In the

Supreme Court of the United States

CENTRAL TABLET MANUFACTURING COMPANY,

Petitioner,

v.

UNITED STATES

No. 73-593

Washington, D.C.
March 25, 1974
March 26, 1974

Pages 1 thru 47

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v.	:	No. 73-593
UNITED STATES	:	

Washington, D.C.

Monday, March 25, 1974
Tuesday, March 26, 1974

The above-entitled matter came on for argument at 2:41 o'clock on March 25 and was continued over to 10:13 o'clock a.m. on March 26, 1974.

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:

LARRY H. SNYDER, ESQ., 209 South High Street, Columbus, Ohio 43215 Attorney for Petitioner

STUART A. SMITH, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C. 20530 Attorney for Respondent

C O N T E N T S

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear argument next in No. 73-593, Central Tablet Manufacturing Company versus the United States.

Mr. Snyder, you may proceed whenever you are ready.

ORAL ARGUMENT OF LARRY H. SNYDER, ESQ.,

ON BEHALF OF PETITIONER

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

Central Tablet Manufacturing Company versus the United States is an income tax case arising under Section 337 of the Internal Revenue Code.

Section 337 provides in substance that sales or exchanges by a corporation within a 12-month period following adoption of a plan of liquidation shall be free from tax to the corporation provided that during the same 12-months period all of the assets of the corporation are conveyed or transferred to stockholders in liquidation of the corporation.

Section 337 is a remedial statute enacted in 1954 to eliminate the need for determining in the course of a corporate liquidation whether assets are sold sold by the corporation or whether instead they are sold to stockholders following distribution of the assets to the

shareholders.

By eliminating this determination, the statute eliminates the tax on both the corporation and the stockholders by the same sale or exchange transaction.

In the series of lower court decisions following the enactment of 337, it was held that involuntary conversion by casualty ought to be included within the term "sales or exchanges" as used in Section 337. These decisions were subsequently acquiesced in by the Internal Revenue Service.

The narrow question presented here by the Central Tablet is whether, in the application of Section 337 to involuntary conversions by casualty, the involuntary conversion occurs at the time of the casualty, which in this case, Central Tablet, preceded adoption of a plan of liquidation or whether it occurs when the right to insurance proceeds arises which under the facts of Central Tablet, occur after adoption of the plan of liquidation.

Briefly stated, --

QUESTION: Let me see if I understand that. I thought that liability was accepted here.

MR. SNYDER: Well, liability was neither accepted nor rejected, your Honor. I think, in response to your question and trying to state it fairly, I think the very fact that we negotiated these insurance claims was a recognition tacitly on the part of the inusrance carrier

that there was some liability. But they neither admitted nor disallowed liability. They did, however, reject our proofs of loss in the case.

QUESTION: But everything on which their liability depended had already occurred?

MR. SNYDER: Well, I don't know. A fire had occurred, of course.

QUESTION: And the policy had been issued and --

MR. SNYDER: The policy had been issued. The proof of losses had been rejected. Now, certainly, this is a condition to recovery under the policy.

QUESTION: But from then on, it was -- if there were arguments over facts that had already occurred or the meaning of instruments already issued.

MR. SNYDER: Yes, I think that is correct.

There was no challenge to the validity of the policy.

Let me briefly state all of the facts that I think are necessary for the Court to understand, the factual background of Central Tablet.

QUESTION: Incidentally, was the basis of the property, the adjusted basis, very low here?

MR. SNYDER: Yes, it was an old company, the --

QUESTION: Was it zero, as a matter of fact?

MR. SNYDER: No.

QUESTION: It was not.

MR. SNYDER: I don't believe so.

QUESTION: So that the amount of the insurance proceeds, then, bore on whether there would be a gain or a loss, I take it?

MR. SNYDER: Yes.

QUESTION: Was there ever any question as to the amount so that a loss could have resulted?

MR. SNYDER: I don't believe so, no. I don't know -- frankly, I don't recall the figures. The biggest dispute with regard to the building policy was whether or not a coinsurance clause applied. The insurers took the position that it did.

Had it applied or if it did apply, it reduced the limit of coverage approximately 40 percent. Now, this, like every other factual issue that we got into, in the course of the negotiations, was never determined. What finally happened is we started to talk in terms of numbers and agreed on a dollar amount. But in addition to this, of course, there was the usual question of the value of the building at the time of the loss.

With regard to the personal property, it was a question of the value of the property, of course, at the time of the loss there was a question of whether some of the personal property was repairable. There was even a

question with regard to a part of the machinery and equipment, whether the damage to it had been caused by the fire and the water that had been used to put out the fire or whether, instead, it had been caused by the elements and the failure of the insured to properly take care of that equipment after the fire. This was not a great bone of contention and I can't tell you how many, percentagewise, the number of machines that it involved, but it was a question.

Here again, it was never settled. It was never decided that the insurer was or was not at fault. We finally agreed on numbers and not dollars.

The negotiations of these claims took some two years. The building claim took approximately nine months to reach a settlement. Settlement was after the adoption of the plan of liquidation. The personal property tax claims were settled approximately a year after the fire. The business interruption loss claim, which is not here in contention, was two years after the fire before it was settled. But the negotiations were lengthy, as indicated by that time span and they were quite intense and there were a number of questions that arose and to repeat my statement and answer your question before, there was never any admission of liability on the part of the insurer, neither did they specifically deny it, except that they did reject our proofs of loss.

The question that is raised by Central Tablet was, of course, raised for the first time in the case of United States versus Morton, an Eighth Circuit Court of Appeals decision decided in 1968 in which Morton -- in which the Court of Appeals in the Eighth Circuit held that insurance proceeds received after a plan of liquidation as a result of a fire occurring before that plan of liquidation, were entitled to the nonrecognition provisions of Section 337.

The Circuit Court of Appeals judgment in this case, Central Tablet, is, of course, directly in conflict with Morton.

It also conflicts with Kinney versus the United States, which is a District Court case in California which held that in that case the acceptance by the insurance carriers of the insured's proof of loss at the time of the completion of the involuntary conversion by casualty, the court further held that Section 337 applied to that case and that the taxpayer was thereto entitled to the remedial provisions of Section 337.

Despite Morton and Kinney, of course, the Court of Appeals in this case has held that for the purposes of the application of Section 337, an involuntary conversion by casualty occurs in every case at the time of the casualty.

Of course, this is the position of the government here.

It is the position of the government that an involuntary conversion by casualty is a single destructive act. It is the contrary position of Central Tablet that an involuntary conversion by casualty is not a single destructive act, but is, instead, a transaction which is complete for the purpose of the application for 337 when an enforceable right to insurance proceeds arises.

It is our further position that under the facts of Central Tablet, that occurred when the insurance carriers excepted our proofs of loss. This, of course, as I have said earlier, occurred following adoption of the plan of liquidation in this case.

Now, we submit that --

QUESTION: Mr. Snyder, does the record show whether the fire was an important fact in the decision to liquidate?

MR. SNYDER: Yes, it was a -- the record does not show that, but it was. I don't believe it does. But is was, in fact, an important determination in liquidation.

QUESTION: So that, presumably, had the fire not occurred, Central Tablet would still be functioning?

MR. SNYDER: I don't think I can go that far because at the time of the fire and at the time all this happened, Central Tablet was in the throes of a strike and this may have -- incidentally, this was one of the reasons

that extended the problem with the business interruption loss because we had to then determine when the strike might have ended had there not been a fire, in order to determine the period of business interruption, so that entered into the picture. But, no, I can't say that. I think there is no question but that the fact of the fire was an important element in determining whether or not the corporation was to go out of business, but it was not the only factor.

QUESTION: But I guess the Government's position is, even if the liquidation was forced by the fire, that the event was still before the plan was adopted.

MR. SNYDER: Yes, I think the Government's position is flatly, as I understand it, that the time of an involuntary conversion is always at the time the cash --

QUESTION: And the tax would -- the gain would not be recognized if there was a voluntary liquidation but it would be recognized if there was a compelled one.

MR. SNYDER:Well, it seems to me that that --

QUESTION: That seems to be their position.

MR. SNYDER: It seems to me that that is where the Government comes out, yes, but I suppose that they had better speak to that themselves.

QUESTION: I take it you feel the Morton case is indistinguishable from this one, factually.

MR. SNYDER: Well, it is not indistinguishable

factually in that in Morton the taxpayer was a cash -- on a cash basis and in Central Tablet we are on an accrual basis but I think that the reasoning of Morton applies here. I I think that Morton was correctly decided on the basis of a cash basis taxpayer.

I think that in Morton -- might have, in the case of an accrual basis taxpayer as Central Tablet might conclude that Central Tablet would have to report.

Of course, now, we are talking about 337 but for the purposes of accounting, that the accrual was at the time that the proofs of loss of Central Tablet were accepted by the insurers, rather than as it held, in that case, that it wasn't until receipt of the proceeds of insurance that it was even --

QUESTION: Is it fair to say that being on the accrual basis makes your case a little harder than for the taxpayer in Morton?

MR. SNYDER: Well, I suppose, in fairness that it is, except that under the facts of Central Tablet it is distinguished from the facts of Morton and the facts of Kinney; I think we have the easier case.

QUESTION: But did you say that an accrual basis taxpayer would accrue this loss in a year in which the proofs of loss were accepted?

MR. SNYDER: Well, I think you could come to that

conclusion, yes. I think at that time an enforceable right to insurance proceeds occurs and I think probably at that time you could also determine that the amount is reasonably determined.

QUESTION: I thought you accrued losses in the year they occurred or that the event occurred, that the loss actually -- that the impact was on --

MR. SNYDER: I don't think so, no. That is not my understanding.

QUESTION: Well, then, your case is just as easy as Morton was.

MR. SNYDER: I think it is, yes. I think it is.

QUESTION: What about the condemnation cases? Do you take comfort from them or despair?

QUESTION: Well, the condemnation cases, of course, are the cases that the Government relies heavily on. Frankly, I think they misplace reliance on the condemnation cases. All of the cases they cite and all of the cases that are litigated, of course, are those cases which occur under the "quick take" statutes or in jurisdictions in which it is held that the take occurs at the preliminary filing of the declaration of condemnation or whatever it might be.

I think if you examine the majority of the statutes and the majority of jurisdictions, you will see that the take doesn't occur normally until there is a deposit

made in court or until sometimes there is an actual decree or a verdict and I think when you analyze both condemnation cases against this voluntary conversion by casualty, you will see that the take is the significant point in the condemnation case because it is that time that the right to compensation arises and that is the basis of holding that it is the time of taking or that a condemnation occurs.

If you look at the similar event, an involuntary conversion by casualty, I believe you will have to come to the conclusion that that is going to be comparatively when the right to insurance proceeds arises and we submit, of course, and it is the basis of our case that that does not occur until at least the proofs of loss are accepted by the insurers.

QUESTION: Mr. Snyder, what is a procedure under Ohio law for what you call a "quick take" method of condemnation?

MR. SNYDER: Well, like most jurisdictions, your Honor, there are a number of statutes, some of which the filing of the complaint or the petition will -- is held to be the time of the taking for the purposes of entry and the right of the Government to take possession. There are other statutes, however, in which the time of the take is not until the deposit -- a deposit is placed in court by the condemnor.

QUESTION: Is the owner of the property notified?

MR. SNYDER: I beg your pardon?

QUESTION: Does the owner of the property receive notice and have an opportunity to be heard before his property is taken?

MR. SNYDER: No. He receives notice but there is no hearing on the -- there is no preliminary hearing. There is a statutory procedure whereby you can challenge the power of the authority of the condemnor to institute this proceeding, but that is after the take. I suppose it would be likened to -- if that procedure were utilized, it would be likened to sort of a condition subsequent to the take.

QUESTION: I think you do better than that in Virginia.

QUESTION: But there is a deposit, isn't there?

MR. SNYDER: Yes.

QUESTION: Of the state's estimate of the value.

MR. SNYDER: The state's estimate of the value is always deposited.

QUESTION: Which he can take down.

MR. SNYDER: Yes. But very rarely, of course, do they, but that has nothing to do with the substance of the thing.

QUESTION: And if he doesn't take it down, it draws interest -- an award draws interest from the date of

taking.

MR. SNYDER: I assume so, but again, I am not sure.

QUESTION: Can you take it down and still litigate for more?

MR. SNYDER: I don't believe so, no. I think if you take it down, that ends the question of the reasonable value of the property which has been taken by the condemning authorities.

QUESTION: Are you drawing any distinction between the state condemnation and a federal one?

MR. SNYDER: No, because I think that, like the state, to my knowledge, under federal law there are a number of statutory procedures, one or two or which are "quick take" in which at the time -- as a matter of fact, I don't even think you have to file a court proceedings but I think at the time of the take, which is at the -- almost at the earliest time of the condemnation, the right to compensation arises.

But I think it is only on that basis that you can justify these quick take statutes, as I read the decisions of this Court and some basic concept of Constitutional law, I think the right has to arise then or the statute is not validly applied.

MR. CHIEF JUSTICE BURGER: We will resume there in the morning.

MR. SNYDER: Thank you, sir.

[Whereupon, at 3:00 o'clock p.m., the Court was adjourned until the following day, Tuesday, March 26, 1974 at 10:00 a.m. This argument was resumed at 10:13 a.m.]

MR. CHIEF JUSTICE BURGER: We will resume arguments in Central Tablet Manufacturing against United States.

Mr. Snyder, you may resume.

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

To summarize Central Tablet versus the United States, the question is whether an involuntary conversion by casualty for the purposes of the application of Section 337 occurs at the point of the casualty, which in this case preceded adoption of the plan of liquidation, or whether, instead, it occurs at the point that an unconditional obligation to pay insurance proceeds on the part of the insurance carriers arises which, in this case, post-dated adoption of the plan of liquidation.

As stated yesterday, it is the position of the Government that an involuntary conversion by casualty for the purposes of the application of Section 337 occurs in every case at the point of the casualty and that an involuntary conversion by casualty is a single destructive event.

It is our contrary position that an involuntary conversion by casualty is a gain or loss producing

transaction and that for the purposes of Section 337, that transaction is complete when an enforceable right to insurance proceeds arises.

We submit that the casualty is much like an executory contract of sale and an executory contract of sale by Treasury regulation is distinguished from a contract of sale.

A contract of sale, in turn, is defined as a contract in which there is an obligation on the part of the buyer to buy and an obligation on the part of the seller to sell and it is not until there are those obligations that a sale under Treasury regulation is complete for the purposes of the application of Section 337 and we submit that the comparable event, the taxable event to that sale is an involuntary conversion when an enforceable right to proceeds arises.

QUESTION: Could I ask you what difference it makes in this case which it is held to be?

MR. SNYDER: What difference it makes in this case? Are you talking about dollar difference?

QUESTION: That and what --

MR. SNYDER: It makes approximately --

QUESTION: Will there be two taxes?

MR. SNYDER: Two taxes?

QUESTION: One on the corporation and one on the --

MR. SNYDER: Oh, yes, there will be two taxes, one of the corporation and one on the stockholders.

QUESTION: What is the rate on the corporation?

MR. SNYDER: I don't know offhand.

QUESTION: Wouldn't it be the regular corporate rate?

MR. SNYDER: Oh, yes, it would be at the regular corporate rate.

QUESTION: And the rate on the shareholders would vary.

MR. SNYDER: Would vary depending on their base, yes.

QUESTION: Yes.

MR. SNYDER: Yes, that is the difference. I thought you were asking for a dollar --

QUESTION: Well, in terms --

MR. SNYDER: In other words, there would be two taxes.

QUESTION: Yes.

MR. SNYDER: One on the corporation. In fact, there has been a tax on the corporation. This is a refund claim.

QUESTION: What was the refund claim? How much?

MR. SNYDER: Well, it was $85,000. Now, some part of that was business interruption insurance, a question

which is not before this Court. It was not taken on appeal but I would say approximately $70,000 is in issue here and that is the tax to the corporation which was paid under protest.

QUESTION: Thank you.

MR. SNYDER: But, of course, there is a tax due at the time of liquidation of the assets and the distribution of those assets to the stockholders which is, of course, a point that has already been completed.

QUESTION: Mr. Snyder, what do you regard as the purpose of Section 337?

MR. SNYDER: Well, it is a remedial provision. I think the purpose is to eliminate this kind of double tax in a situation, really, gain or loss producing transaction. We are talking about gains. You have the same gain-producing transaction and I think the purpose of the statute is to eliminate a tax from that single transaction on both the corporation and the stockholders when distribution is made in liquidation within the period of 12 months.

QUESTION: How does your position here give weight and force to that purpose?

MR. SNYDER: How does it give weight or force to that purpose? Well, because under the facts of this case, it would clearly fall within that. There will be a tax on the corporation and a tax on the stockholder.

QUESTION: Well, true enough, but, of course, your casualty had happened before the decision to liquidate had taken place.

MR. SNYDER: The casualty happened, yes.

QUESTION: Yes.

MR. SNYDER: Well, I distinguish between a casualty and an involuntary conversion and I think the statutes and Treasury regulations distinguish between a casualty loss and an involuntary conversion.

QUESTION: Well, wasn't the purpose of the statute, as you say, to enable corporations in this kind of a tax situation as your corporation was, a low-base, to liquidate without the hazard implied by the court case, the one that came down later, depending on the slight difference in factual set-up? But I was wondering, when this casualty is thrown upon you -- and as you indicated yesterday, was a vital factor in the decision to liquidate rather than carry on, whether your posture here for an accrual basis taxpayer is sponsoring that statutory purpose in any way?

MR. SNYDER: Well, of course, I can do no more than repeat my attempt at an answer before, which is that this is the same kind of transaction, that 337 was, obviously, on the surface, designed to meet. What is the difference between a casualty and an executory contract of sale? The only difference is, is it is trhust upon this

taxpayer. He has no choice, or it has no choice.

In an ordinary sale or an exchange, a taxpayer can take his own time and maneuver and negotiate and then still have the remedial effect of Section 337 and on the equity basis, I think it is more equitable to include an involuntary conversion by casualty than it is an ordinary sale.

Mr. Chief Justice, I would like to reserve remaining time for rebuttal.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Snyder.

Mr. Smith.

ORAL ARGUMENT OF STUART A. SMITH, ESQ.

ON BEHALF OF RESPONDENT

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

I think it would be useful for the Court to focus on the text of this statute which is set forth at page 2 of Petitioner's brief. The statute provides that, one, if a corporation adopts a plan of complete liquidation and then, two, within a 12-month period beginning on the date of the adoption of the plan, all of its assets are distributed in complete liquidation to its shareholders, then and only then shall no gain or loss be recognized to the corporation from the sale or exchange by it of property

within the 12-month period.

The statute mandates a particular consequence of events. First, a plan must be adopted, thereby identifying the corporation as one which is commencing a liquidation process.

Secondly, once the plan is adopted, then a 12-month period begins to commence running forward in time. The statute is a strict statute insofar as sales or exchanges occurring before the adoption of the plan or sales or exchanges occurring after the 12 month period has run, cannot be protected by the nonrecognition provisions of the statute.

Now, here, the sequence of events which have occurred in this transaction demonstrates that it is exactly the reverse of the situation that Congress intended to benefit by the statute because first, we have here the fire on September 10th, 1965.

At that point in time, the taxpayer did not evidence any intention to liquidate. Indeed, as has been discussed, the fire itself prompted the decision to liquidate in part because a major asset of the corporation was destroyed.

Then, some more than eight months later, in May -- on May 14th, 1966, Petitioner adopted a plan of complete liquidation by action of its board of directors and

presumably by ratification of its shareholders.

Now, in order to place the gain accruing from the insurance proceeds, the Petitioner must somehow place that gain after the adoption of the plan. That is, after May 14th, 1966 for if it arises before, the statute cannot apply.

Now, it does this by arguing that what has occurred here after the plan was somewhat like a negotiation of sale. It dickered with the insurance companies over the amount of the award and ultimately that was concluded sometime in August, after the adoption of the plan.

But it is plain what occurred here was not a sales negotiation in any sense that that term represents. It was simply a compensation for loss which the insurance company paid pursuant to the contract of fire insurance. These post-fire discussions which the Petitioner had with its insurance company were simply directed to the amount of the compensation and the fact that this transaction is not a sale is well-settled by this Court's decision in Flaccus Leather Company.

Now, the fact that this is not a sale might be deemed to be the end of the matter for we have a statute here that talks about a sale but it is not the end of the matter because two court decisions, the court of claims in the Towanda Textiles case and the Kent Manufacturing decision of the Fourth Circuit, have included within the compass of

Section 337 gains from involuntary conversion such as these, that is, gains from the destruction of property.

But the situation of those cases is entirely different insofar as the facts of those cases can be fit within the time sequence mandated by Congress in this statute, that is, that the plan occur first and then the gain arise afterwards.

Now, in the case involved in the Towanda Textiles case, you had a situation where the corporation first adopted a plan of complete liquidation and then subsequent to that time, the fire occurred. In that sense, one could say, as the court of claims did, that the fire interrupted the liquidation process which had already been commenced by the operation of the plan pursuant to the statute and as the court of claims reasoned, if the destruction had not occurred to Towanda Textiles, the property would have been sold in the normal course of liquidation pursuant to the Section 337 plan within the 12-month period.

QUESTION: Mr. Smith, did the Government oppose that result in the court of claims?

MR. SMITH: The Government opposed that result in the court of claims on the ground that no sale or exchange occurred.

QUESTION: Suppose we have the adoption of the plan, and then the fire within the 12-months period, the

final insurance settlement 15 months after the adoption of the plan. What is the Government position as to that?

MR. SMITH: Well, the Government's position surely is that if all the assets of the corporation are not distributed within the 12-month period, then the statute doesn't apply. But that is the kind of situation, Mr. Justice Blackmun, which is easily remedied by a corporation in that posture simply by distributing the claim to its shareholders pro rata so there would be no problem about arranging for compliance with the statute.

QUESTION: The Commissioner acquiesced ultimately in Towanda, didn't he?

MR. SMITH: The Commissioner acquiesced to the propostion in those cases that a sale or exchange -- that Section 337 gains include gains from involuntary conversion. Well, the point of those cases, Mr. Justice Rehnquist, is that the statutory time sequence was observed in those cases insofar as what this statute was meant to cover was a corporation identifying itself as a corporation in liquidation and that without the adoption of a plan, such a corporation has not commenced a liquidation process and I think that those cases can best be explained in terms of the reason that prompted their result by the fact that had fire not occurred in those cases, the corporation surely would have sold the property pursuant to the normal kind of Section 337 plan that

tax practitioners are well-familiar with.

But what we have here are, at the time of the fire, the Petitioner was not planning to sell its building pursuant to a plan of liquidation. Its intention to liquidate was formed after the fact and to that extent, we feel that the plan here should not relate back to the fire any more than a plan should relate back to a prior sale.

QUESTION: What taxes are at issue here, for what year? The year of the casualty or the year of the payment?

MR. SMITH: Well, the taxes at issue here presumably are for the year of the payment.

QUESTION: Well, do you mean the Government -- do you think that when a fire takes place in December of '65 and the proceeds are finally paid in '66 and there is a gain, a gain is accruable in '66?

MR. SMITH: Well, if you are an accrual-basis taxpayer and all the events have been fixed, the gain would be reportable in '65.

QUESTION: That isn't what your colleague stated and it just so happens that the taxes at issue here are '66 taxes or not?

MR. SMITH: I think they are '66 taxes, but the point of that, Mr. Justice White, that simply goes to when the taxes -- when that gain is realized for purposes of

recording in --

QUESTION: All right, it does; yes, it does and if there had been a loss, let's assume there had never been a -- let's assume that the insurance proceeds didn't pay off.

MR. SMITH: Yes.

QUESTION: Didn't pay the basis -- it was a new building, didn't pay it. When would the loss be accruable?

MR. SMITH: The loss would be accruable presumably at a time when it became clear that the loss -- that there would be a loss but following that point to its conclusion, I think it should be pointed out that the net effect of the taxpayer's position in this case would be to foreclose its recognition of a loss under such circumstances because if the loss arose as of the time that the insurance company finally decided not to pay off or to pay off not in excess of basis, then Petitioner's position here that that loss should be recognized at that time would result in the loss arising after the adoption of a plan.

QUESTION: Yes, but just in the ordinary case where there is no liquidation involved and there is a loss that the insurance does not cover. I take it you suggest that the loss would be accruable in the year the proceeds are paid?

MR. SMITH: Well, yes, certainly for a cash-basis taxpayer. For an accrual-basis taxpayer, I would suggest

that if at the end of the year, let's say on December 20th, it became clear what the amount of the loss was but the checks were not paid until the next year --

QUESTION: No so here.

MR. SMITH: Apparently not so here.

QUESTION: Yes. Go ahead.

MR. SMITH: Now, in view of the fact that an -- since the statute clearly would not apply to a situation where a sale took place and then the plans were adopted, I think that the implication of the Petitioner's position here would be to give a preference to those taxpayers suffering a destruction of property that is not available to tax payers simply selling corporate assets in the normal course of the liquidation.

Now, we think that the condemnation cases, the line of decisions involving condemnations, offer a useful analogy and are instructive as to correct results which should be reached here. What we have in this line of decisions is a uniform holdings of all the courts of appeals to the effect that in a condemnation situation where the taking of the property takes place prior to the adoption of a plan of liquidation, then the gain from that condemnation cannot be covered by Section 337 because the plan arose afterwards.

Now, these are the holdings of these cases notwithstanding the fact that a condemnation proceeding may

be litigated for several years and the exact amount of the award may not be fixed for several years.

QUESTION: Don't you, though, at the time of taking under most state law and under federal law, have the right to draw down at least the amount the condemnor has deposited so that you get some cash proceeds?

MR. SMITH: Mr. Justice Rehnquist, the situations are varied under both federal and state condemnation proceedings. We cite a case called Dwight versus United States. It is a Second Circuit case which involved a state condemnation. In that situation, very much like the sudden event of a fire, the Board of Estimate of New York City simply filed a damage map in the court and that resulted in the taking of property. The condemnation proceeding to fix the amount of the just compensation stretched over many years without any payment and the Second Circuit held in that case that notwithstanding the fact that the condemnation was sudden and that the petitioner there could not even timely adopt the plan, even had it known of the -- because it did not know of the event, still Section 337 did not apply to insulate these gains from corporate taxation.

There are other federal condemnation situations, notably in this Likins-Foster Honolulu case which we cite where there are depoists paid into court and the condemnee can draw down on it but I think that the situations are

sufficiently varied that you can't really make a general rule about the practice under condemnation proceedings.

Now, when the Second Circuit considered the Dwight case, it was faced with a situation far more, shall we say, harsh than this case, because the Board of Estimates simply filed this damage map and that was the end of the matter. The taxpayers simply did not have time to adopt the plan of complete liquidation.

The Second Circuit simply said that the statute has strict requirements and if it is to be modified to cover all gains from involuntary conversion, then Congress has to modify the statute.

As we point out in our brief, an advisory commission in 1959 so urged Congress to modify this statute to cover all gains from involuntary conversion whether they arise before or -- whether the event arises before or after the adoption of the plan and Congress did not act on this proposal.

So what you have here is a situation where taxpayers subjected to sudden events such as condemnation clearly cannot have the benefit of this statute if they do not abide by the statutory time sequence of first adopting the plan and then within the 12 months, experiencing this event.

What the taxpayers position here would lead to, we submit, would be a situation where taxpayers suffering

destruction of insured property would be accorded a preference over taxpayers suffering a sudden condemnation very similar to what happened in the Dwight case.

Now, Petitioner attempts to distinguish these condemnation cases. It says, condemnation creates an enforceable obligation to pay a certain amount of just compensation by the condemning authority but the destruction of this insured property here gave rise, so it says, to simply a conditional or contingent plan.

But what are these contingencies that the taxpayer is relying upon to base its argument to push forward the dispositive event after the adoption of the plan in May?

It talks about the filing of a notice of loss. It talks about the filing of a proof of loss and it talks about complying with other procedural requirements under the contract of insurance.

But the record here indicates that these procedural requirements had already been met by Petitioner prior to the adoption of the plan. For example, the record indicates here that negotiation -- well, the fire started -- the fire was on September 10th, 1965. The negotiations that the Petitioner commenced with the insurance company began as early as October 8th, 1965.

In fact, Petitioner's own counsel in the district court testified that the proof of loss in this case was

filed prior to December, 1965, again, prior to the adoption of a plan. Petitioner does not meet its own proposed test and that is the test proposed by the District Court in the Kinney case upon which it relies.

But in any event, we don't think that these procedureal requirements under the insurance contract create the claim against the insurance company because just as the condemnation taking creates the claim against the condemning authority, so does the destructive events of the fire, we submit, create the claim against the insurance company.

It is this irrevocable event of either taking by condemnation or by fire which converts the property into the obligation running against the insurance company or the authority.

QUESTION: Would it make any difference to your submission if the casualty occurred in the absence of insurance and yet the owner of the building, for example, which burned, thought it had been caused by the negligence of someone whom he intended to sue so that there was no contractual right, argueably, of any right to recover?

In other words, suppose the only claim was a contingent negligence suit? Would that make any difference?

MR. SMITH: I don't think it should make any difference, Mr. Justice Powell. I think what you have here is a -- in effect, an irrevocable transformation of property

from -- property which exists to property which has been destroyed and that creates, in the case of -- in your case of negligence case, it creates an obligation under common law, I suppose, for recompense which will not elevate it to a contractual claim, would nevertheless still represent the claim against the negligent party. I don't think that should make a difference.

QUESTION: Well, I suppose, in my brother Powell's hypothetical case, in the year of the fire that would be a casualty loss to the corporation, wouldn't it?

MR. SMITH: It would be a casualty loss to the corporation, yes.

QUESTION: And then in the year of the -- any subsequent year of recovery, it would be what, ordinary income?

MR. SMITH: I can take that into -- well, I --

QUESTION: What would it be?

MR. SMITH: It would be a casualty loss unless it was covered under another provision, Section 1231 of the Code, which provides for netting of losses from involuntary conversions against gains from the sale of capital assets so I don't think I could answer completely that that would be, you know, an ordinary loss but if there were no other gains, presumably it would be an ordinary loss, absent such --

QUESTION: It would be a casualty loss and that is

an ordinary loss, not -- it not the equivalent of a capital loss.

MR. SMITH: Right. Right.

QUESTION: After long-term --

MR. SMITH: After such details as depreciation recapture.

QUESTION: Right, right.

MR. SMITH: Right.

QUESTION: And then in my brother Powell's case in a subsequent year if the corporation should get a judgment against the negligent person who caused the fire, what would the tax effect be on that?

MR. SMITH: You'd have to ake that into income.

QUESTION: On your income.

MR. SMITH: That is the principle of --

QUESTION: Of course, he question was, what if the corporation was under a 12-month plan of liquidation at the time of the recovery?

MR. SMITH: If it were in a 12-months plan of liquidation at the time of the recovery, I think that these questions as to when you take something into income are wholly apart from the question as to whether the plan applies. I mean, if the casualty occurred prior to the -- let's say, in the middle of the plan of complete liquidation, then, presumably, you'd have -- if that were a loss -- an

uninsured loss, so to speak, then you would have a loss that wouldn't be recognized. Isn't that right? Becuase it would occur after the plan.

QUESTION: I guess so.

MR. SMITH: So then in the subsequent year when you get money into income, since you have not deducted that loss, presumably that -- I would imagine that would have to be taken into income. I can't think of any reason why it shouldn't.

QUESTION: It may be only the net over the loss.

MR. SMITH: Well, this raises a question as to whether you -- I suppose, under the tax benefit rules, you haven't got any tax benefit from the loss. You don't have to take that into income.

QUESTION: I would think so.

MR. SMITH: I would imagine it would be only the net over the loss. I think that is right.

Now, we think that these subsequent events upon which Petitioner relies, that is, its negotiations with the insurance company, its compliance with the procedural requirements of the policy, simply go on aid of the collection of the claim. They do not create the claim against the insurance company.

Now, while the taxpayer recognizes that this transaction is not a sale here, it argues that, in its

reply brief, that it has many of the characteristics of a sale. What it says, in effect, is that the insurance award is analagous to a sales price and it assumes that you can't have a sale without its determinable sales price.

Well, this assumption, which was made by the Morton opinion as well, we think is erroneous. There are many instances where you can have a sale, not only for tax purposes, but for any purpose without the existence of a determinable sales price.

For example, a business can be sold for a percentage of future profits over a stated period of time. The sales price in that situation is not determinable until the end of the period. No one would doubt if there were a transfer of the benefits and burdens of ownership of that business that there was a sale. Clearly, a sale occurs in that case and to that extent, we think that Petitioner's analogy is false.

Alternatively, the taxpayer argues here that the payment by the insurance company could be a sale. It talks about a situation where the insurance company will pay an adjustment for salvage and, presumably, take over the ownership of the property.

Now, first of all, there is no showing that this occurred here or didn't occur here. This payment was simply a compensation for a loss. But even if there was -- even in

such a situation, we think that the compensation for the loss element of the payment would not be analagous to a sales price, so to speak, because that simply is a payment for a decrease in value of the damaged property, value which has disappeared, that can in no way be analogized to an element of a payment which would be deemed a sales price.

And finally, as we pointed out in greater detail in our brief, we think that the net effect of Petitioner's position here is contrary to settled rules governing the holding period of property. Almost 40 years ago, this Court held in the McFeely case that holding period, the concept of holding period is coterminus with the concept of ownership and as a collary to those cases, there are other cases which hold that when property is destroyed, its holding period ends.

Now, those holdings were rendered in situations involving sunken ships, but the lesson is equally instructive here. In those cases, a taxpayer bought a ship on January 1st and it sunk on March 1st, to use the example.

The insurance proceeds, however, were not paid until July 15th and what the taxpayers in those cases argued was that their holding period should be stretched forward beyond six months to the point where the insurance proceeds were paid and in that way, to try to get long-term capital gains.

Now, the courts rejected that notion. The holding period ended when the ship sunk, when the destructive event occurred so we think that those holdings are instructive as to the error that Petitioner is making in this argument because if Petitioner's argument is right that it's so-called "sale" under this statute did not occur until the insurance proceeds were paid, the implication of its argument is that a sale occurred after its coterminus holding period and ownership have ended.

We think that that is wrong and we think that is simply another demonstration of the error of Petitioner's position and the reason why the court's judgment of the court of appeals should be affirmed.

I have nothing further to say, if the Court has no further questions.

QUESTION: May I ask you another question, Mr. Smith? Let us assume that the proceeds of this fire had been received by the party whose property was burned and it had planned to and did carry out a plan of reconstruction of the destroyed building. Let's assume the proceeds received within the statutory period that permits them to be received for reconstruction purposes without recognition of gain.

MR. SMITH: Section 1033.

QUESTION: 1033, right. Then let's assume that

the day after the building was reconstructed, a plan of liquidation was adopted. Would there be any problem with that?

MR. SMITH: And then the property was sold?

QUESTION: Yes.

MR. SMITH: Presumably, I don't think there would be a problem because what you have got there is simply the property is sold after the adoption of a plan. The fact that they took advantage of another provision in the Internal Revenue Code to reconstruct the property and get a carry-over basis, I don't think would present any problem.

QUESTION: You end up with what might be regarded as substantially the same result, don't you?

MR. SMITH: Substantially the same result, yes, but in the situation you posited, I think, Mr. Justice Powell, that the statutory time sequence of Section 337 is observed insofar as the property is restored, then the plan is adopted and then the property is sold.

QUESTION: I understand that.

MR. SMITH: There are many ways to skin a federal tax cat. That didn't occur here.

QUESTION: The Government just really wants to put the taxpayer to all that trouble, does it?

MR. SMITH: Well, I mean, these are -- we view these statutory requirements as precise and it is a cliche,

but nevertheless somewhat with a ring of truth to it that you can't be judged for federal tax purposes on the basis of what you didn't do and they didn't do that here.

I have nothing further to add.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Smith.

Do you have anything further, Mr. Snyder?

MR. SNYDER: Yes, briefly, your Honor.

REBUTTAL ARGUMENT OF LARRY H. SNYDER, ESQ.

MR. SNYDER: Counsel prefaced his argument with a reference to the strict time sequence required by this statute and he also ended his argument largely in the same vein. With that in mind, I would like to read Treasury Regulation 1.337-2A which says, "In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiation for sale may have been commenced, either by the corporation or its shareholders or both shall be disregarded.

"Moreover, an executory contract to sell is to be distinguished from a contract of sale. Ordinarily a sale has not occurred when a contract to sell has been entered into. The title and the property have not been transferred."

This is the strict time sequence that Counsel refers to. The Government is committed to the proposition, because it acquiesced by revenue ruling in it, that an involuntary conversion by casualty is a sale or exchange, so

it has to be treated that way, but they want to treat it differently. They want to treat it differently from a sale.

They want to treat it as a single and destructive event, which it is not.

The whole thrust, the whole purpose of the Internal Revenue Code, of the income taxes, is directed to the realization of gain or loss and a transaction which has produced this gain is not complete until there is some enforceable right to gain and that doesn't occur here --

QUESTION: But didn't the Government in this case claim the gain was realized in Fiscal Year '65?

MR. SNYDER: Well, we still have that; in the event that this decision is affirmed, we'll go back to the district court and go through that.

QUESTION: But the Government has been consistent, anyway.

MR. SNYDER: Yes.

QUESTION: In saying that the gain was actually realized --

MR. SNYDER: Right.

QUESTION: -- in '65 rather than '66.

MR. SNYDER: Right. It is saying that the gain was relized --

QUESTION: As well as the 337 issue.

MR. SNYDER: That is right.

QUESTION: That is, in the year of the fire.

MR. SNYDER: That is in the year of the fire. Now, we have that question as to business interruption insurance.

QUESTION: Well, that is different.

MR. SNYDER: It is a question of the time of the accrual, is it not? And we litigated that question and the Government dropped it. I think in all fairness it dropped it because it didn't want to cloud this rather narrow issue but there has been a tax court case since which has held that business interruption insurance -- the time of the recovery of the insurance is the time it is reported. It doesn't relate back.

QUESTION: Well, are there some cases that indicate in what year --

MR. SNYDER: Yes.

QUESTION: -- a gain such as this should be realized? Let's forget the liquidation.

MR. SNYDER: Well, let's take Lucas versus North Texas Lumber Company. Now, that was an action to purchase timber land.

QUESTION: How about in a fire case? Do you have some cases like that?

MR. SNYDER: In a fire case, a casualty loss.

QUESTION: Casualty loss. When the insurance

proceeds are paid in the following taxable year. Now, in which year --

MR. SNYDER: The nearest thing that I have to it that I can cite to you, or I think the nearest thing, Mr. Justice White, is Helvering versus Hammel, which is cited somewhere, either in the petition for writ of certiorari or our brief --

QUESTION: All right. All right.

MR. SNYDER: -- and that was a foreclosure sale. And they said -- this Court said that the sale was not recordable at the time of the decree of foreclosure, that in the following year the sale actually took place. That was the decision of this Court as to an accrual-basis taxpayer. And I think that situation is --

QUESTION: And you say, I take it, that if there had never been a liquidation here, and the proceeds had been paid exactly as they were paid here, that the company, by good accounting practice and good tax accounting practice would have returned the gain in fiscal '66?

MR. SNYDER: Yes, no question about that in my mind and I think the cases that I have cited -- I can't cite you a prior case or casualty off-hand but I think this line of cases, Lucas versus North Texas Lumber Company, which is also cited somewhere in the briefs, Helvering versus Hammel, they all hold to this effect, that it is at the time that an

obligation arises, even an accrual-basis taxpayer, that the gain is reported, and not at the time of the incident, whether it be a casualty or the exercise of an option or a foreclosure sale when a petition is filed.

QUESTION: How about condemnation?

MR. SNYDER: Well, the condemnation occurs, of course, at the time of the take. There is no question about that. The only difference is, all the cases that the Government cites -- we talked about this yesterday -- are under those statutes which are peculiar and a minority, fewer statutes, I am sure, that say, under particular statutes, that at the time a declaration is filed, the Government has the right to possession and the majority --

QUESTION: And that is the taking under those statutes.

MR. SNYDER: That is the taking, but under a majority of statutes, that doesn't happen until the deposit is put up or till the decree is put up and then the taking occurs and when you compare an involuntary conversion through those cases, you see it is not the casualty itself, it is the creation of the right that the obligation that compares to the taking and this occurred in this case after the adoption of the plan of liquidation.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you,

gentlemen.

The case is submitted.

QUESTION: Is there one case that involved this fire business, the casualty business of the loss in one taxable year and payment the next?

MR. SNYDER: I am sure there is, but I can't cite to you by name and report number the case. We did -- this was involved in the district court and we prevailed there and it was not taken to the court of appeals by the Government, I think, in all fairness, for the reason that I just said to you. I don't think they wanted to cloud up this issue.

QUESTION: But, certainly, I take it, as of here and now, you and the Government are at loggersheads on that issue. They would say --

MR. SNYDER: Yes. As a matter of fact, when the decision was handed down in the court of appeals in this case and before we could file our petition, the Government filed a motion in the district court to consider this very question so I say that if we lose here, we are going back to the district court to argue that question. I have no --

QUESTION: What question? Whether --

MR. SNYDER: The question of whether --

QUESTION: -- whether the corporation must pay for '65 or '66?

MR. SNYDER: Yes, in which year and I don't have any doubts as to how it is going to come out. I think we are going to prevail, but nevertheless, they haven't given up on this question.

QUESTION: Well, it is rather relevant to this case, isn't it? To the treatment --

MR. SNYDER: Well, it is relevant --

QUESTION: You don't think it is in an important point or not with respect to the --

MR. SNYDER: The time of the accrual? Yes, I think it is, but I think that the two concur in this case. I think that the involuntary conversion by casualty concurs with the accrual of the right to receive insurance proceeds. So it is important to that extent, yes.

QUESTION: Well, did the judgment of the district court that was handed down purport to finally adjudicate all of the tax liability involved in your refund claim?

MR. SNYDER: Well, I think that the court thought it had but there is -- if I say, again, a repeat -- if we lose here, then we do have the question.

The Government has not abandoned that point and, of course, holding that these proceeds were entitled to demand recognition, the court, the district court was not presented then with the question of when are these proceeds reported? So it is -- as I say, it hinges upon the decision

of this Court as to whether that is litigated.

Thank you.

CHIEF JUSTICE BURGER: Thank you, Mr. Snyder.

Thank you, Mr. Smith.

The case is submitted.

[Whereupon, at 10:55 o'clock a.m., the case was submitted.]