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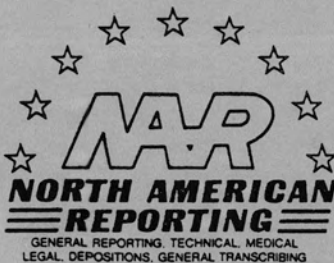
# Supreme Court of the United States

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COMMISSIONER OF INTERNAL REVENUE, :   
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Petitioner, :   
:   
v. : 79-1907  
:   
PORTLAND CEMENT COMPANY OF UTAH, :   
:   
Respondent. :   
:   
-----X

Washington, D.C.  
January 13, 1981

Pages 1 through 38

# ORIGINAL



1 IN THE SUPREME COURT OF THE UNITED STATES

2 ----- :  
3 COMMISSIONER OF INTERNAL REVENUE, :

4 Petitioner, :

5 v. : No. 79-1907

6 PORTLAND CEMENT COMPANY OF UTAH, :

7 Respondent. :  
8 ----- :

9 Washington, D.C.

10 Tuesday, December 13, 1981

11 The above-entitled matter came on for oral argument  
12 before the Supreme Court of the United States at

13 2:16 o'clock p.m.

14 APPEARANCES:

15 STUART A. SMITH, Esq., Office of the Solicitor  
16 General, Department of Justice, Washington,  
D.C. 20530; on behalf of the Petitioner

17 DENNIS P. BEDELL, Esq., Miller & Chevalier,  
18 1700 Pennsylvania Avenue, N.W., Washington,  
D.C. 20006; on behalf of the Respondent

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C O N T E N T S

ORAL ARGUMENT OF

PAGE

STUART A. SMITH, ESQ.,  
on behalf of the Petitioner

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DENNIS P. BEDELL, ESQ.,  
on behalf of the Respondent

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REBUTTAL ORAL ARGUMENT OF

STUART A. SMITH, ESQ.,  
on behalf of the Petitioner

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P R O C E E D I N G S

1  
2 MR. CHIEF JUSTICE BURGER: We'll hear arguments  
3 next in Commissioner of Internal Revenue v. Portland Cement  
4 Company.

5 I think you may proceed when you are ready, Mr.  
6 Smith.

7 ORAL ARGUMENT OF STUART A. SMITH, ESQ.,  
8 ON BEHALF OF THE PETITIONER

9 MR. SMITH: Thank you. Mr. Chief Justice, and  
10 may it please the Court:

11 This income tax case comes here on a writ of  
12 certiorari from the United States Court of Appeals for the  
13 Tenth Circuit. The questions involve an application of a  
14 well established formula method set out in the Regulations for  
15 more than 40 years, for measuring the gross income from mining  
16 of a taxpayer who mines and thereafter produces a finished,  
17 manufactured product, the so-called integrated miner-manu-  
18 facturer. The object of the formula which is called the  
19 proportionate profits method is to determine the price at  
20 which the taxpayer would have sold his mined ore to itself  
21 in a hypothetical sale, so as to confine the depletion deduc-  
22 tion to its intended purpose of compensating for the exhaustion  
23 of the mineral deposit, the depletion deduction is a fixed  
24 percentage of gross income from mining. The method, the  
25 proportionate profits method is employed as it was in this

1 case, where there is no representative field price or sales  
2 of -- actual sales at the cutoff point, at the point in which  
3 the mining activity ceases, or where there's -- essentially  
4 at arm's length. And the underlying theory of the propor-  
5 tionate profits method, which is a cost-ratio method, which  
6 is set out in our brief at page 3, it's a formula which  
7 essentially multiplies a fraction, the numerator of which  
8 is mining costs over total costs -- that is, mining plus  
9 non-mining costs, times the gross sales of the first market-  
10 able product which here is finished Portland cement and  
11 that figure --

12 QUESTION: May I interrupt you right there,  
13 that gross sales figure? That is the actual -- that isn't a  
14 constructed figure, is it?

15 MR. SMITH: No, not at all.

16 QUESTION: That is an actual figure representing  
17 the sales price of the finished product, whatever that product  
18 is?

19 MR. SMITH: Exactly, exactly.

20 QUESTION: Of the first marketable product?

21 MR. SMITH: Of the first marketable product.

22 QUESTION: And so that if it, normally, that price  
23 would be enough to cover all costs, anyway?

24 MR. SMITH: Yes.

25 QUESTION: Or they will go broke --

1 MR. SMITH: Yes, exactly.

2 QUESTION: So it's the gross sales price?

3 MR. SMITH: Exactly.

4 QUESTION: All right.

5 MR. SMITH: And the theory of the -- the underlying  
6 theory of the method is that each dollar of cost earns its  
7 proportionate share of gross sales and thereby, of profits.  
8 And the questions in this case are two, and they involve a --  
9 they both involve detailed applications of the method.

10 The first question involves, is whether the gross  
11 sales figure, that is, the multiplier of the first marketable  
12 product includes bulk and bagged cement as the regulations  
13 require, or whether, as Respondent contends, simply bulk  
14 cement. And the second question involves the denominator  
15 of the fraction, that is, the total cost and whether the --  
16 whether that denominator should include costs of bags, bagging,  
17 storage, distribution, and sales should be included as the  
18 regulations require.

19 QUESTION: While the two questions are separate, they  
20 are interrelated, are they not?

21 MR. SMITH: Absolutely, absolutely.

22 QUESTION: And they have to kind of be answered the  
23 same way?

24 MR. SMITH: Exactly, exactly.

25 QUESTION: Well, you couldn't lose the first

1 question and still not change the denominator, could you?

2 MR. SMITH: No, no. While the questions are inter-  
3 related, I think the --

4 QUESTION: Well so if -- if your first marketable  
5 product is bulk cement, you're certainly not going to include  
6 in the denominator the cost of bagging?

7 MR. SMITH: No, exactly. The facts --

8 QUESTION: Let me ask one fact question, Mr. Smith.

9 MR. SMITH: Sure.

10 QUESTION: On his tax return, did the taxpayer,  
11 with respect to sales costs and office administrative costs,  
12 did the taxpayer seek to exclude them entirely or to place  
13 some of them in the numerator?

14 MR. SMITH: My understanding is that he sought to  
15 exclude them entirely; that's basically the position that the  
16 Court below, which as we set forth in our petition and in our  
17 brief, is really -- has been out of line with not only the  
18 regulations, but with all of the other Courts of Appeals.

19 QUESTION: Does the taxpayer take a different  
20 position on that than it did in the court below?

21 MR. SMITH: I think so. My understanding in looking  
22 at the briefs now, is the taxpayer is seeking a prorated --

23 QUESTION: Yes.

24 MR. SMITH: -- a prorated approach.

25 QUESTION: Well Mr. Smith, if the court below had

1 agreed with you that the first marketable product was both  
2 bulk and bagged cement, I'm not sure it would have excluded  
3 any costs from the denominator.

4 MR. SMITH: Well, it's hard to tell. I mean, I  
5 can't put myself --

6 QUESTION: Well I know, but it said that the first  
7 marketable product was bulk cement --

8 MR. SMITH: Yes, yes, so it more or less then --

9 QUESTION: -- in this event, you should throw out  
10 some costs from the denominator.

11 MR. SMITH: Yes, and I --

12 QUESTION: So your first question, if you win on  
13 the first question, you win.

14 MR. SMITH: I think if I win on the first question,  
15 as a logical matter the second question is a subsidiary ques-  
16 tion which takes care of itself. But it's hard to know exactly  
17 how the court below felt about this question. Generally,  
18 because it had-- this question has been kicking around in  
19 the Tenth Circuit ever since the Ideal Basic case.

20 QUESTION: There's no suggestion that they would  
21 throw those costs out of the denominator even if --

22 MR. SMITH: No.

23 QUESTION: -- even if the first marketable product--

24 MR. SMITH: No, well what the Tenth Circuit has  
25 said, which we take strong disagreement with, is that the



1 first marketable product was bulk cement. So let me just  
2 simply sketch out the facts which are relatively simple.

3 QUESTION: Which do they sell most of, by the way?

4 MR. SMITH: They sell mostly bulk cement, the  
5 bagged cement accounts for about 7 or 8 percent of its --  
6 let me put it this way, the cement in bags, it's the same  
7 product, it's whether it's sold in a railroad car, whether  
8 it's packed in bags, pursuant to particular kind of customer  
9 demand for cement in bags.

10 The facts are relatively simple. This respondent,  
11 like all others in the cement industry, is an integrated  
12 miner-manufacturer of Portland cement. The mining process  
13 involves a quarrying and a digging of this cement rock, it's  
14 a calcium carbonate kind of rock, it's reduced in size. It's  
15 then ground to a high degree of fineness, water is added,  
16 to produce something called the slurry. And then that slurry  
17 is stored in tanks and agitated to maintain uniform mixture  
18 until such time as it passes to the manufacturing process.

19 QUESTION: Mr. Smith, is it agreed that the mining  
20 phase stops at the point where slurry is --

21 MR. SMITH: Yes, I think that is -- that is agreed.  
22 Because the mining process, and Congress has, you know,  
23 ratified this in Section 613(c)(4)(f) which was enacted in  
24 response to the Court's Cannelton decision, the mining pro-  
25 cess stops at the kiln feed, everything after that is

1 non-mining. And then this liquid slurry as I've averted  
2 is then fed into these rotary kilns which are fired and a  
3 hard substance called a clinker is ultimately formed, that  
4 clinker is cooled, ground up with purchased gypsum, to produce  
5 the finished cement. And then there is a final grinding and  
6 then the finished cement is stored in silos.

7           Some of the cement is sold in bulk in tankcars, or  
8 piggyback, or gondola cars, a variety of different forms for  
9 large consumers that need cement in that kind of quantity.  
10 But the important thing is that cement has to be kept dry,  
11 otherwise if it becomes wet it becomes worthless, so some  
12 people don't need that much cement and for those customers  
13 this manufacturer as well as all others in the integrated  
14 industry, pack the bag, pack the cement in bags of --  
15 which are a standard 94-pound weight as I understand it.

16           QUESTION: Mr. Smith, I suppose it never happens,  
17 but suppose this manufacturer sold everything in bags, would  
18 you have a different case?

19           MR. SMITH: Then I would have a different case, but  
20 I don't think there would be a quarrel, I mean, essentially  
21 it would be the same marketable product; in our view, it  
22 would still be cement, the bagging costs would be a cost of  
23 sale and we would contend that that would be -- that would  
24 have to go into the denominator and the bagging --

25           QUESTION: So the Commission would take the same

1 position that he took --

2 MR. SMITH: Right, but I assume that this taxpayer  
3 couldn't really argue that anything else was a first marketable  
4 product.

5 QUESTION: Mr. Smith, it has nothing to do with  
6 this case at all, but what's the difference between concrete  
7 and cement?

8 MR. SMITH: Concrete as I understand it -- and I  
9 should know this because I'm a city boy, I think is what  
10 happens when the cement is, you know, put in the building and  
11 it hardens. I think you talk about a concrete sidewalk, I  
12 don't think you talk about a cement sidewalk. But I could be  
13 wrong on that.

14 Well, this taxpayer, the Respondent computed its  
15 gross income from mining, in accordance with the proportionate  
16 profits method; indeed, it had to, because as I said, there  
17 is no representative field price, and it did not sell as --  
18 nor did anyone in this industry, sell kiln feed, so there's  
19 no way to know how much kiln feed would sell for. But  
20 contrary to the command of the regulations, and I have to  
21 emphasize that these regulations which are set forth in  
22 detail and are the appendix to our brief, are detailed and  
23 more or less pre-empt this area, and pre-empt it in accordance  
24 with a command of Congress in Section 611(a), that the Commis-  
25 sioner promulgate such regulations, the Respondent computed

1 its gross income by excluding bagged cement from the compu-  
2 tation, and by excluding the costs of bagging, storage, dis-  
3 tribution, and sales from the total costs element in the  
4 formula of the so-called denominator in that fraction.

5 The Tax Court in this case upheld the Respondent  
6 because the Tax Court has a rule in which it will follow the  
7 relevant circuit to which a case will go, the so-called  
8 Golsen rule. And since this Court of Appeals had already  
9 expressed itself, in the Ideal Basic case, that's why the  
10 Tax Court held the way it did and the Court of Appeals  
11 followed its Ideal Basic decision.

12 Now in our view with respect to the first question,  
13 the Respondent's first marketable product is finished cement,  
14 regardless of the form of packaging. As I said, the theory  
15 of the proportionate profits method is that each dollar of  
16 cost produces the same percentage of profits. To exclude  
17 any costs or any element through any aspect of gross sales  
18 received in production or sale of the first marketable  
19 product compromises the integrity of the formula.

20 QUESTION: Well what about the companies that sell  
21 on delivered price basis, and they pay for the transportation?  
22 You don't include transportation? You deduct transportation  
23 costs from gross sales price, don't you?

24 MR. SMITH: Only certain kinds of transportation,  
25

1 Mr. Justice White. The --

2 QUESTION: So long as you don't make a profit on  
3 it?

4 MR. SMITH: Well essentially, if they are delivered  
5 over to a transporter, it's the transporter's profit. That  
6 is an accomodation that the regulations make with respect  
7 to purchase --

8 QUESTION: So you do not include all elements of  
9 gross sales?

10 MR. SMITH: Well that as I understand it is the only  
11 element of gross sales that is not included.

12 QUESTION: Why isn't it included?

13 MR. SMITH: It's not included as I --

14 QUESTION: Because the company doesn't make a profit  
15 on it?

16 MR. SMITH: Because the company -- basically,  
17 because it's the transporter's profit.

18 QUESTION: Well, so yes, I'm right. The company  
19 itself doesn't make a profit on it?

20 MR. SMITH: The company does not make a profit on  
21 transportation, but --

22 QUESTION: Well what if it didn't make any profit  
23 on its bagging?

24 MR. SMITH: It -- well, I don't think we'd have to  
25 worry about that in this case, because --

1 QUESTION: I know you don't want to worry about  
2 it, but that's the very worry in the case.

3 MR. SMITH: No, it's not the very worry --

4 QUESTION: Well then it's one of them.

5 MR. SMITH: Well no it isn't, Mr. Justice White.  
6 And the reason it isn't, is because the Respondent -- because  
7 it's been stipulated in this case that the Respondent realized  
8 a net profit on the sale of each bag of cement and --

9 QUESTION: That is not, it is not stipulated that  
10 he made a profit on his bagging expense?

11 QUESTION: On the bags.

12 MR. SMITH: Well, if you -- yes, yes --

13 QUESTION: Is it?

14 MR. SMITH: It is not stipulated that he made a  
15 profit --

16 QUESTION: As a matter of fact, the claim is that  
17 he loses; that it costs him more to bag than he adds to the  
18 price from the bagging.

19 MR. SMITH: Yes. But the point of the proportion of  
20 profits method is that it has to measure the sales of a  
21 finished product. And part of the -- and this Respondent,  
22 as well as all other cement integrated producers sold bagged  
23 cement in response to a customer demand for cement in bags,  
24 and there is no suggestion here that -- and it seems to me,  
25 that the relevant fact is that this Respondent earned a

1 profit on each bag of cement that it sold. And once it is  
2 assumed that that is a profitable aspect of its business,  
3 all of that has to go into the equation --

4 QUESTION: Except transportation because he doesn't  
5 make a profit on it?

6 MR. SMITH: Well except transportation, because  
7 transportation basically is taken out of his hands and put  
8 into the hands of the transporter and our point is with  
9 respect to transportation that I know that the --

10 QUESTION: The point is that he doesn't make a  
11 profit out of it.

12 MR. SMITH: Exactly, exactly. But he did make a  
13 profit on the sale of bagged cement, and I think that makes  
14 all the difference in the world.

15 QUESTION: I know you do.

16 MR. SMITH: The conditions of the regulation, the  
17 purchase transportation regulations, are set forth at page  
18 13(a) of our appendix to our brief, and you can see that the  
19 conditions are very narrow. It says which -- it's not trans-  
20 portation conducted by the taxpayer, but which is performed  
21 in conveyances owned or leased by persons other than the  
22 taxpayer rather than conveyances owned or leased by the tax-  
23 payer, which are performed solely to deliver the taxpayer's  
24 minerals and mineral products to the customer rather than to  
25 transport such minerals or products from packaging or other

1 additional processing which are charged to the customers in  
2 such a way that the taxpayer does not ordinarily earn any  
3 profit with respect to such transportation.

4 Now that is the, as I understand it, the only  
5 arguable exception to the integrity of the method, because  
6 the method demands that all -- the method won't work with  
7 respect to carving out that aspect of gross income from  
8 mining unless the denominator in that fraction includes all  
9 of the costs and the multiplier includes the gross income  
10 from mining. And since this taxpayer sold cement in bags and  
11 charged a price for it, that whole price has to be included  
12 because if it isn't, you don't get -- it's an approximated  
13 method but the approximation you know, starts to depart from  
14 the intended ambit of the depletion allowance which is to com-  
15 pensate for the exhaustion of the mineral deposit and not to  
16 compensate -- and not to provide any deduction for non-mining  
17 activities.

18 QUESTION: Well what if the taxpayer's price list  
19 said on it, I'll sell cement to you either in bags or in  
20 gross for exactly the same price per 100.

21 MR. SMITH: For exactly the same price per 100?  
22 Then I assume that, you know, people would either take it one  
23 way or the other. That doesn't mean the taxpayer is not  
24 making a profit of, or it means that he's selling bagged  
25 cement for less.



1 QUESTION: And so what if he's -- had a price system,  
2 says I'll sell you bulk cement for \$2.00 and bagged cement  
3 for \$2.10?

4 MR. SMITH: Yes?

5 QUESTION: And so it doesn't make any difference  
6 what his price list is. Or what the cost of bagging is.

7 MR. SMITH: No, it doesn't make any -- well, it  
8 does make a -- your example makes a difference, but the point  
9 is that his gross sale of his first marketable product in  
10 that -- in your latter example, is either \$2.00 or \$2.10.  
11 And we assume as --

12 QUESTION: And you said it wouldn't make any  
13 difference to your case if it were stipulated that the cost  
14 of bagging was \$.20, would it?

15 MR. SMITH: It wouldn't make any difference to me,  
16 that the cost of bagging and in fact, you know, it was  
17 essentially that there was a disparity between the bagging  
18 premium and the bagging costs in this case. But essentially  
19 all that means is that he's selling the cement for less. I  
20 mean, we have to assume that this taxpayer sold bagged  
21 cement and you know, the Third Circuit more or less inferred  
22 that in Whitehall, and there's an array of appellate authority  
23 that rejects the notion that you can simply say well the  
24 bagging aspects of this thing are just an entirely different  
25 business, and that we're going to ignore them. Because the

1 regulations provide with explicit direction that the first  
2 marketable product is cement, no matter how it is packaged,  
3 in either bulk or bagged form. Now if I can, to refer the  
4 Court to page 8(a) of our appendix, which says here the first  
5 marketable product means the product produced by the taxpayer  
6 as a result of the application of non-mining processes. And  
7 the formal condition in which such product or products are  
8 first marketed in significant quantities by the taxpayer,  
9 is meant with specific reference to the cement industry, they  
10 say here, for example, if a cement manufacturer sells his own  
11 finished cement of various types in bulk and bags, and also  
12 also sells concrete blocks or dry ready-mixed aggregates,  
13 containing additives of finished cement of various types in  
14 bulk and bags, constitutes the first marketable product.

15 QUESTION: And your suggestion is that's a per-  
16 missible construction of the statute?

17 MR. SMITH: Absolutely.

18 QUESTION: And that's -- if it isn't, you lose,  
19 but if it is, you should win?

20 MR. SMITH: I think we should win because the  
21 statute simply permits the Commissioner to permit the reason-  
22 able allowance in all such cases, being made under regulations  
23 prescribed by the Secretary or his delegate. Now that's a  
24 very broad delegation. We view those regulations as legis-  
25 lative in type, and this Court has held in cases which are

1 legion, that the Commissioner's regulations are entitled to  
2 that --

3 QUESTION: What is the source of the language  
4 first marketable product?

5 MR. SMITH: What is the -- I assume that the source  
6 of the first --

7 QUESTION: Is that in the regulations anywhere?

8 MR. SMITH: Yes.

9 QUESTION: Is it in the statute?

10 MR. SMITH: It is not in the statute, but I assume  
11 that the --

12 QUESTION: So the first marketable product is a  
13 product of the Commissioner's mind?

14 MR. SMITH: Based upon his reading of this Court's  
15 decision in Cannelton Sewer Pipe, which talked about commer-  
16 cially marketable products.

17 QUESTION: Well isn't it a little strange to say  
18 that there are three products that are the first marketable  
19 product, even though bulk cement, you have to do something  
20 else to it to get it into bags?

21 MR. SMITH: Put it in the bag, yes.

22 QUESTION: Well I know, but you have to do some-  
23 hingtelse to it to get it into cement block.

24 MR. SMITH: Oh yes.

25 QUESTION: And it costs you money to do it, and

1 yet you say all three are --

2 MR. SMITH: No, no, no. I -- that's not what I  
3 said, the block is not the first marketable product.

4 QUESTION: You said it was.

5 MR. SMITH: No, no, I didn't. Here also -- it  
6 says the finished cement of various types in bulk and bags,  
7 constitutes the first marketable product, but the blocks and  
8 the aggregates and the sakrete, or whatever, that's a differ-  
9 ent product.

10 QUESTION: What about the bagged cement? It's  
11 costing them money --

12 MR. SMITH: That's --

13 QUESTION: -- there's a whole, another process to  
14 go through to put it in bags.

15 MR. SMITH: Yes, Mr. Justice White --

16 QUESTION: And if so, how can there be two first  
17 marketable products?

18 MR. SMITH: Of course -- no, there's only one first  
19 marketable product. Cement, no matter how it is packaged.

20 QUESTION: I know that is what you say --

21 MR. SMITH: Yes. Because in our view, bagging is  
22 not a chemical or a physical process that adds, that alters  
23 the character of the manufactured product. The manufactured  
24 product is Portland cement, whether it's in a railroad car --  
25 the Fifth Circuit stated this with excruciating detail --

1 whether it's in a railroad car, or piggyback, or whatever,  
2 it's still cement.

3 QUESTION: Well, Mr. Smith, is that consistent  
4 with the Tenth Circuit's opinion at 14(a) of the petition,  
5 down toward the bottom, where the Court there says the  
6 government seeks to have "bagged cement" be the "first  
7 marketable product" and to so include the expenses associated  
8 with the bagging. Did the government take the same position  
9 as the Tenth Circuit --

10 MR. SMITH: Oh well, that's really a mischaracteri-  
11 zation of the government's position. The government argued  
12 that the first marketable product is finished cement, no  
13 matter how it's packaged. And I -- reading this most  
14 charitably, I would assume that what the Court meant is that  
15 government seeks to have bagged cement included in the first  
16 marketable product, because it's the same cement, it's simply  
17 put in a bag.

18 QUESTION: One answer might be that the reason you  
19 are here is because the Tenth Circuit, from your point of  
20 view, did not understand the case?

21 MR. SMITH: I think that's right. I mean, the Tenth  
22 Circuit took the position that bulk cement was the first  
23 product and bagged cement was the second product, but --  
24 putting something in a bag is not the chemical or physical  
25 processing that the Court in Cannelton averred to when it

1 tried to fix the cut-off point as to when mining stops and  
2 when manufacturing begins. And you know, the bagging is  
3 clearly part of the manufacturing cost, but it goes into the  
4 sales of what this Respondent and all other integrated pro-  
5 ducers sell as the first marketable product.

6 QUESTION: Mr. Smith, may I ask you a question  
7 prompted by some of Mr. Justice White's questions? As I  
8 understand your position, as a matter of fact you contend  
9 that the taxpayer actually made a profit on the bagged cement--

10 MR. SMITH: Yes.

11 QUESTION: They wouldn't sell it otherwise.

12 MR. SMITH: Yes.

13 QUESTION: But the profit on the bagged cement is  
14 less than the profit on the other cement because the bags are  
15 more --

16 MR. SMITH: Sure.

17 QUESTION: -- costly than the bagging premium.  
18 But is it not true that in your analysis of the case, even if  
19 they lost money on the bagged cement, say the bags were so  
20 terribly expensive that they packed them up in Christmas  
21 packages or something, they lost money on the bags, but you'd  
22 still make the same --same basic argument?

23 MR. SMITH: Sure, it would have to be included in  
24 the gross sales of the first marketable product. And then  
25 it would be, you know, it may affect the --

1 QUESTION: Just as -- well, from your point of  
2 view, just as if they'd maybe had a price cut during February,  
3 and they lost money for --

4 MR. SMITH: Sure, sure.

5 QUESTION: -- three or four weeks, then you would  
6 still use the same basic ingredients --

7 MR. SMITH: Exactly, exactly. And the suggestion,  
8 and the argument that I'm making is simply not one that's  
9 based upon regulations that we contend deserve great defer-  
10 ence as legislative regulations. The Court has held in a  
11 variety of depletion cases, that the Commissioner has special  
12 powers in the depletion area because the legislative author-  
13 ity delegated -- the authority delegated to him is so broad,  
14 but the Respondent is faced with an array of appellate  
15 decisions in which the Court below stands as the sole exception,  
16 that the first marketable product in this area is bulk and  
17 bagged cement; that is, finished cement. I would like, since  
18 the second question is a subsidiary one, and I assume that  
19 costs necessarily included in the denominator flow from the  
20 first opinion -- from the first question, I would like to save  
21 my remaining time for rebuttal.

22 QUESTION: Well just one more question. Is your  
23 case really boiled down and perhaps oversimplified, something  
24 like the difference between buying a loaf of bread in Paris,  
25 where you put it under your arm, and buying one at the

1 supermarket here, where it's all wrapped up in a package?

2 MR. SMITH: Exactly, it's the same bread. And if  
3 there are tax deductions that -- or computations that flow  
4 from that, that involve gross sales; if the supermarket  
5 in the United States has to sell some -- has to raise the  
6 price to take into account the bag, or if it doesn't those  
7 sales have to be included in gross sales.

8 And I'd like to save the rest of my time for  
9 rebuttal.

10 MR. CHIEF JUSTICE BURGER: Very well. Mr. Bedell.

11 ORAL ARGUMENT OF DENNIS P. BEDELL, ESQ.,

12 ON BEHALF OF THE RESPONDENT

13 MR. BEDELL: Mr. Chief Justice and may it please  
14 the Court:

15 The question in this case seems to have been cast  
16 in terms of preserving the integrity of a mathematical,  
17 automatically functioning formula rather than in terms of  
18 preserving the integrity of the purpose for which that formula  
19 is being applied. The purpose, the purpose is to ascertain  
20 an integrated miner's gross income from mining.

21 QUESTION: Well, let me put -- I am alternately  
22 confused and find the case simplified. When and what is it  
23 that can first be sold, what can first be sold here?

24 MR. BEDELL: Bulk cement. And bulk cement --

25 QUESTION: Is the case any more complicated than



1 that?

2 MR. BEDELL: Not really. That is, that is the  
3 product that is sold in a substantial quantity. And indeed,  
4 as the Tenth Circuit has correctly recognized, bagging is  
5 something that occurs additionally and it has a discreet  
6 income component --

7 QUESTION: Well this sounds as though you agree  
8 with Mr. Smith, which I --

9 MR. BEDELL: I do not agree with Mr. Smith.

10 QUESTION: -- it sounds as though you do, though.

11 MR. BEDELL: No, --

12 QUESTION: You say bagged cement is not a -- one  
13 of the first marketable products, or even part of it?

14 MR. BEDELL: I certainly do, because bulk cement is  
15 sold in significant quantities.

16 QUESTION: More bulk than bag.

17 MR. BEDELL: Indeed. Approximately 95 percent in  
18 bulk. This is the first product --

19 QUESTION: Well now what if the situation were  
20 reversed, suppose there were more in bags than in bulk, only  
21 one percent of bulk, would your position here be exactly the  
22 same?

23 MR. BEDELL: No, it would not. Because you have to  
24 have sufficient sales to establish the price so that you have  
25 a meaningful first marketable product.

1 QUESTION: Well where is that --

2 MR. BEDELL: Just as in the case of our represen-  
3 tative field price where the product is sold after mining  
4 ends --

5 QUESTION: Where is that line of demarcation,  
6 50 percent, 40 percent?

7 MR. BEDELL: Cases in the depletion area under the  
8 representative market or field price generally are found  
9 10, 15, 20 percent. It has to be determined with reference  
10 to the realities of the market.

11 QUESTION: What do you want to be included in your  
12 gross sales figure, the multiplier there? You just want the  
13 -- your gross sales of bulk cement in that or not?

14 MR. BEDELL: The sales figures should include the  
15 gross sales of bulk cement and the sales value of the cement  
16 which is sold in bags, because that also is the product of  
17 cement rock which was mined by the taxpayer and manufactured  
18 into finished cement.

19 QUESTION: So you say that -- you say, along with  
20 Mr. Smith then, that you include in the sales figures the  
21 cement sold in bags?

22 MR. BEDELL: You have to include an income figure  
23 for cement sold in bags, and the proportionate profit formula  
24 contemplates this, because it takes actual sales of the first  
25 marketable product, sales of cement in bulk and with respect

1 to products that are second or third, a further processed  
2 or product after first marketable product, they take the  
3 constructed sales value derived from sales value applied to  
4 the first marketable product.

5 QUESTION: You used the word process, what was the  
6 process in putting it in the bag?

7 MR. BEDELL: It is the activity of putting it into  
8 a bag, Mr. Justice Marshall.

9 QUESTION: That's not a process is it?

10 MR. BEDELL: It is not in the sense usually used  
11 in the depletion area, it is not.

12 QUESTION: Mr. Bedell, on the portion of the gross  
13 sales that represent product that was bagged, what is the  
14 constructive sales price that the taxpayer contended for?  
15 Is it the equivalent of the unbagged cement, or is it the  
16 actual price less the bagging cost?

17 MR. BEDELL: The taxpayer took what is the less  
18 favorable position; namely, less favorable to itself, of the  
19 actual sales price less the bagging costs, because in this  
20 case, as the Court has noted, the bagging cost exceeded the  
21 bag premium and the additional revenue generated by selling  
22 the cement in bags rather than in bulk. So the taxpayer took  
23 sales figure of cement sold in bags, reduced that by the costs  
24 of bagging, which was greater really than the additional  
25 income generated by it, and put that in the sales figure that

1 then was allocated in accordance with the proportionate profits  
2 formula.

3 QUESTION: It doesn't seem to me that's consistent  
4 with your basic position, that the sales cost is the cost of  
5 the unbagged cement. I mean, the sales price is the price  
6 of the unbagged cement. It may have been good tactics to do  
7 it that way, because I see what you're saying, but I think  
8 it's somewhat inconsistent.

9 MR. BEDELL: The taxpayer was following the law  
10 as had been set forth by the Tenth Circuit Court of Appeals,  
11 in 1968 in the Ideal Basic case. When it interpreted the  
12 manner in which the proportionate profits formula functioned  
13 in the case of a cement manufacturer.

14 QUESTION: Do you agree, by the way, that the govern-  
15 ment's position is the one that the regulation commands? So  
16 you must attack the regulations?

17 MR. BEDELL: No, I do not agree with that. It seems  
18 to us that there is within the regulation, room to find a  
19 result which is consistent with the purpose of the regulation.  
20 The language Mr. Smith read to us which said that the bulk  
21 and packaged products are considered to be essentially the same  
22 product -- it doesn't say they are, it says they are con-  
23 sidered to be -- that is language of presumption, not language  
24 of absoluteness. And when a result occurs under regulatory  
25 language, that clearly is at conflict with a purpose of the

1 language, that it seems to me that this language is sus-  
2 ceptible of being interpreted in a manner as to cure the  
3 distortion which will result under Mr. Smith's interpretation.  
4 And indeed, I think that distortion should be focused on,  
5 because it is material to realize the manner in which the  
6 purpose of the -- applying the formula is being frustrated.  
7 Let's return momentarily, the purpose is to determine the  
8 gross income from mining that is, the value of the taxpayer's  
9 mineral that could have been realized had it been sold after  
10 mining processes end, so we're looking to a market value for  
11 the raw mineral product. That's the purpose for which the  
12 formula is being applied.

13 QUESTION: And when did the process end, in your  
14 view?

15 MR. BEDELL: The mining process ends at the point  
16 of kiln feed -- when that is introduced into the kiln, there  
17 is no dispute between the government and the taxpayer with  
18 respect to that. But the taxpayer's cement rock, under  
19 the government's interpretation, would have one value, if  
20 that cement rock was manufactured into finished cement and  
21 sold as bulk cement. But a different value, the same identical  
22 mineral, would have a different value if it was manufactured  
23 into finished cement and sold in bags. Or look at it differ-  
24 ently. In a given year, the taxpayer sold five percent of  
25 its cement rock in the form of finished cement in bags, the

1 cement rock on an overall basis would have one value. The  
2 next year it sells 20 percent in bags from the same cement  
3 rock from the same quarry, assuming the same economic condi-  
4 tions, drops in value. On the other hand, if it went down  
5 to zero instead of seven percent it had here, the cement  
6 rock changes value. This is the identical mineral, which  
7 under the government's theory is having a change in value  
8 because of this bagging activity, an activity which occurs  
9 after all mining and all manufacturing processes have been  
10 completed.

11 QUESTION: What, to echo my brother Blackmun's  
12 question, what if your client sold all his cement in bags,  
13 and always had and always will?

14 MR. BEDELL: If all the cement were sold in bags,  
15 bagged cement would be the first marketable product, because  
16 what is being --

17 QUESTION: And bagging would clearly be part of  
18 the --

19 MR. BEDELL: Then bagging would be part of the costs  
20 in arriving at that. But what is being looked to is what is  
21 the point in the activity of getting to market when the  
22 taxpayer --

23 QUESTION: What if a competitor sold all his cement  
24 in bulk? The difference of the mined product would be  
25 different between the two companies, wouldn't it?

1 MR. BEDELL: Under --

2 QUESTION: Although it would be an identical pro-  
3 duct.

4 MR. BEDELL: Under the proportionate profits  
5 formula, yes.

6 QUESTION: To carry it one step further, what if  
7 the industry as a whole sold largely or totally in bulk?  
8 And this one manufacturer sold it just in bags?

9 MR. BEDELL: There would be -- because of the  
10 manner in which the formula, mathematical formula operates,  
11 there would be a different result. Now the question is, in  
12 this case, there are actual facts --

13 QUESTION: Right.

14 MR. BEDELL: There are actual facts which can be  
15 looked to, to avoid what is an unrealistic result from the  
16 application of mechanical formula. And that really is the  
17 question: can actual facts be taken into account? The  
18 bagging cost and the amount of additional income because it  
19 is clear, on the record, that the taxpayer realized a certain  
20 increment of revenue when it sold cement in bags rather  
21 than in bulk. An additional amount of revenue.

22 QUESTION: Well how is that different from, say,  
23 you have three or four methods of sales. Some you sell through  
24 distributors and some on commission, and some through door-  
25 to-door salesmen, and there are different sales costs for

1 ten percent of your business and another 20 and another 50,  
2 but still all cement. Would you -- and those proportions  
3 vary from year to year, the value of the mined product would  
4 also vary from year to year, I suppose, would you say that  
5 nevertheless, those are -- would you say that's all one  
6 marketable product, or does it change from time to time?  
7 Say that none of it was in bags but some of it was sold  
8 in smaller quantities at somewhat different prices because of  
9 different sales techniques -- How is that any different than  
10 the bagging problem?

11 MR. BEDELL: One -- since the -- well, it seems  
12 to me it is different in two reasons, because in the first,  
13 there may be sales much closer to the manufacturing plant  
14 itself, and so --

15 QUESTION: I'm leaving out transportation because  
16 I'm just working on sales price.

17 MR. BEDELL: The other, the other thing is that  
18 sales costs, sales costs are costs which a number of the  
19 Courts that have looked at it, the lower Courts, have decided  
20 are cost allocable both to the mining and the manufacturing  
21 activity.

22 QUESTION: Well that's exactly what -- say the  
23 bags are allocated to both, too.

24 MR. BEDELL: Right, they allocate -- well, the  
25 government though, under its interpretation of the formula



1 would allocate the cost of bagging solely to the manu-  
2 facturing non-mining side.

3 QUESTION: Well, Mr. Bedell --

4 QUESTION: That goes into the total figure,  
5 doesn't it? Just as the sales costs go into the total figure.  
6 Maybe I'm wrong, but I thought that -- say you have a  
7 general sales manager, where is his salary?

8 MR. BEDELL: The salary of a general sales manager  
9 should be treated as both in the numerator of the formula  
10 and in the denominator.

11 QUESTION: Is that what you did in your tax  
12 return?

13 MR. BEDELL: Again, following the Tenth Circuit,  
14 the Tenth Circuit interprets --

15 QUESTION: Yes, or no, did you or did you not?

16 MR. BEDELL: No. Because that is not the matter  
17 which the Tenth Circuit interprets.

18 QUESTION: If one reads the statutory language  
19 itself, 611(a), the general rule, in talking about mines,  
20 it says that the -- a large depletion for depreciation  
21 improvements according to peculiar conditions in each case.  
22 Such reasonable allowance in all cases to be made under  
23 regulations prescribed by the secretary or his delegate,  
24 is it conceivable in view of that reference to peculiar  
25 cases that the numerator/denominator worked out by the

1 secretary could itself be unreasonable in some cases?

2 MR. BEDELL: Exactly, exactly. It is contemplated  
3 by the statute, not only by the language that it be reason-  
4 able but that it take into the account the variation  
5 in different cases.

6 Obviously, administrative convenience and simplic-  
7 ity require ignoring some variations, but when you have  
8 variations that are supported by definite facts such as  
9 in this case, peculiar circumstances, what we have here,  
10 ascertainable income items and ascertainable costs asso-  
11 ciated with the bagging activity, then that is the type of  
12 case which it should be dealt with.

13 And indeed that is what the Tenth Circuit has  
14 consistently held, the Ideal Basic case in 1968, the Port-  
15 land Cement Company of Utah case in 1979, and then in  
16 this case. Because this actual fact, it is a factor which  
17 can be taken into account and supports the determination  
18 as the Tenth Circuit has held that the first marketable  
19 product was cement in bulk.

20 The confusion between the premise, the premise  
21 of the proportionate profits formula and the purpose which  
22 it serves of trying to find gross income for mining, has  
23 clouded the issue and in many contexts that's been looked at  
24 up until now.

25 There is this distortion which occurs if

1 additional processes bar their way from the crude mineral  
2 product which is being valued or taken into account. The  
3 Tenth Circuit realized that, and the Tenth Circuit because  
4 it realized the purpose of the proportionate profit formula,  
5 is to value the mineral product found the place closest to  
6 the mine, closest to the point where the mineral product is,  
7 and that is cement in bulk. And treated that as the first  
8 marketable product so that it was the starting point for the  
9 application of this mathematical formula to ascertain the  
10 market value, it did away with the recognized distorting  
11 effects which occur if additional activities on which a profit  
12 is not earned are included in the computation in the same  
13 manner as the regulations explicitly recognize with respect  
14 to purchased transportation. Purchased transportation by  
15 common carrier to the customers, to deliver the material to  
16 the customer is specifically excluded. Why, because there  
17 is a reason. It is not reasonable to presume that the miner  
18 earns a profit on the transportation, because the carrier earns  
19 it. Evidence of a tariff demonstrates that. Here, the  
20 facts, the evidence of the bagging premiums and the bagging  
21 costs demonstrate that it is not appropriate to attribute  
22 any further profit to the bagging activity. And so the  
23 Tenth Circuit excluded that from the computation in a similar  
24 manner by its determination that the first marketable product  
25 is cement in bulk. The result of making the proportionate

1 profits method work in the best manner it can, to serve its  
2 purpose, can be accomplished as the Tenth Circuit did or by  
3 finding implicit in the regulatory language flexibility to  
4 make its application a reasonable one, one consistent with  
5 the actual facts. I thank the Court.

6 MR. CHIEF JUSTICE BURGER: Very well. Mr. Smith,  
7 do you have anything further?

8 ORAL REBUTTAL ARGUMENT OF STUART A. SMITH, ESQ.,  
9 ON BEHALF OF THE PETITIONER

10 MR. SMITH: I think that the Respondent's emphasis  
11 on actual facts is belied by the provisions of the regulation  
12 which provide that the Commissioner may determine that a  
13 method of computation is more appropriate than the propor-  
14 tionate profits method or the method being used by the tax-  
15 payer, and that the taxpayer can request such a determination,  
16 of an alternative method.

17 Here, the taxpayer has, because of its integrated  
18 status and the absence of a representative field price, has  
19 invoked the proportionate profits method of computing its  
20 gross income from mining. It hasn't sought to bring any  
21 actual facts to the Commissioner before going into this liti-  
22 gation. The proportionate profits method provides in detail  
23 as in the language I read to the Court about a cement manu-  
24 facturer and we talk about the flexibility of the regulations.  
25 The regulations provide at page 21(a) of our appendix with

1 precise reference to this case, if a cement manufacturer  
2 et cetera, et cetera. There was no room for any flexible  
3 reading, what the Respondent seeks in this case is nothing  
4 less than an invalidation of these regulations which three  
5 Courts of Appeals have approved and which the Court below  
6 stands in sole and persistent invalidation of and there's no  
7 way that one can read these regulations in a flexible way to  
8 take account of what Respondent seeks in this case, which  
9 in our view is nothing less than an expanded depletion  
10 allowance that would include part of its non-mining income.

11           The cost ratio method is indeed an approximation,  
12 but it is an approximation which is designed to take into  
13 account the fact that each dollar of costs produces a pro-  
14 portionate amount of gross sales --

15           QUESTION: Well that in itself is something of a  
16 fiction.

17           MR. SMITH: Well of course it's a fiction, but --

18           QUESTION: Or at least --

19           MR. SMITH: -- it's an approximation which is based  
20 upon the fact that there's no really better way to do it,  
21 and regulations like that, the choice that the Commissioner  
22 makes in areas like technical area like depletion, and in  
23 othe areas of the Code, has been consistently upheld by this  
24 Court and by the Court and basically --

25           QUESTION: Your point is that this taxpayer

1 elected to proceed under --

2 MR. SMITH: Elected the proportionate profits method  
3 and you can't simply elect parts of the proportionate profits  
4 method. Putting a cement -- putting cement in a bag is,  
5 in our view and in the view of the regulations, not processing.  
6 It doesn't alter the character of the cement, the cement  
7 whether it's in a tankcar, or whether it's in a bag, is still  
8 Portland Cement. That was the Respondent's first marketable  
9 product and the gross sales of those things -- if the taxpayer  
10 had sold Portland Cement at a great killing at a very high  
11 price, whether it would still be in gross sales -- in other  
12 words, you know, it may produce some variations or some  
13 distortions, or if the market goes down it would still be in  
14 gross sales. And the fact that, you know, it sought to  
15 satisfy a particular kind of demand of small customers in  
16 the construction industry for 94 pounds, bags of cement,  
17 that was part of its business.

18 QUESTION: Did you say that --

19 MR. SMITH: And if it's part of its business --

20 QUESTION: Did you say for the same reason that  
21 sales expense after bagging is included?

22 MR. SMITH: Sales expense after bagging to get it to  
23 the customer is -- goes into the denominator, exactly.

24 QUESTION: For the same reason, the same reason.

25 MR. SMITH: Exactly, exactly. And for all -- for

1 all those purposes we think think that the judgment should  
2 be reversed. Thank you.

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

5 (Whereupon, at 3:04 o'clock p.m. the above matter  
6 was submitted.)

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6 No. 79-1907

7 COMMISSIONER OF INTERNAL REVENUE,

8 V.

9 PORTLAND CEMENT COMPANY OF UTAH

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11 and that these pages constitute the original transcript of the  
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13 BY: Will J. Wilson  
14 William J. Wilson  
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