In the

Supreme Court of the United States

NATIONAL MUFFLER DEALERS ASSOCIATION, INC.,

PETITIONER,

v.

UNITED STATES OF AMERICA

No. 77-1172

Washington, D. C.
November 27, 1978

Pages 1 thru 48

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Washington, D. C.
Monday, November 27, 1978

The above-entitled matter came on for argument at 1:0; o'clock, p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM BRENNAN, 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
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

MYRON P. GORDON, ESQ., Hoffberg, Gordon, Rabin & Engler, 32 East 57th Street, New York, New York 10022, on behalf of the Petitioner

STUART A. SMITH, ESQ., Assistant to the Solicitor General, Office of the Solicitor General, Department of Justice, Washington, D. C., on behalf of the United States of America

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments first this afternoon in National Muffler Dealers against the United States.

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

ORAL ARGUMENT OF MYRON P. GORDON, ESQ.,

ON BEHALF OF THE PETITIONER

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

The question for decision here is whether or not an association of franchisees of a specific franchisor loses the exemption under Section 501(c)(6) of the Internal Revenue Code as a business league, even though it might and does otherwise qualify solely by reason of the fact that it does consist of all franchisees of a particular franchisor--in this case, Midas Muffler franchisees.

I should like to begin the argument by describing very briefly this association, Petitioner in this case, and I think it is best described in the words of Chief Judge Kaufman of the Second Circuit who pointed out that it was organized at a time when an internal struggle was taking place within the parent company. The franchisor and many of Midas's franchisees were concerned that they might suffer from the pending corporate shake-up.

As a consequence of this, they formed the association

to secure themselves against the whims of a new Midas management.

Judge Kaufman goes on to say, in a later portion of his opinion: "In its endeavors, the Association sought generally to redress the inequality of bargaining power existing between ---

MR. CHIEF JUSTICE BURGER: It seems, Mr. Gordon, that that would be a little bit like a union being organized when a non-union plant changes hands, with a new owner.

MR. GORDON: Exactly similar to that, and we make the argument in our papers that there is great similarity between a union and in this case, while not a union, nevertheless a group of businessmen, if you will, getting together to bargain collectively with their franchisor; and that there are many similarities between the union analogy and the franchisee association analogy.

In any event, Judge Kaufman goes on to say that the Association "has been a formidable force at the negotiating table," which follows through exactly to the analogy between a union and an employer.

So that the genesis of this trade association or business league was protective and defensive; it's not a profit-making organization--it was never intended to be that; and, again, merely formed to redress an inequality of bargaining power between an individual franchisee and a monolithic,

strong financially franchisor.

QUESTION: Mr. Gordon, I suppose it's irrelevant, but do we have very much money involved here taxwise at all?

MR. GORDON: Well, there could be--there is some money involved here, and there could be significant amounts of money involved, only because it is very frequently the case that a franchisee organization builds up a reserve to have as kind of a war chest, if you will, and during those times that it builds up the reserve when its income exceeds the amount of its outgo for any particular period of time--for one year, two years, or three years, or any time--and it shows an excess of income over expenditures, there is that much involved. We are dealing here with several years; it may involve a substantial sum of money. I have not figured it.

QUESTION: I suppose I should ask government counsel that question really, because they have other cases presumably. It didn't seem to me as though it would make a great deal of difference.

QUESTION: You are not one of those non-profit organizations with a million-dollar war chest.

MR. GORDON: Well, we don't have a million-dollar war chest in this case, and ---

QUESTION: But you could get one.

MR. GORDON: We could--but, on the other hand, I would say, your honor, that if any association, any business

league or trade association, ever built up an unnecessary accumulation of surplus. The Internal Revenue Service has plenty of tools ---

QUESTION: Well, wouldn't they first have to drop the word "non-profit"?

MR. GORDON: That's correct. And "non-profit" means essentially ---

QUESTION: Non-profit.

MR. GORDON: --- and it's defined in the statute, that no part of the income goes to any individual association member, so the amount of money I don't think is an issue here.

QUESTION: Your client gets what, dues and contributions from its members?

MR. GORDON: This Association is solely financed by dues from its members, that's correct. And those dues may be raised from time to time, may be lowered, as the case may be, in order to deal with specific situations.

QUESTION: Would it make any difference to your case if they had a million dollars or two million, instead of whatever it is that they have?

MR. GORDON: It might, it might then be said ---

QUESTION: In this case in its present posture?

MR. GORDON: No, not to this case.

QUESTION: That would be some future case.

MR. GORDON: That's correct. In some future case, if

it is determined that there was an unreasonable accumulation, that perhaps it had lost its so-called non-profit status because of the way it operated, as I say, I am sure the Internal Revenue Service has adequate means with which to check on that and change the ruling or look at it.

QUESTION: Well, non-profit--you have to file returns.

MR. GORDON: I beg your pardon.

QUESTION: Don't non-profit organizations have to file returns?

MR. GORDON: Yes, they do.

QUESTION: So it would be easy to check on it.

MR. GORDON: That's right; they file annual returns and are subject to audit by the Internal Revenue Service the same as any other organization, and if it is found, as indicated, that they are no longer non-profit, there are adequate means at the Internal Revenue Service to correct it.

QUESTION: Well, if you win this case, will you have to file any returns?

MR. GORDON: We have been filing returns, your honor.

QUESTION: You are exempt from taxation.

MR. GORDON: We have filed returns as non-exempt from taxation, claiming that there is ---

QUESTION: No, as exempt from taxation, don't you?

MR. GORDON: No, we are filing, claiming that--since we have been denied the exemption, we have been filing regular returns under protest, and we have filed for refunds in each case--and that's how we get here, because ---

QUESTION: But if you win this case, if you win this case ---

MR. GORDON: Yes, sir.

QUESTION: --- will you continue to file returns?

MR. GORDON: Certainly. We are required to under the statute. We file special forms of returns--I don't know the form number--as a non-profit organization.

QUESTION: I see. Now, more than that, as an organization that comes under this particular statute.

MR. GORDON: That's correct.

QUESTION: Not just as any non-profit organization.

MR. GORDON: No, no, no--as one under 501(c)(6), we would be required to file annual income tax returns.

QUESTION: Well, there's no general statutory exemption for non-profit corporations, is there?

MR. GORDON: No, sir, there is not.

QUESTION: And (6) is one of about what--sixteen or seventeen different sub-categories of groups that are exempt?

MR. GORDON: That is correct. And this category--if I may go to the statute now--the business league: the statute, which was passed in 1913 (and I should say in passing

that it was long before franchising was known to the economy of the United States), granted an exemption from income tax to business leagues, chambers of commerce, and boards of trade. And there were two amendments subsequently: in 1928 real estate boards were added to the list of exemptions; and in 1966 football leagues were added to the list of exemptions. And no place in the statute is there any further definition of "business league." The only thing that we do have is a statement that it is not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

And that is the entire statute.

QUESTION: What would you think about a baseball league under that statute?

MR. GORDON: I don't know why football leagues, I confess, have been preferred over baseball leagues--I do not know; I have no knowledge of that.

In any event, the only reason now that we have been denied the exemption is the claim that a business league must be similar to a chamber of commerce or a board of trade. We contend that that position is not warranted by either the legislative history, judicial history, or in fact by the way the Internal Revenue Service has itself treated business leagues and other trade associations.

Actually, in the regulation, which has been in effect

for many, many years--the first sentence, with some modifications, has been in effect for many, many years--it says: "A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit."

We submit that that sentence properly states the intent of Congress and does define what a business league is.

Now, peculiarly enough, in 1929 there was something added to the regulation--and in 1929, for the first time, we find the second and third sentences indicating that the business league is supposed to be an organization of the same general class as a chamber of commerce or board of trade, and thus its activities "should be directed to the improvement of business conditions of one or more lines of business..."

However, before 1929 that was not the rule. And we have handed up to your honors something that I apologize for having found late, but nevertheless of great importance, I think--and that is that before the 1929 amendment, there was a specific sentence, the second sentence of the regulation: "Its work"--meaning the business league's work--"need not be similar to that of a chamber of commerce or board of trade."

Now, what happened between 1913 and 1929 to justify that complete 180-degree turnabout in the Internal Revenue Service's position, I don't know.

QUESTION: When was this regulation that you handed up adopted, do you know?

MR. GORDON: It was adopted under the 1926 statute; to the best of my knowledge it was a continuation of what had gone before.

QUESTION: The statute or the regulation?

MR. GORDON: Well, the regulation, sir--every time--what they did was, when they revised the Internal Revenue Code during various periods of time, they re-adopted the statute, and the regulation was changed each time.

QUESTION: What I am trying to get at is the contemporaneousness of the regulation. To me it would make more of an impression if the regulation had been adopted simultaneously with the statute than if it were changed, say, forty years later, if you suggest that it was.

MR. GORDON: No, I suggest that I know it was in effect since 1926, and it may have been in effect--perhaps Mr. Smith knows more about that than I do at the moment--to the best of my knowledge that was the rule all the way back to the adoption of the statute.

QUESTION: That certainly would be easy to track down.

MR. GORDON: Yes, it will.

QUESTION: The regulations are still extant.

MR. GORDON: And if I may submit the other

regulations at the conclusion of the argument, I would be grateful for the opportunity to do so, so that your honors have the full picture.

As I say, I must apologize--I didn't realize until the last minute that there had been that change, and that's why I only handed up what I found at the very last minute, on Wednesday.

But we look and see what was the reason for the change, and the only reason that we have been able to determine--the only reason for the change in 1929--was the statement which appears in the government's brief, that it came about as a result of a case of the Board of Tax Appeals in 1928. And there is no other legislative history that we can find on that. And the fact is, if that were the case, there is nothing in that case which in any way justifies the change and this 180-degree turn in the regulation.

Before I get to that, however, I would like to point out that the statute I don't think needs the application of Latin maxims, such as noscitur a sociis, as has been used several times in the past, in order to determine what a business league means. In other words, if the statute had said that there shall be an exemption for a chamber of commerce or a board of trade or other business league, then it might very well be said that the Congress had in mind that "other business league" might have the same general characteristics

as a chamber of commerce or a board of trade. But we don't find that; we find these in the disjunctive--business league separately, chamber of commerce separately, and board of trade separately.

So that there is nothing that I can see in the statute itself which warrants any construction that says that the business league must be similar and have similar characteristics to a chamber of commerce or board of trade, and, as I pointed out before, in fact the Internal Revenue Service took the opposite position up until 1929.

QUESTION: Well, certainly there are distinctions between a professional football league and a chamber of commerce.

MR. GORDON: There certainly are, sir; there certainly are. I have tried to determine the reason for the inclusion of football leagues in the 1966 amendment, and I have been told on the one hand it's a Congressional aberration, which may very well be, and on the other hand that nobody really knows the reason, that they were always exempt, that they were just put in to make sure that the exemption was granted to them. But the fact of the matter is, as your honor has pointed out, that if we are going into these characteristics, and have the same general characteristics--and even if we assume that a real estate board, which was added in 1928, has the same general characteristics, then your honor is quite

right. I see no justification for categorizing a football league and putting it in the same category as a chamber of commerce or a board of trade.

And it strikes us that this evidences an intention of Congress not to make them similar--and never was intended to be similar.

QUESTION: Has anyone shed any light on why basketball leagues and baseball leagues are not in the Act, except perhaps they didn't have a lobby?

MR. GORDON: No--it may very well do that. I have also been told that football leagues were always considered exempt, but there was some question because football leagues were operating pension plans, and they put that phrase in, which may or may not operate a pension plan, as a way to make sure that they got their exemption.

But I merely point out that the football league, whether or not it operates a pension plan, as has been pointed out, is hardly in the same category as a chamber of commerce or a board of trade.

QUESTION: It was also concluded years ago that football teams weren't worth anything.

MR. GORDON: That may be, sir.

QUESTION: That's not true today.

MR. GORDON: Yes, it may be. But we look and see if there is any legislative history which will shed any light,

and the government says the only legislative history it has found is some representations to Congress back when the exemption was originally adopted by the United States Chamber of Commerce, glorifying the effect of non-profit associations of businessmen.

I would think that that is hardly a substitute for some language by any of the legislators or some language in any committee report which indicated that that was the intent of Congress.

And I think it is reaching pretty far to take self-serving declarations of the United States Chamber of Commerce and say that that constitutes a matter of precedent for determining that that was the intent of Congress, the Congressional intent may be determined by people who plead before Congress for a specific exemption.

Now, there is no question about the fact that if we are correct, and that the business league is properly defined in the first sentence of the regulation, that the appellant in this case meets every phase of that intent. It fits the first sentence of the regulation.

It strikes us, therefore, that the language of the statute, the regulation as it existed prior to 1929, the first sentence of the regulation, the lack of any other judicial precedent except, of course, the decision of the Seventh Circuit which was contrary to that of the Second Circuit--and

that's why we are here, I guess--that by definition Petitioner is entitled to the exemption, as a matter, again, of simple statutory construction.

QUESTION: So you would take the same position that the regulation had always been like it is now?

MR. GORDON: I could, I could take that position.

QUESTION: Or you would, I take it.

MR. GORDON: I would because I think that that regulation was intended to do something less than is now claimed for it. I think if the regulation were read carefully, you would find that what it attempts to do is make a distinction between improvement of business conditions--because in that sentence it says "as distinguished from the performance of particular services for individual persons," so that in effect we can see that any group, business league or otherwise, that is formed for the purpose of performing services, particular services for its members, which the members could themselves do, except that possibly, like a cooperative buying organization, they can do it more cheaply--they are not entitled to the exemption, that was not the intent of Congress under these circumstances.

But as distinguished from that, any other group of businessmen that have a common business interest and form together to promote that common business interest are, we submit, entitled to the exemption. And that was definitely

the intent of Congress.

QUESTION: Well, how long has the statute been interpreted and applied as the government is seeking to interpret and apply it?

MR. GORDON: Only since 1929, your honors.

QUESTION: Only since 1929.

MR. GORDON: But the first sixteen years, which I think might be a lot closer to the original ---

QUESTION: Let's assume from the very outset that it had interpreted and applied the law this way, and the Revenue Code had gone through all the changes that it has gone through since then, and the statute was never amended.

MR. GORDON: I would say that under those circumstances we would have a different case, but this is not the same case here. In the first place, ---

QUESTION: Well, maybe if the Commissioner could have applied it from the outset the way he now wants to apply it--it's just that in 1929 he changed his mind. We have had a good many cases where government officials have changed their mind, and both interpretations have been in the statute.

MR. GORDON: Well, it would strike me that if in fact the Commissioner did change his mind, there should have been a logical reason for the change of mind, and there should have been something in either the judicial precedents or in a review of the Congressional intent which would indicate that

that is what should have been done.

QUESTION: But if he has power to issue regulations, he has power to issue regulations, and his regulation reflects one view of the statute, doesn't it?

MR. GORDON: But on the other hand--yes, it's true, it reflects his view of the statute, but unless that view is reasonable, I submit that it is not entitled to the force of law, even though it may have been encrusted on the books of the Internal Revenue Service for almost fifty years--if in fact it is not reasonable.

And to answer your honor's question still further, the fact is that during these years since 1929, there was no direct case similar to this until we come to the Pepsi-Cola case in the Seventh Circuit--and in that case, as your honor knows, they held that an association of franchisees was a business league entitled to the exemption. And that was the only Appellate case directly on point until the National Muffler case in the Second Circuit.

QUESTION: But the Commissioner obviously never acquiesced in that ruling.

MR. GORDON: He did not acquiesce in it, that's correct.

QUESTION: And so in every other circuit he was still applying the law the way he read it.

MR. GORDON: It may very well be that he was applying

the law that way, but, as I say, I do not know of any specific cases--you see, we tend to confuse, in the history of these cases, in the long history of these cases, statements of so-called general principle which are really not applicable, because in the Second Circuit case, which originally determined this case, which originally used that term noscitur a sociis, and which quoted from the regulation--the fact is, it was not an issue. There there was a group of people, a group of businessmen, who got together to do something for themselves that they could have done for themselves. And that case could have very well been decided on the simple ground that they were clearly not exempt, and there was no necessity to go into all of these questions.

I think that I would like to conclude my argument, if your honors please, by pointing out that there is no logical basis for the distinction made in this case.

We have pointed out before that franchisees of a single franchisor have a common business interest, as defined in the regulation--protection against a powerful franchisor. We have pointed out that that common business interest is more compelling than may obtain for other groups of businessmen. We have pointed out in our petition for the writ in this case the burgeoning position of franchising in this country, in the millions and millions and millions of dollars that are being spent by the public with franchise organizations, and

the necessity, if you will, for franchisees to band together to do the very thing the petitioner in this case did.

We have pointed out that there was one case only recently, in one of the district courts, in which a judge pointed to the great need for a--one of the traditional control mechanisms of a franchisor has been to keep its franchisees disorganized. Franchisees by necessity must have access to the franchise group in order to act together, to deal with common problems, whether those problems be the oppressiveness of the franchisor or some less momentous concern.

QUESTION: Wasn't that involved in the Dairy Queen case in the Second Circuit? I don't mean your quote there. Wasn't that point in there?

MR. GORDON: I don't think so, sir. At least, I have not come across it in that context.

So we ask, finally, I think, by what logic can it be argued that a group of businessmen who join together to bargain with a union are exempt--and they are; there is no question about it, not only, as has been pointed out, are the union workers getting together to bargain with their employer exempt, but groups of businessmen may get together to bargain with a union of their employees--and they are exempt--by what logic can a distinction be made between that group and a group who join together to bargain with their franchisor?

We see no way that these can possibly be distinguished

logically. We believe that the Seventh Circuit was right in its holding, and we submit that the case should be reversed here.

MR. CHIEF JUSTICE BURGER: Well, Mr. Smith?

ORAL ARGUMENT OF STUART A. SMITH, ESQ.,

ON BEHALF OF THE UNITED STATE OF AMERICA

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

Although the Petitioner denies it, we see the import of his argument as a challenge to the validity of a Treasury regulation that has been outstanding for almost fifty years. The regulation in question is set forth at page 37 of the appendix to our brief.

QUESTION: Mr. Smith, you will comment on the form of the regulation prior to 1929?

MR. SMITH: Yes, I shall. The regulation says: "A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit."

The Petitioner would stop here.

The regulation, however, goes on to say: "It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of

business as distinguished from the performance of particular services for individual persons."

Now, the Court has said on many ---

QUESTION: You are not going to answer Mr. Justice Blackmun's question right now then?

MR. SMITH: I will be happy to do that.

QUESTION: Well, I want to ask you a question, but if you are going to answer his, I was not going to ask you mine. If you are not going to answer his now, I will ask you mine.

MR. SMITH: I will answer his and then I will turn to you.

The regulation that my brother has cited and distributed to the Court was issued under the Revenue Act of 1918 and stood outstanding until the Revenue Act--through the Revenue Act of 1926. In 1928 Congress added the phrase "real estate boards," and the Board of Tax Appeals in the interim--well, two things happened. The Bureau of Internal Revenue issued a legal opinion, which we set forth at page 20 of our brief (L. O. 1121), which discussed the general construction of the statute and it held there that a stock exchange was not a tax-exempt business league. Three years later, as we point out, the Board of Tax Appeals ruled that a corporation organized by associations of insurance companies to provide printing services to their member companies was not an exempt business

league. And, in so holding, the Board said that a business league to be entitled to the exemption should be engaged in and limited to activities similar to those of the ordinary chamber of commerce or board of trade.

As a result of that decision, as we say in the brief, the Commissioner revised the regulation to its present form in order to incorporate what we see as the correct construction of the statute. And that has been the outstanding construction of the statute for almost fifty years. And that is that the statute talks about business leagues, chambers of commerce, real estate boards, and boards of trade, and that those ---

QUESTION: What about professional football leagues?

MR. SMITH: Professional football leagues came in in '66.

QUESTION: Why?

MR. SMITH: I can address that separately.

QUESTION: Before you do, Mr. Smith, certainly your footnote 4 is a blind footnote with respect to the pre-1928 regulations.

MR. SMITH: Well, but we have another footnote--9.

QUESTION: You merely recite the earlier regulations are, and just giving their title. But without pointing out the seemingly opposing analysis in those prior regulations.

MR. SMITH: Well, the old regulations, Mr. Justice Blackmun--the history of the regulations--are discussed in

detail in the Produce Exchange Dealers case, which is the old Second Circuit case of Judge Swan which the Court of Appeals relied on in this case.

QUESTION: Are they discussed in detail in your brief? I think not.

MR. SMITH: Not in the same detail, no. But I think the point simply is that the Commissioner in 1929 construed this--changed his mind, as Mr. Justice White put it, and that is that the intent of Congress, as we set forth in our brief, is that this statute came in in 1913 at the behest of the United States Chamber of Commerce, emphasizing the quasi-public civic nature of these broad-based organizations, organizations that are supposed to benefit a broad spectrum of the business community. And in 1929 the Commissioner recognized that that was the intent of the statute. In fact, it is really demonstrated inferentially from the way Congress added real estate boards to the statute in 1928. The real estate board people came in and said, you know, we are just like chambers of commerce.

QUESTION: There is nothing particularly wrong with this. The Commissioner frequently has done this. And I would have hoped that your brief would point out the decision in, well, collateral cases anyway, that led to the change, as you do, to a degree, on pages 20 and 21.

MR. SMITH: Yes, we do--and if we haven't done so in

detail, I regret it.

QUESTION: I certainly was hung with your footnote 4, which counsel has brought to your embarrassing attention, I would say.

QUESTION: Mr. Smith, if Congress takes the position that chambers of commerce are exempt because they are so great for the country, well, why wouldn't General Motors be exempt when it was said that what was good for General Motors was good for the country?

MR. SMITH: Because, Mr. Justice Marshall, it's engaged in a business, as the regulation says, a regular business, "of a kind ordinarily carried on for profit." It's not simply great for the country.

QUESTION: And your next answer will be why football.

MR. SMITH: Well, I think Mr. Gordon touched on it in part. My understanding of the tax treatment of sports leagues is that sports leagues generally, if they are broad-based enough to cover, you know, a wide spectrum of major sports activity, have been given an exemption under this statute.

QUESTION: In addition to football leagues?

MR. SMITH: Yes. What happened was ---

QUESTION: Name some.

MR. SMITH: You know, the American League, I would think--I am talking about, you know, baseball leagues and

things like that.

QUESTION: They have been given ---

QUESTION: If they are not, they would have a Constitutional case under the Fifth Amendment, the equal protection component of the Fifth Amendment.

MR. SMITH: I suppose so.

QUESTION: Not after Radovich ---

MR. SMITH: The shape of a ball.

QUESTION: Oh, now you are telling us that even though baseball leagues are not ---

MR. SMITH: No, baseball leagues have enjoyed the exemption.

QUESTION: I know, that's ---

MR. SMITH: Now, what happened ---

QUESTION: Just a minute, Mr. Smith, will you?

MR. SMITH: Yes, I'm sorry.

QUESTION: Nevertheless they added football leagues specially? Why?

MR. SMITH: They added football leagues specially, it is my understanding, because the National Football League operates a pension plan, or the Football League, and there was some concern expressed as to whether the pension plan constituted an inurement to the benefit of the members, and it might be disqualified under that basis. As a result, in 1966, Congress added the phrase "or professional football leagues,

whether or not administering a pension fund for football players," in order to clarify ---

QUESTION: Don't baseball leagues operate pension funds for baseball players?

MR. SMITH: I am not aware that baseball leagues do. My understanding is that pension plans and baseball leagues may be administered by the individual teams. I am not aware of who administers the pension ---

QUESTION: Under this regulation it would make no difference whether they did or did not have a pension plan, would it?

MR. SMITH: Well, a pension plan--it might be considered to be an inurement for the--no, that's not so.

QUESTION: Well, it's certainly a broad disclaimer, whether or not they operate a pension plan.

MR. SMITH: Well, that's right. My understanding is that that was the reason for the insertion of the provision for football leagues.

But putting all that aside, I don't think that this ---

QUESTION: Well, do football leagues operate for the beneficent purposes you described, that are performed by chambers of commerce and boards of trade?

MR. SMITH: Well, they do in the sense that I think is germane in this case; they do in the sense that they don't

exclude a large spectrum of the relevant business community the way that Petitioner does here; in other words, the National Football League sort of includes, you know, a whole gamut of teams; it doesn't include everybody who plays football, but it includes the major football activity.

Here ---

QUESTION: It doesn't include the American Football League.

MR. SMITH: No, but that was a separate league, as I understand.

QUESTION: Well, if it's so easy, why don't we have a baseball team?

MR. SMITH: This Court?

QUESTION: No, the District of Columbia. If it's so easy.

MR. SMITH: Oh, I am not saying that it is very simple, and I would like to turn actually to this case and ---

QUESTION: It's close to a monopoly, isn't it?

MR. SMITH: Well, you know ---

QUESTION: Or is it worse than a monopoly? Even a monopoly, we could get a team, I imagine--if we paid enough.

MR. SMITH: I suppose that's so, but I think the point of all this is, is that if Congress wants to legislate specifically with respect to professional football leagues, whether or not they administer a pension fund, that really

doesn't help the Petitioner in this case, because I think that this case turns on the validity of the provision in the regulation that the activities of the (c)(6) organizations should be directed to the improvement of business conditions of one or more lines of business, and the Court of Appeals held in this case--and I think quite properly--that this organization was not directed to the improvement of business conditions of one or more lines of business; it was simply directed to the improvement of the conditions of Midas franchisees.

QUESTION: Mr. Smith, if you finish out that third sentence in the regulation after the words "more lines of business," you go on to the language "as distinguished from the performance of particular services for individual persons," which I take it is what is not permitted in the exemption.

What are some examples of the "performance of particular services for individual persons"?

MR. SMITH: Well, Mr. Justice Rehnquist, the cases that we discuss in our brief cite some examples--the produce stock clearing association upon which the Court of Appeals cited the earlier Second Circuit decision (that was an organization of stockyard owners which--stock dealers, you know, which provided for clearing services for its members); the Evanston North Shore Real Estate Association, which was a Court of Claims case, which operated a multiple listing service for its members. There is another old Sixth Circuit case

called Automotive Electric Association, the principal activity of which was to publish a catalogue, advertising the products of its members. These kinds of things are regarded as performance of particular services for individual persons.

QUESTION: And you say that the Muffler Dealers Association falls under the head of "performance of particular services for individual persons."

MR. SMITH: Well, I would have to answer that question in two parts. I think principally its activities are not directed to the improvement of business conditions of one or more lines of business; it flunks that part of the regulation.

QUESTION: Well, is that a two-part test? I would have read that sentence as just meaning these are the kinds of things that fall on one side, and these are the things that fall on the other, not that you have to go through both A and B in order to qualify.

MR. SMITH: One can read the regulation the way you suggest.

QUESTION: It's quite difficult to read it otherwise.

MR. SMITH: Well, but the courts have uniformly read it the other way, as an existence of two different tests; in other words, you have got to be engaged in activities which improve business conditions of one or more lines of business,

and you also can't perform particular services for individual persons.

QUESTION: Well, what reason do those courts give for the inclusion of the words "as distinguished from," if they are correct in their reasoning?

MR. SMITH: Well, I think that what those courts have said is essentially that--well, I think the courts have read that sentence to provide for a positive requirement and also incorporating a negative requirement. Now, I suppose the best way to construe--I mean, the way we construe the regulation is as follows: on the one hand you've got, you must meet the line of business requirement of the regulations--that's what the Court of Appeals held and that is what this taxpayer unquestionably does not meet. And I think that the purpose of the regulation, by setting forth another negative polar example, is to assure that--is to provide a kind of bright-line rule on the theory that most organizations that provide services, particular services for individual persons, would be the kinds of organizations that will not--activities will not be directed across one or more lines of business. And let me ---

QUESTION: Then it's not a two-part test really; it's just illustrative on the one hand, and illustrative on the other.

MR. SMITH: I suppose that's right. Now, in this

particular case, I think, you know, you can really see how the two parts of the sentence of the regulation more or less come together in the--you know, as applied to the facts of this case. Here you have an association of Midas muffler dealers; they exclude everybody else. Midas, by undisputed stipulated fact, constitutes about 21 percent of the market. The whole thrust of this organization's activities is to boost the competitive position of Midas vis-a-vis the rest of the muffler industry.

QUESTION: Couldn't we tell from this record, Mr. Smith, what would happen if one of these dealers decided to leave the Midas franchise and take one of the competing franchises? Could he still remain a member of this organization?

MR. SMITH: On paper, yes, in the sense that--what happened in this particular case was the taxpayers' original by-laws provided that you had to be a Midas franchisee to be a member; they then dropped that more or less as a cosmetic--I think there's no doubt about that--as part of their campaign to get the exemption.

But it is undisputed here that you had to be a Midas member and Midas franchisee to continue to be a member under both the old and the new version of the by-laws. And I think the answer to your question is that they would be dropped as a member. In fact, all the correspondence talks about "Dear Fellow Midas Dealer"--I don't think there is any question that

if you left the Midas family, you would be dropped from membership.

QUESTION: Well, you would drop yourself as a member.

MR. SMITH: Sure.

QUESTION: There would be no possible reason for your belonging to the organization, would there, if it is only to service and to be of help to Midas franchisees?

MR. SMITH: Well, it's possible, I suppose--one could continue to be a member in order to receive the benefit of what the competition is thinking.

QUESTION: If you don't get much mail, maybe. There would be no reason to continue to pay dues.

MR. SMITH: Unless you felt there was some need to get some intelligence from Midas, from the Midas operation.

QUESTION: Mr. Smith, you said the whole purpose of this organization was to improve the competitive position of the members vis-a-vis other muffler dealers. Your opponent argues that the purpose is to bargain more effectively with the franchisor.

Now, they are two different concepts.

MR. SMITH: Yes.

QUESTION: What is there in the record that supports your view of the relationship? I was quite persuaded that it was basically a bargaining organization, sort of like a union, to help them renegotiate the contract terms and handle problems

on terminations and things like that.

MR. SMITH: Well, I think that the part of the facts that I was referring to are set forth in our brief at ---

QUESTION: I thought your argument was quite different, that you in effect interpolated the word "entire" into the regulation, and said it must not only be directed toward improving business conditions in one line of business, but it must improve business conditions in the entire line of business--and you then define the line of business to be muffler dealers.

MR. SMITH: Yes, the muffler--you know, it does flunk that.

QUESTION: In other words, you pretty much adopt the reasoning of Judge Kiley's dissent in the Seventh Circuit?

MR. SMITH: Exactly; in other words, what Judge Kiley said in his dissent in the Seventh Circuit is that bottling Pepsi-Cola is not a line of business.

QUESTION: It's only a fragment of a line of business.

MR. SMITH: Bottling soda is a line of business. But getting back to your question, Mr. Justice Stevens, I think that the principal fact is that this association pay fifty percent of the cost of a market study in order to maintain and strengthen the position of Midas in the muffler replacement business. And it also established committees to "help make

the Midas program an ongoing source of profit for everyone." Those two things are set forth at page 31 of our brief.

QUESTION: The market study and the ---

MR. SMITH: And one other thing is that it set up a kind of monitoring of pipe prices in order to assure that it receives the lowest price pipes from Midas International, in order to make sure that it could, I suppose, do its work at prices lower than the competition.

QUESTION: There are a number of trade associations that represent maybe sixty or seventy percent of an industry, that don't have 100-percent membership, because some of them emphasize certain aspects of the business.

Are they generally granted the exemption or not? Do you have a 100-percent requirement?

MR. SMITH: Oh, I don't think you have to have a 100-percent requirement, but I think--you know, this case is sort of, in our view, a blatant case because it essentially excludes, you know, by undisputed estimation, 79 percent of the industry.

QUESTION: What if everything they did would be beneficial to the people in the muffler industry, but they happen to have their membership comprised just of franchise dealers for Midas? Say, in other words, they took a lobbying position on tax legislation, and things trade associations generally do, but their membership happened to be composed of

just twenty percent of the industry and people all handling the same product?

Would that be disqualified because it is not a broad enough base?

MR. SMITH: I would think it probably would be, but, of course--and I think the answer simply is that, you know, it's difficult for the Service to administer a statute where, you know, you could say, well, this organization, though it is not broad-based, really provides direct and indirect benefits to the industry as a whole, while this one, which is not broad-based, is pretty narrow. I think in order to sort of reduce the energy needed to monitor these organizations, the best way to insure that they are broad-based is to limit the exemption to those organizations which open their doors to people in the industry generally, and not have to rely on kind of indirect benefits.

QUESTION: Mr. Smith, what if you had a Ford dealers association? Would that be denied the exemption because it excluded Chevrolet dealers?

MR. SMITH: Yes, it would be, and the Service has so ruled.

QUESTION: So it has to be an automobile-wide ---

MR. SMITH: It has to be an automobile dealers--in fact, there are all sorts of cases involving Ford dealers that can federate for purposes of joint advertising and things

like that.

QUESTION: But can, for instance, a Chrysler dealers or an American Motor dealers association have quite different common problems than Chevrolet dealers?

MR. SMITH: They may well have different common problems, and there may be an advantage to them to get together and discuss them, but the (c)(6) exemption is limited to those whose activities are directed across at least a line of business.

QUESTION: Well, Mr. Smith, you haven't excluded automobile associations because they don't include railroads.

MR. SMITH: Of course, there are gradations of categorization, and, you know, one could say, I suppose, that there ought to be--you know, if you carry that to an extreme, there ought to be a single trade association for business generally. But the Service has wisely refrained from taking that position.

QUESTION: This is an even more unfair question than the ones I usually ask. You weren't around in 1966. Do you know why the government didn't seek cert in Pepsi-Cola?

MR. SMITH: There was no conflict.

QUESTION: Well, we have got a lot of cases where we don't have conflict.

MR. SMITH: Well, quite frankly, Mr. Justice Blackmun, the acquiescence in this case was a source of a good deal of concern to us only because--and it is a propos of your question

to Mr. Gordon earlier--there was very little money involved in this case. If you look at page 11a of the appendix, the taxpayers' complaint indicates that $5500 of tax involved in this case ---

QUESTION: Had the Second Circuit gone the other way, would you be here petitioning for cert?

MR. SMITH: I doubt it very much. But the point is, we do think that the Second Circuit's decision is correct and that the Seventh Circuit's decision is incorrect.

QUESTION: Did the Commissioner announce his non-acquiescence in the Seventh Circuit?

MR. SMITH: Yes, in 1968. And the industry is on--in fact, in our acquiescence we pointed out that there are about thirteen pending applications presenting this issue, so we thought everyone would benefit from the uniform rule. And we think the uniform rule has been the rule that has been extant since 1929, and that is that the line-of-business requirement, as Judge Kaufman said, is well-suited to the legislative intent of limiting the exemption to those organizations that provide benefits to a broad spectrum of the business community and not simply Midas muffler dealers or Sacramento tomato juice canners, or whatever--but tomato juice canners. And you don't have to take the position that it has to be all food or all juices or all beverages, and you don't have to include the distillers if you want to have an organization

limited to tomato juice processors.

QUESTION: Mr. Smith, am I not correct that you do grant the exemption to segments of an industry, without being the whole industry, that are arranged to bargain with unions, for example?

MR. SMITH: Yes, there is a ruling that is discussed in both briefs, that says that, but it is the broad base of an industry. It would be, for example, you know, the power tool manufacturers, or whatever, rather than ---

QUESTION: Let's say only 40 percent of the market gets together to do the bargaining with the union--that still would be exempt.

MR. SMITH: I think that would be all right, assuming that the organization opens its doors to ---

QUESTION: Well, here the doors are open, as far as I understand the record, but nobody wants to come in. It's just like a Chevrolet dealer doesn't want to join the Ford dealers organization.

MR. SMITH: Well, I think that really, if you will permit me, blinks at reality, because while they changed their by-laws, they never made any attempt to solicit non-Midas dealers, and I think Mr. Gordon would agree that they have no intention of doing that, that the whole thrust of the organization is to limit its members to Midas franchisees. And I think that the case has to be considered on that basis.

QUESTION: You feel they should have had an affirmative action policy?

MR. SMITH: Well, maybe in ten years we could see the results of all of this and the Court could continue to hold the case, I suppose.

QUESTION: Well, maybe the line is there, but I have to confess I don't see in terms of what they do in the business community why these people are significantly different from an industry-wide trade association.

MR. SMITH: Well, they are significantly different because, as Judge Kaufman said, in short, the bulk of the industry is excluded.

QUESTION: Well, the bulk of the industry doesn't participate, but--what's the difference between a quarter of an industry and a half of an industry, for example? Say, they had--also the Rayco dealers joined up with them, but all other dealers stayed out, and then they would suddenly be entitled to the exemption. I don't understand why it is any different. And they get together and they talk about how best to rearrange franchise terms and what to do when there is a termination of a franchise and all of this sort of stuff--I just don't see the difference.

MR. SMITH: I think the difference is simply that this organization is pretty much, you know, in a way, an adjunct of Midas in the sense that it is designed to boost the

competitive ---

QUESTION: Its purpose is to bargain with Midas, not to ---

MR. SMITH: That's true; that's part of its activities as well. But simply because it is bargaining with Midas --you know, I think that ---

QUESTION: You have farming groups that bargain with the farmers; I mean, you know, milk dealers bargain with farmers over what the price should be.

MR. SMITH: But I think the bargaining aspect of it is not necessarily controlling, because I think the Second Circuit said in a footnote, toward the end of its opinion, "In pressing this argument, the Association notes the similarity between itself and labor unions, which are granted an exemption under 501(c)(5). It has, however, made no claim that it is qualified for an exemption as a labor organization. We accordingly express no opinion with respect to the relevance of that section under the Code."

I mean, here, you know, those rules that talked about bargaining and provided for business league status, you know, had a broad-based membership--and I think that, you know, if people don't--I think there is quite a difference between closing the door to non-Midas people and opening the doors and having no one choose to come in. I think that that is quite a big difference, and I don't think that this case

ought to be looked at on the basis of the fact that ---

QUESTION: Well, it's a big difference all right, but what does it have to do with collecting taxes, that's what I don't see. The tax policy of which group should pay, you know, should not have to file returns.

MR. SMITH: Policy in this area is always difficult; you know, one could make a case that lots of things, lots of organizations engage in commendable activities, you know, that benefit society--General Motors does, as well, though it's not tax-exempt.

Here, I think, you know, the evidence is clear that Congress wanted to benefit chambers of commerce, boards of trade--you know, and that business leagues were supposed to be analogous to those kinds of things. Now, the accepted definitions of "chambers of commerce" and "boards of trade" are broad-based organizations, whether they, you know, like the U. S. Chamber of Commerce, which includes, you know, the Fortune 500 and lots of organizations like that, whether it's a board of trade that may be the Milwaukee Board of Trade that includes all sorts of businesses, both large and small.

Here we have, you know, the polar example: Midas franchisees. It's hard to imagine any class narrower than that. And that is not like a board of trade or a chamber of commerce. Congress has made that decision. It's opened up the exemption to professional football leagues. Every time

there is pressure of one sort or another, Congress either speaks or doesn't speak.

And it seems to us that to start legislating in this area and abrogating rules that have been extant for fifty years is quite hazardous. Congress has ---

QUESTION: How could Congress speak beyond the way it has spoken.

The question here is, as I understand it, whether or not this Petitioner comes within the definition of "business league," isn't it?

MR. SMITH: I suppose Congress could ---

QUESTION: Isn't that the question?

MR. SMITH: That is the question.

QUESTION: That's the precise question, isn't it?

MR. SMITH: Yes, that is true.

QUESTION: And, of course, the Petitioner says Congress has spoken by exempting business leagues from taxation, and that his client is a business league, period.

MR. SMITH: It's hard to imagine--in our view, though, we take the contrary position: the accepted definition of "business league" is not as Petitioner sees it, and I suppose Congress could speak by--you know, the Internal Revenue Code could be quite ---

QUESTION: By saying the Midas Muffler Dealers Association, Inc.

MR. SMITH: Well, it wouldn't have to go into such crass detail.

QUESTION: Well, what would it have to do?

MR. SMITH: It would have to say a business league shall not be denied exemption solely on the grounds that it is limited to the franchisees of a single branded product, or something like that. The Internal Revenue Code, I think the Court well realizes, can be quite detailed when it wants to be.

QUESTION: It can be, but here it hasn't been; it's been quite general.

MR. SMITH: It's been quite general.

QUESTION: As Judge Kaufman pointed out.

MR. SMITH: It's been quite general, but yet, for the last fifty years, the regulations have filled that gap and we think quite properly so.

QUESTION: What in the regulation filled the gap for the baseball league?

MR. SMITH: What in the ---

QUESTION: How did the regulation fill the gap to allow the exemption for the baseball leagues?

MR. SMITH: The regulations didn't, and my understanding is that the activities of a baseball league are directed to the improvement of business conditions across a line of business of baseball activity, although one, I suppose,

could argue to the contrary.

My understanding is simply as an administrative matter, as of the moment, baseball leagues and similar sports leagues that cover a broad spectrum of major sports activity are enjoying the exemption. Now, whether that will continue, I don't know.

QUESTION: Incidentally, baseball does have its own pension program; the league runs it.

MR. SMITH: It does, it does. Well, all I want to say in closing, I suppose, is that, you know, when Congress speaks, it speaks with precision.

QUESTION: It hasn't here; I think everybody agrees with that.

MR. SMITH: Right, but I mean with respect to things like professional football leagues; it's hard to imagine anything more detailed than that. I don't think one can analogize football to baseball, given the decisions of this Court.

QUESTION: But then you tell us that under the football language they have included baseball, if I understood you correctly.

MR. SMITH: No, if I said that, I didn't mean to say that. I think that football exemption came in--the only reason it came in is more or less to ratify the activities of the professional football league in administering a pension plan. I think the better argument would be that you can't analogize

the case for baseball from the football language of the Code. I wouldn't want to take that argument, but I had to because it is agreed that that is a detailed provision.

QUESTION: The only difference is that a baseball is round and a football is not.

MR. SMITH: The shape of the ball is different, that is true.

QUESTION: But I think that the amendment by Congress which included football leagues did operate to deprive you of your noscitur a sociis argument pretty much, didn't it?

MR. SMITH: No, Mr. Justice Stewart, I don't think it does deprive us of that, because I think that, you know--I think that just has to be put aside; I think Congress could have ---

QUESTION: Well, if you put it aside, then you still have the argument.

MR. SMITH: I think that professional football is so different than everything else that preceded that, that our argument noscitur a sociis still applies to the first three phrases of that paragraph.

QUESTION: If you forget about the football league.

QUESTION: Mr. Smith, isn't really all that is at stake in this case is that, if you are right, these associations have to be careful at the year end and adjust their dues periodically and avoid getting any income--isn't that all that

is at stake here?

MR. SMITH: Of course, and if they had done that, I suppose we wouldn't be here. But ---

QUESTION: We are litigating over an awfully trivial issue.

MR. SMITH: I think it is a--it is not one of the humdingers of the Court's term.

[Laughter]

But nevertheless I think we do have here a situation where income does exceed expenditures, and the case has to be decided accordingly.

MR. CHIEF JUSTICE BURGER: Do you have anything further, Mr. Gordon?

REBUTTAL ORAL ARGUMENT OF MYRON P. GORDON, ESQ.,

ON BEHALF OF THE PETITIONER

MR. GORDON: I would only add one thing, if your honors please, and that is that there is no basis whatsoever for the argument made by Mr. Smith that this organization was formed to enhance the Midas program in any way. Mr. Justice Stevens is quite right: the organization was formed as a protective and a defensive measure only, and there is no other justification for its existence. That it may from time to time help and work together with Midas is something that a union does from time to time with an employer, working together to enhance the position of both.

But in the ultimate--the general position is entirely that it has been formed and acts as a defensive measure and as a point merely for bargaining, collective bargaining, if you will, with a franchisor.

Thank you.

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

(Whereupon, at 2:01 o'clock, p.m., the case in the above-entitled matter was submitted.)