MORNING SESSION 10:08 a.m.

MR. CHIEF JUSTICE BURGER: We'll resume the arguments in Ivan Allen Company against the United States.

Mr. Crampton, you have 18 minutes remaining.

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

I'd like to point out in continuing our argument that if the resources of this corporation had been entirely reflected in plant and equipment, then there would obviously be no liability here for the unreasonable accumulation and I think counsel for the Taxpayer has agreed in his oral argument that the money that they invested in the Xerox stock is, in fact, extra money that the corporation really didn't need, other than, perhaps, the $100,000 in costs.

QUESTION: I suppose included in the first part of your statement would be the land, for example, that was purchased for possible plant expansion, if they could demonstrate the valid basis.

MR. CRAMPTON: That is right. Yes. I think anything, if they can really firm it down, that they planned to move the plant or expand it or do something like that, if they have a solid, reasonably-anticipated need, that would qualify under the exemption.

QUESTION: If it was land they bought for speculation, for a rise in the market, then would it fall in the same category, in your view, as the Xerox stock?

MR. CRAMPTON: No, because it would not be a net liquid asset. It wouldn't be readily realizable. I think they do make a distinction -- you have to look at what your current situation is and if you had it tied up in long-term investments like that, I don't believe any of the cases say that you would consider that.

Now, perhaps --

QUESTION: It turns on liquidity, then.

MR. CRAMPTON: Yes. I assume if they kept investing, say, hundreds of thousands of dollars in land just to, perhaps with the thought of avoiding this, why, maybe the Commissioner might step in but basically they have been looking at liquid assets.

QUESTION: Although neither the statute nor the regulations say anything about liquid assets.

MR. CRAMPTON: No but I think the case law has pretty well developed that and that is the -- the theory, I think, back of it is that if you have the money invested in such a way that you really can't get your hands on it, then nobody could criticize you for not paying the dividends that otherwise would be due.

QUESTION: Well, and yet the whole -- if the whole fulcrum of decision were whether or not the assets were liquid, it seems to me that that would perhaps provide a good many opportunities to violate the -- both the letter and the spirit of section 532, if corporations could go off and buy Rembrandt protraits and things like that, that would be, certainly, an incorporated pocketbook, wouldn't it?

MR. CRAMPTON: I think so and that was why I qualified my answer to the Chief Justice that I thought if this became obvious, the Commissioner might very well move in. You shouldn't just let them, as you say, buy portraits or buy land that they don't anticipate ever using at all but I think, as a --

QUESTION: Maybe -- is there any decision of this Court that says that the test is whether the assets are liquid? Or easily convertible into cash?

MR. CRAMPTON: The <u>National Grocery</u> --

QUESTION: There is nothing in either the statute or the regulations that says a word about that.

MR. CRAMPTON: You are right. But the <u>National Grocery Company</u> case that we mentioned earlier focussed on the liquidity of the assets, pointing out that the securities that were really liquid had dropped in value --

QUESTION: Had depreciated --

MR. CRAMPTON: -- $2 million.

QUESTION: -- unrealized depreciation --

MR. CRAMPTON: Yes.

QUESTION: -- and the Court in that case said that was a factor to be taken into consideration.

MR. CRAMPTON: Yes.

QUESTION: And that is about all it said, isn't it?

MR. CRAMPTON: That is right, yes.

QUESTION: But in any event, in this case, the assets are liquid.

MR. CRAMPTON: That has been stipulated and they are, everybody knows Xerox stock is liquid and that is the principal asset that they had here.

QUESTION: Well, how about the old French saying that everything has its price? You know, you can take something that doesn't have -- isn't traded on a market and yet, presumably, if you wanted to sell it, you can sell it and if somebody wants to buy it, they can buy it.

It is just a question of getting together on the price.

MR. CRAMPTON: I think that is true, but I think part of the answer to this problem of putting your securities or your assets in long-term investments are that probably the board of directors, as a practical matter, would not want to do that because most corporations closely-held, they probably want to have their assets where they can reach them or readily convert them if they need to.

QUESTION: Unless it is an incorporated pocketbook.

MR. CRAMPTON: That is right. But even, I think a lot of people with incorporated pocketbooks may not want to put their money into land that they feel they couldn't get it out for 15 or 20 years at anywhere they had put it in but I do -- coming back to this case, I think we have stipulated that question out of the case and stipulated that we do have liquid assets here and as I say, we can, this corporation could realize, could convert this if it needed to or borrow against it or utilize the assets to pay the dividends.

QUESTION: That is fine if liquidity is an important aspect of the test.

MR. CRAMPTON: Well, I think it is.

QUESTION: So, I gather --

MR. CRAMPTON: I mean, that is what the cases -- the lower courts that have considered this have upheld that, time and time again.

QUESTION: It is a rather limiting test, isn't it, when you consider that in certain periods, land, investment in land could be a shelter that could be quite as liquid as Xerox stock with a very high return in certain areas of the country, capital gains.

MR. CRAMPTON: Well, that is true but I don't think that your land -- your problems with land usually -- I would say, as a practical matter are much more complicated than they are with the securities on the New York Stock exchange.

So often, even though you think you have got a great bargain in land, you may have title problems or questions of state regulations, zoning and things like that which complicate your life if you are putting your assets into land but you certainly do not have those with listed securities.

Now, coming back to that National Grocery --

QUESTION: In other words -- pardon me, if I interrupt you again, are you really saying that the liquidity test is something like making a comparison of whether the asset is in about the same shape as it would be if it were sitting in the bank?

MR. CRAMPTON: Yes.

QUESTION: In the bank it would clearly be --

MR. CRAMPTON: Readily available.

QUESTION: -- subject to this penalty.

MR. CRAMPTON: If it is --

QUESTION: And you are saying that any asset which has essentially the same kind of liquidity as money in the bank is then subject to penalty provisions.

MR. CRAMPTON: It is subject to being considered in determining whether or not the reasonable needs of the business can be met from the available resources.

QUESTION: Mr. Crampton, alluding to our discussion yesterday and having in mind the question by the Chief Justice as to stock being equivalent in terms of liquidity with cash, what would you advise a corporation? What would you have advised this corporation, bearing in mind, as I noted yesterday, that Xerox stock varied, according to one of the manuals, from 35 to 134 last year, what would you have advised this company, at the beginning of the year on your theory of the law as to when to sell the stock or whether to sell it and would you have advised the client that Xerox stock, at 134, was the equivalent of cash when it dropped to 35 before the year was over?

MR. CRAMPTON: No, I would -- to answer your question, I think I would have suggested that the corporation look at that movement of the Xerox stock during the year and if they had bought it -- I forget what the price was per share but in your example, supposing they had bought it at 5 and it never got below 35 and they had this type of earnings and they had this volume of shares so that they had a -- if you used the value of 35, they were maybe two or three times above their earnings -- I would certainly suggest that either they declare their earnings as a dividend or do so realizing that they would risk a tax under the penalty provision here of accumulated earnings tax.

QUESTION: You would do that at the first of the year?

MR. CRAMPTON: No, I think you would look at that at the end of the year. You would see where the movement has been during the year and I think that your bottom would be, the lowest thing would be the factor that you would really consider if you wanted to be safe.

QUESTION: So on the last day of your fiscal year, you would take a look at the market value of the stock. I think you said yesterday that you thought you could average it or take the low figure. What would you do with your real estate that we talked about yesterday? Would you get appraisals of it --

MR. CRAMPTON: No.

QUESTION: -- at various times during the year?

MR. CRAMPTON: No, because I don't think the cases say you take into consideration real estate, unless, in the example you gave me, you could establish that it was readily marketable.

But here again, I think you look at what the assets are that are available for -- to pay the dividends. Can you pay the dividends without disrupting the normal life of this corporation in a serious way and if you have liquid assets, the question is, why shouldn't the dividends be paid?

I would like to, if I might, just mention briefly the one statement from that National Grocery case that I think does state the position of this Court on the question.

It said, "Depreciation in any of the assets is evidence to be considered in determining the issue of fact, whether the accumulation of profits was in excess of the reasonable needs of the business."

And as near as I know, that quoted statement has never been questioned or repudiated and if you do look at the depreciation in the assets, then it seems to us that if the economic test applies when the assets are going down, that you are certainly justified in looking at it when they go up.

The stipulation we have mentioned shows that this Xerox stock had a cost of $102,000 for the fiscal year '66 and it had a fair market value, as the parties stipulated, of almost $2 million and a half so that that is 20 or 25 times the original cost.

The margin here is such that this corporation could certainly have paid a dividend of $344,000 that year without any substantial loss of economic muscle as we view the situation.

I was asked yesterday --

QUESTION: It would have had -- in order to do that, it would have had either to sell part of the stock or borrow against it, wouldn't it?

MR. CRAMPTON: It might have, yes.

QUESTION: If we are talking about liquidity.

MR. CRAMPTON: That is right.

QUESTION: If we are talking about cash dividends.

MR. CRAMPTON: Well --

QUESTION: They could use it to pay out dividends in kind, too, could they not?

MR. CRAMPTON: Yes, they could, but to pay out -- if they paid out the Xerox stock, it would have come out at their cost and the taxpayers would have picked it up at market value and I think that that would have been a -- they wouldn't do that as a practical matter, I don't think.

QUESTION: Although they did do it in a previous year.

MR. CRAMPTON: Yes, as to a few shares, 870, I think.

I was asked yesterday about the considerations for accounting -- pardon me.

QUESTION: Well, why would that be disadvantageous to do? If the corporation paid it out in kind and under their regulations it is at cost, it at least would not have been a realizable or taxable gain. They would just have paid it out at cost and then the shareholders would have received it at fair market value with fair market value as the shareholders' basis in the event of subsequent sale. Why would that have been disadvantageous economically?

MR. CRAMPTON: Well, I believe the corporations would have had to pay a tax on receipt of dividends at fair market value when they received the shares.

QUESTION: The --?

MR. CRAMPTON: The shareholders, pardon me. Yes.

QUESTION: At fair --

MR. CRAMPTON: At fair market value.

QUESTION: As ordinary income.

MR. CRAMPTON: Yes.

QUESTION: But that would be true of cash, too.

MR. CRAMPTON: That is right. But if they distributed the stock they would be picking up -- they'd get $100,000 credit and pick up $2.5 million of ordinary income, whereas I don't think that if the stockholders [that] are using this corporation are concerned about it, they would not probably want to pick up that kind of income in any one year.

QUESTION: But if they paid out a million dollars in Xerox stock to the stockholders as dividends, to the stockholders of their own company, they would save a fairly substantial amount in commissions, would they not?

In broker's fees.

MR. CRAMPTON: I think on a block that big, the commission would be maybe one or two percent. We have stipulated here, I think, a 6 percent commission rate, but that was being liberal.

QUESTION: That is unrealistically high, I think.

MR. CRAMPTON: Yes, we thought so. I mean, I think so, on a block of that size.

If I could touch just briefly on this question of the Securities Exchange Commission situation, it seems to us that any financial statement that might be submitted to the Securities and Exchange Commission or for accounting purposes are usually designed to reflect a financial condition for a fixed period.

They do not usually look at the external sources for supplemental information such as valuations and the question here is whether the corporation is in a position to distribute these current earnings as dividends.

If the corporation contends that it has business needs, then, as we have mentioned, we look at the available resources and this requires a measuring of assets during the period.

Their actual costs some years earlier is really, we think -- we believe -- irrelevant to this economic examination of the period in time and I think the correctness of this position is demonstrated by the fact that you use value if it is less than cost in determining total resources, as this Court has done in the <u>National Grocery</u>

case.

If the cost were, in fact, the test, you might find a situation where the Taxpayer had assets on his books considerably higher than their existing value at the time and they really didn't have them.

In summary, it seems to us that the statute requires the consideration of economic needs of the business.

If the corporation has net liquid assets substantially in excess of economic needs, it should distribute its earnings or pay the tax.

It certainly should not be permitted to avoid the tax by simply investing funds in readily marketable securities.

We believe that the decision of the Fifth Circuit was correct and should be affirmed.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Crampton.

Mr. McAlpin, you have three minutes left. Do you have anything further?

MR. MC ALPIN: No, sir.

MR. CHIEF JUSTICE BURGER: Do you submit?

MR. MC ALPIN: Yes, sir.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

[Whereupon, at 10:25 o'clock a.m., the case was submitted.]