackacre and have to pay a six thousand dollar commission on sale, that commission is deductible and only the net amount would be subject to estate tax.

Q The difference, however, is any, is that in the one case it is a seller's commission, and in the other case it is a buyer's commission.

MR. GRISWOLD: Yes, Mr. Justice, but I do not think that really makes any difference, because I think that is really the difference between a sale on a market and a retail sale. When you sell real estate, you sell it on a market. And similarly with respect to ordinary stocks and bonds held by a decedent's estate. The value for estate tax purposes would not be reduced by a commission on sales, even though such a commission would reduce the amount which could actually be realized on the sale of the shares.

In this case the load becomes a part of the retail

price, just as the retailers markup in a drugstore or a grocery store becomes a part of the retail price, including a portion of the markup which he devotes to a commission to his sales people. And yet the retail price would be the fair market value of the property and would include the sales commission.

Q Mr. Solicitor General, in your Blackacre example one might sell through an agent but also one might sell it privately and might realize the $100,000. Is that true with respect to a share in a mutual fund?

MR. GRISWOLD: It is true if you can find a buyer who will pay you the full price. Experience and the record show that that is a rare occurrence, though it does sometimes occur. The problem of disposing of the shares--suppose you do dispose of them at the net asset value. Then you can deduct the amount of the difference between the public offering price and the net asset value as an administration expense if you sell them in connection with the administration of the estate. So that you would only be taxed if you actually do sell them on the net figure.

On the other hand, if you do not sell them, you have got something which costs the full amount in the only place where you can legally buy them and practically buy them. The offering price is in fact the price at which large numbers of these shares change hands every day from willing sellers to

willing buyers. Thus, the record in this case includes Exhibit 11, offered by the taxpayer, which shows the numbers of shares sold for a number of different fiscal years for each one of these three funds.

Exhibit 11 shows that in the fiscal year ended October 31, 1965, which is the year in which the decedent died, Investor Stock Fund sold 15,213,000 shares, which works out to about 60,000 shares per day.

Investors Mutual sold 34,499,000 shares in the year ended September 30, 1965. That works out to about 138,000 shares per day, which shows that there was a very large number of willing buyers who were willing to pay the net offering price at retail to sellers who were ready, willing, and available to sell the shares at the public offering price.

The third fund, Investors Selective Fund, was considerably smaller. It sold 1,500,000 shares during the applicable fiscal year. But even that would work out to 6,000 shares per day, which passed from willing sellers to willing buyers.

This is very persuasive evidence, it seems to me, that the offering price is in fact the price at which these shares freely transfer from a willing seller to a willing buyer, or at least that the regulation which provides that they should be valued on this basis, prospectively applied, is a proper one

for the Commissioner of Internal Revenue to make and should be sustained by this Court.

Q Mr. Solicitor General, is it really accurate to say that the fiduciary of an estate can find a willing buyer at the public offering price?

MR. GRISWOLD: No, Mr. Justice, but I do not think that is necessary. Perhaps this is as good a time as any to bring in this Court's decision in Guggenheim against Rasquin, which involved a gift of a paid-up life insurance policy. And the contention was there made on behalf of the taxpayer that the gift should be valued at the surrender value of the life insurance policy, which is the only amount which the donee could obtain either from the insurance company or from a bank if it wanted to borrow on the policy. And this Court held in Guggenheim against Rasquin that the proper value for gift tax purposes was the cost of that policy. This was the price which would have to be paid in order to obtain such a policy. It is, in effect, not the liquidating value, which the surrender value would be, but the retail price of the policy. And it used as an analogy a gift by a man to his wife of a new automobile.

Let us say that the automobile was a Cadillac which cost $6500, for which he paid $6500. He drove it to the house in order to deliver it to his wife as a gift. By that time it was a used car and it could be turned in toaa dealer

only for a sum considerably less than $6500. But the regulations have always provided that the value in such a case is the retail price, the price which would have to be paid for such an item.

Now let me take, for example, these very mutual fund shares.

Q Mr. Solicitor General, the regulations have always provided that, but it is not without some reluctance on the part of tax counsel to concede that they are right.

MR. GRISWOLD: I do not think, Mr. Justice, there has been much reluctance since Guggenheim v. Rasquin, which is 30 years ago.

Q Let me ask one thing which gives me some perceptual difficulty. It seems to me there are two sets of willing sellers and willing buyers here. There is, if you will, the estate and the fund; and there is, on the other side of that coin, the fund and the buyer in the market place. And one could say that the Government's position is linking the buyer in the one couple with the seller in the other, and eliminating the fund. Is this perceptually a difficulty?

MR. GRISWOLD: Mr. Justice, there are difficulties here, of course. Nevertheless, to me the really controlling factor in determining whether the regulation made by the Treasury can be sustained or not--after all, this Court does not have to decide whether it is right. This Court need only

decide that it was proper for the Treasury to make this regulation. And the fact is that very large numbers of these shares are transferred every day between willing sellers and willing buyers at the net asset price.

It is said in the Guggenheim case that although the insurance policy had a lot of value above and beyond the surrender value and it is proper to take that into account in determining the value of the insurance policy, but the same thing is equally applicable here. Mutual fund shares are widely sold on the representation,which has great substance, that this is the only way that a small investor can get diversification.

They are also sold on the representation, which may or may not work out in experience but presumably has some effect to it and at least for which people are willing to pay, that through the mutual fund you can get expert management. You can get for your relatively small investment the same kind of supervision and watching and care and foresight that a very large investor can have.

Q Are there any other examples of the Treasury, of the Revenue Service, valuing an asset at an amount that the owner of it can never realize under any conditions whatsoever?

MR. GRISWOLD: Yes, Mr. Justice, Guggenheim v. Rasquin and the--

Q Under any conditions?

MR. GRISWOLD: Under any conditions? Well, I do not know. Just as much as here, because the share may be valued at its net asset value on the decedent's death at $10,000, let us say, although he can only realize $9200 by turning it in. But by the time he does turn it in, the market has gone way up and he gets $11,000 for it. There is no impossibility of his obtaining the full amount of the value, which is determined at the date of the decedent's death.

Q You would never let him off for that amount then, either? The load charge under that.

MR. GRISWOLD: No, I do not think you would add any load charge onto that. If he later sold the shares for $11,000, he would have a gain of $1,000 and of only $1,000, although he had in fact realized $1,800 more than he could have realized on the date of death.

Q But you do not do that in other contexts, do you? How about an ordinary share of stock?

MR. GRISWOLD: If the item is sold on the market, then you do not take into account either buying or selling commissions. On the other hand, if the item is sold at retail--and let us take jewelry, I have already referred to an automobile--if the item is sold at retail, it is customarily and always has been valued at its retail price.

Q Of course, you have not had your automobile regulations sustained either, have you?

MR. GRISWOLD: No, Mr. Justice. The automobile regulation goes back a great many years, and Guggenheim v. Rasquin goes back 31 years now. But this regulation not only is 12 years old, but it was officially promulgated more than a year before this decedent died and it is in our contention a permissible approach by the Treasury to take to this problem. As this Court has twice said recently, in Correll and Bingler: "Alternatives are of course available; improvements might be imagined, but we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing all needful rules. In this area of limitless factual variations, it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustment. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner."

Q What was the case, Mr. Solicitor General, Correll?

MR. GRISWOLD: Correll. Correll is in 389 U.S. 299, and this quotation appears and the citations appear on page 9 of our brief.

Q I am a little bothered by the exchange between

you and Mr. Justice Blackmun earlier in just my own analysis of the case. If the Commissioner had defined the valuation of mutual funds for across-the-board purposes, I would find it much easier to accept than applying the definition just to estate tax purposes and apparently leaving open the question of what the taxpayer who is giving mutual funds to a charity--how that will be valued.

I know you said in answer to Mr. Justice Blackmun's question it was your position it should be valued the same way. But what was the practice of the Treasury at the time that it sought to assess this estate?

MR. GRISWOLD: Mr. Justice, the regulation is not limited to estate tax. It also applies expressly to the gift tax and was issued on the same day in the same Treasury decision with respect to the gift tax.

With respect to the income tax, I know of nothing which makes clear any practice in this respect. It is my position and a position which I would advise the Treasury to follow, that they should treat the public offering price as the value for gift tax purposes, for determining the amount of the gift in a deduction under the income tax.

Q Do you know whether they would do the same thing with respect to an automobile which is given to a hospital?

MR. GRISWOLD: Yes, Mr. Justice. If they gave a

brand new automobile, I would think they would be entitled to, let us say, an ambulance. I think they would be entitled to deduct the cost of that automobile as a gift to the hospital.

Q Suppose it were a used car, would it be the retail value?

MR. GRISWOLD: If it were a used car, I think it would be the price which they properly paid to a dealer in used cars. In other words, the retail price for a used car.

But let me take an instance which seems to me to be very close. Let us just take a gift of mutual fund shares. Suppose a man gives his daughter $10,000 worth of mutual fund shares as a Christmas gift. He would suppose, I think, that he has made a ten thousand dollar gift and that he should make a corresponding report on a gift tax return. And that is precisely what the regulation prescribed. This is on page 27 of our brief. We have set out the gift tax return, likewise applicable with respect to gifts made after October 10, 1963.

That seems clearly the right value for gift tax purposes of mutual fund shares. And yet there is no basis for distinguishing the value for gift tax purposes and the value for estate tax purposes. If the bid price determines the value for estate tax purposes, then it is hard to see why the bid price should not control the value under the gift tax. On this basis the father would have made a gift of $9200 and not $10,000. That is, his gift would be valued at the net asset

value after excluding the load and not at the offering price, which was in fact the price at which the willing father purchased the shares from a willing seller. And, to me, the controlling concept here, at least in determining whether the Treasury had a rational basis for its conclusion, is the retail price. The retail price of these shares is the public offering price, not the net asset value.

Q Mr. Solicitor General, I suppose in the settlement of a very large estate, running into many millions of dollars, it is a common experience to sell large blocks of stock, and there are some SEC regulations that if they were selling one block in one company they cannot sell it without some clearances, and additionally if it were a large block it might depress the market. So, the executors hire Goldman, Sachs to sell it, and Goldman, Sachs charges them a fee of $50,000 to liquidate a couple of million dollars worth of this stock. That is what, an expensive administration--

MR. GRISWOLD: That is an administration expense which is deductible.

Q Only from the income of the estate?

MR. GRISWOLD: Deductible in computing the net estate for estate tax purposes, not the income of the estate--

Q Yes, that is what I meant to say.

MR. GRISWOLD: --in computing the net estate for estate tax purposes.

Q May I ask you one more question; I have asked too many. Let us take into account an unlisted stock which is traded over the market, with bid and ask prices on a given day. As I recall the regulations, I have not looked at them recently, the estate is allowed to take the average between the bid and the ask.

MR. GRISWOLD: Yes, Mr. Justice.

Q Is this inconsistent? Why should it not take the bid price?

MR. GRISWOLD: I do not think so, Mr. Justice, because I think that really highlights the very point I am trying to make, the difference between a sale on the market in which case neither selling nor buying commissions are taken into account, whether they are paid or not. And in the case of an over-the-counter share, if it is sold on that day, then that determines the market price. If it did not sell on that day, then you take the mean between the bid and the ask, because that is the closest you can come, although if it is sold on the day before or the day after, that is also sometimes given some weight in determining the value.

On the other hand, if there is no--

Q But totally unavailable to the estate.

MR. GRISWOLD: What is totally unavailable?

Q This market of which you speak.

MR. GRISWOLD: No, you talked about over-the-counter

securities. I am talking about things which are sold on a market which would include over-the-counter securities. They are sold on a market.

Q But the IDS sale--

MR. GRISWOLD: The IDS sale is not on a market. It is at retail, and that to me is the whole key to this problem.

Q Yes, but the executor cannot sell on that market. Totally barred from that market.

MR. GRISWOLD: A person who buys at retail ordinarily cannot resell, because he is not a retailer; he is a consumer. If he wants to dispose of whatever he buys, whether it is a fur coat or an automobile or something else, he has to find somebody who will give him something which will be less than the amount he paid for it.

Nevertheless, if the item is a thing which is customarily sold at retail, I think that the value for estate and gift tax purposes should be the retail price, that that is in effect what this Court decided in Guggenheim v. Rasquin, that that is the foundation for the regulation in this case, that the regulation may not be inevitable, and I do not contend that it is, is a rational regulation, and that it should be sustained by this Court.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Solicitor General.

Mr. Gregg.

ORAL ARGUMENT OF RALPH J. GREGG, ESQ.,

ON BEHALF OF THE RESPONDENT

MR. GREGG: Counsel for the Government has argued on the premise that the sole issue to be decided here is the validity of the regulation. A mere rebuttal of this would be apt to insure to only leave the Court with a rather narrow and somewhat blurred vision of what this case is all about.

The real issues are factual. Were the shares owned by Mrs. Bennett at the time of her death worth $124,000, that being the amount she could have sold them for? Or were they worth $133,000, that being the amount the executor would have had to pay a broker to purchase as many additional shares as she already owned. And, thirdly, was the $9,000 difference, that being the amount going to the broker, an asset of Mrs. Bennett's estate?

It seems to me that the regulation must stand or fall on the answers to those questions. Then there is also the constitutional question, if the Commissioner may, by regulation, deprive taxpayers of due process of law by fixing an arbitrary value that precludes the consideration of any other relevant facts.

I hope in a matter of ten or twelve minutes to give the Court the benefit, I hope, of a broader perspective of

the mutual fund issue. It was in 1962 that I first became involved in the mutual fund issue, first on behalf of a town police officer, then then on behalf of the estate of my high school home room teacher.

Other cases came along quickly because, beginning in '61, '62, revenue agents were raising the same issue in every estate owning mutual fund shares. We soon discovered that it was useless to argue with revenue agents. Even though they privately agreed with us, they said their orders had come from Washington. There was no one to appeal to inside the Treasury Department.

So, what we did was to pay and sue for refunds in the district courts. We did not have to try those cases because, as the counsel for the Government agrees, the Department of Justice agreed with us and instructed the IRS to refund our money.

But this was all prior to October 11, 1963. There really was not much of an issue to be tried in those days. There was no doubt then as there is no doubt today about the value of the mutual fund share. It is the amount the shareholder can sell it for by asking the company for his money, and the amount is guaranteed.

Q What about the Solicitor General's analogy with the Cadillac? If you took the Cadillac back to the dealer, he would not give you the full price for it very likely.

MR. GREGG: No, sir, he would not. As a matter of fact, if you bought a brand new Cadillac and did not even take it out of his showroom and called up another Cadillac dealer and asked him how much he would give it to you, you would still get a secondhand car price.

Q Then you would say that in your estate, you ought to have the lower price?

MR. GREGG: Yes, sir, by all means.

Q Because there is no way you can realize anything else--

MR. GREGG: No possible way.

Q How would the Cadillac be valued if it was on order and the man died as he left the dealer's establishment?

MR. GREGG: That would depend, sir, would it not, on whether or not the retail dealer required the fellow to take delivery. In that case it would be a used car if he begged off--

Q Assuming he is going to stand on his contract and file a claim against the estate if he does not--

MR. GREGG: Yes. Then he has a brand new car which he has bought, taken titlae to, becomes a secondhand automobile. If he calls up the--

Q At least the dealer might settle with the executors by refunding or accepting just his load.

MR. GREGG: Might very well. But the dealer would

certainly say to him, "I have sold you the car. I got my commission. I have got 23 other Cadillacs just like it sitting out on the lot. I have got to pay my salesmen to sell those. I cannot give you all your money back."

If he were going to give him all his money back, he would not have sued them in the first place.

And this test that I was talking about for mutual fund shares, what they are worth, is exactly the same test that they use for determining the value of a share of General Motors, for example. It is what the shareholder can sell it for.

The amount revenue agents were talking about was the amount that it would cost the executor to purchase as many additional shares as the decedent already had, paying a broker an eight percent commission for shares the decedent did not hold.

Q If I had a share of General Motors and it is worth $100 on the market and I have to pay a commission, I still realize maybe $98, $96, but I still have to include it at a hundred?

MR. GREGG: You say if you had to pay for it, sir?

Q No. If I own a share of General Motors and I included it at $100, even though if I sold it and had to pay a commission I might only net $96.

MR. GREGG: I am sure that is true, because if I say

to my broker--

Q There is no way I can realize more than $96, but it is includable in my estate at $100?

MR. GREGG: I agree with you a hundred percent.

Q That is like the Goldman, Sachs commission that the Solicitor General and I were talking about, is it not?

MR. GREGG: The what one?

Q The four percent. The commission is an expense of administration.

MR. GREGG: No, it is not under the cases, only if it is necessary, only if--if you pay on the higher price, if you pay the estate tax on the higher price, you have a higher basis, if it is then sold by the executor and it is necessary to effect administration and everything of that character, the Treasury says you may deduct that as an administration expense. But you will find that in all the cases they are bitterly opposing the deduction on the grounds that it was not necessary to effect administration or to effect distribution or to pay expenses.

It is a capital loss, and I do not see how the Government says you can take it as an administration expense in an estate.

Q And if you sell merely to protect yourself against an anticipated drop in the market, do you get the

administrative expense deduction?

MR. GREGG: Not at all. Not necessary for the administration or to effect distribution.

Just as you say, if you tell your broker to sell your share of General Motors and another fellow says to buy one, and the sale takes place at a hundred, that is the price at which the share changed hands between a willing buyer and a willing seller under the regulations. One fellow gets only ninety-eight and the other pays a hundred and two. But the commissions paid are immaterial on the question of value, and the Commissioner agrees. But you see here he wants to add the purchasing commission.

Q What do you have to say, however, at the Solicitor General's statement, factual statement, that there are many thousands of buyers on the date of death who are willing to pay net asset value, plus the load?

MR. GREGG: That is the life blood of the whole industry. During the past year, for example, the number of sales at the redemption price for many months exceeded purchases at the public offering price. This is continuous, and there are sales in both markets. But the only market to which Mrs. Bennett had access, or her executor, was the bid price market, the amount she could sell it for.

Q Bearing in mind two sets of buyers and sellers.

MR. GREGG: Yes, yes, Mr. Justice.

I think I have outlined it quite well in my brief that the only difference really between the prices at which mutual fund shares sell and those of listed corporations are the way they are reported in the paper. One is reported with a purchasing commission; the others are reported without any reference to purchasing commission. And that is why, with the only difference between the two, that is why this regulation aroused such bitter opposition among the taxpayers, their lawyers, and accountants. Because it seemed to them that the Government was merely slipping over on them the use of the wrong price as quoted in the financial pages of the paper.

There is no doubt in my mind that the Commissioner was going to lose this argument if the question is, What is the value of a mutual fund share? And I daresay that this case would not be before this Court today except for one thing. The Commissioner has a very powerful weapon to use in such situations. It is a regulation.

A regulation gives the Commissioner an overwhelming advantage. First of all, he has the choice of weapons. He can use the case he wants to try and the court to try it in. The taxpayer has none of these choices.

Value becomes a secondary issue. The taxpayer now has the burden of proving that the Commissioner's regulation is completely unreasonable, arbitrary, and capricious. And, to top it off, the Commissioner has the presumption, the

judicial presumption, that he is right and the taxpayer is wrong.

This is not an isolated instance in which the Commissioner has used his regulation in order to put the taxpayer to disadvantage. He did it with his second class of stock regulations for professional corporations, his Kintner regulations for professional corporations, his business expense regulations under Section 274, just to mention a few that have been struck down recently by the lower courts. And he is even now doing it with his Section 42 regulations on multiple corporations where again the taxpayer is going to have the very difficult burden of proving that a purely arbitrary reallocation of income or expense is so arbitrary as to be completely unreasonable.

Q Mr. Gregg, let me bring you back to Justice White's question about his one share of General Motors. Is it your position that that should be returned in the estate tax return, not at the mean between the high and the low on the day of death but at that less the broker's commission?

MR. GREGG: No, Your Honor. Without subtracting or adding commissions of any kind. It is the price at which--

Q So, you are willing to put it in at a hundred?

MR. GREGG: At a hundred, oh, yes. Oh, yes.

Q And forget about the commissions.

MR. GREGG: Forget about the commissions. The regulations forget about them completely. They never have included--

Q I know what the regulations do, but do you concede that they are right in that respect?

MR. GREGG: Absolutely correct.

Q Why do you say that when you take the position you are as to IDS shares?

MR. GREGG: Because they have added the purchasing commission. And in the normal transaction for--if I do not say it right this time--let us take the five million dollar portfolio of a rich man owning common stocks. He pays a tax on a hundred percent of what those shares can be sold for, regardless of commissions.

Here the Government has ruled that a small investor in a mutual fund must pay a tax on 108 percent of the amount for which they could be sold. This, I say, is wrong.

Q In the General Motors case, at least you get the $100 in your pocket and you might have some expense; but in this case you say it is impossible for you to ever realize under any conditions more than the net asset value?

MR. GREGG: That is all you can get, Your Honor.

Q Is this a difference in degree or in principle?

MR. GREGG: A practicality, matter of fact.

Q A degree, is it not? The size of the load.

MR. GREGG: That is when you purchase. What I can get is the net asset value.

Q The load comes in in this hypothetical case too; eight percent.

MR. GREGG: Eight percent as a purchasing commission on small share lots. It drops to four percent, then one percent in the large brackets. But that is purchasing. What I can get is only the net asset value, and it is stipulated that the only practical method of getting your money is to turn them into the investment company.

Q If you are liquidating a five million dollar block of stock to pay estate and inheritance taxes, probably the only feasible way to dispose of it is to engage a very skilled dealer to handle the liquidation and get the SEC approval.

MR. GREGG: I must have misspoken, Your Honor. Whether you dispose of the stock or not or put it in trust is the question, What are they worth date of death, the five million of common stocks. They are valued at a hundred percent of what they could be sold for on the market, with commissions cutting no ice either way.

But here the Government is saying that this small investor in mutual funds must pay a tax on 108 percent of what they can realize.

Q That is with a small or a large investor.

MR. GREGG: Small or large.

Q If it is a question of mutual funds.

Q Mr. Gregg, when one invests in mutual shares, he pays the eight percent you are talking about at the time he buys the shares.

MR. GREGG: Correct.

Q So that is paying a commission at the time of purchase. When he sells those shares, they are redeemed in accordance with a contract, and he has to pay no commission?

MR. GREGG: Without charge on the assistance, correct.

Q That is right. But if you sell a hundred shares of General Motors, you do pay a commission.

MR. GREGG: You do.

Q And that is the two percent you have been talking about.

MR. GREGG: That is the two percent I was talking about.

Q And if you buy a hundred shares of General Motors, you also pay a commission.

MR. GREGG: You also pay a two percent commission.

Q But in the case of mutual funds the commission is paid only at the time of purchase.

MR. GREGG: Correct.

Q I think there has been some confusion as to

that.

MR. GREGG: I see.

When a regulation has been issued, the taxpayer job is not very easy. He asked the Court to explore the facts and decide the case on its merits. The Government's position, however, is that the only issue to be decided in a vacuum is the validity of the regulation.

And he reminds the Court that if there is at least some plausible grounds or rational basis for the Commissioner's decision, it must be sustained. Here the Government has offered in its brief and verbally an assortment of gift tax cases as lending that plausibility, Guggenheim, the gift tax cases, et cetera.

What connection is there really between gifts of single premium life insurance policies on the life of another, gifts of diamond rings subject to luxury wartime excise taxes?

I think that these arguments have to be recognized for what they really are, a diversionary tactic to persuade the Court that the Commissioner was not totally unreasonable.

Then having gotten all of the plausibility mileage out of these and other equally far-fetched analogies like Blackacre, et cetera, I think then the Government put great emphasis, I think, on the duty of the Court to defer to the judgment of the Commissioner in choosing between so-called

reasonable alternatives, citing the United States v. Correll and Bingler v. Johnson. But again what do those cases have to do with mutual fund shares?

In one, the question was, When is a businessman out of town? In the other, What fellowships and scholarships are exempt from income tax? In both there were any number of definitions, some good, some better, one perhaps the best. And understandably the Court was reluctant to superimpose its judgment on that of the taxpayer in those cases. But this is not a good, better, or best situation. It is a good or bad, is or is not, reasonable or unreasonable situation.

If Mrs. Bennett's shares were $124,000, they could not have possibly been worth $133,000. If the nine thousand dollar difference was payable--if a broker would get that--it certainly was not an asset of her estate.

And then as I pointed out before, with some exceptions, mutual funds are held by people of moderate means, the middle class investor, the rich man with a portfolio, as I said, of a million dollars worth of securities and common stocks listed on the exchanges. He pays an estate tax based on the net asset value of his portfolio. But the Government has ruled here that the small investor must pay a tax on 108 percent of the net asset value of his portfolio.

I do not see how the Commissioner justifies this discrimination, and I would surmise that that is why the

Government did not ask Congress for a blessing on this new regulation. He might have been reminded that Congress, in passing the Investment Company Act of 1940 was recognizing an important public need for a well regulated investment medium for the small investor. And he might have been told that it was not proper to penalize him for investing in the open-end investment company shares that were provided by that legislation.

Incidentally, counsel for the Investment Company Institute as amicus, has given the Court a very authoritative, intelligent, informative brief as amicus, explaining closed-end and open-end investment companies, load funds, no-load funds, how the estate tax regulation ignores the realities of the marketplace, and in addition rather senselessly discriminates against the holders of the load-fund shareholders.

Our position is that the Commissioner in promulgating this regulation was completely unrealistic and arbitrary and unfair. By arbitrarily assigning a value here to these shares, which the estate could never get under any circumstances, and at a price that precludes consideration of any other relevant facts, which is required by his own regulations, we think that he deprives the taxpayer of due process of law, and that is why on behalf of the many thousands of executors and their attorneys for whom I happen

by sheer chance today to be spokesman, I respectfully urge this Court to agree with the federal judge in my district and the judges of the Second Circuit Court of Appeals that the alue of Mrs. Bennett's shares was $124,000, and that the Commissioner was completely unrealistic, unreasonable, and arbitrary in saying that her estate should have to pay a tax on an extra $9000 that even the Government admits her estate could never get for them.

Q Mr. Gregg, I am sticky and I am not thinking very clearly. Tell me again why you can take a position one way with GM and a position another way with IDS.

MR. GREGG: I did not. It is the Government that takes the opposite positions. They value the GM share at a hundred.

Q I understood you were willing to put it in at a hundred.

MR. GREGG: I certainly am but not at--if they said, "You have got to value that General Motors share at a hundred plus the two percent purchasing commission, in other words, the replacement cost," I would disagree with them and they would be disagreeing with their own regulations, because for time immemorial they have said the value of a General Motors share is 100, not 102. But they say that the value of a mutual fund share is not 100, it is 108.

Q Looking at it from the other side of that same

coin, you are arguing the IDS situation now is what the estate can realize but not the GM situation of what you can realize.

MR. GREGG: It so happens that with IDS there is no selling commission or redemption charge. So that I actually do in fact get 100. With the GM situation, I actually get only 98. But I agree that the price at which the shares changed hands was 100 and that that is the fair market value for estate tax purposes.

Q All right.

MR. CHIEF JUSTICE BURGER: Very well. Thank you, Mr. Gregg. Thank you, Mr. Solicitor General.

The case is submitted.

[Whereupon, at 1:59 o'clock p.m. the case was submitted.]

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