OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

IN THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 82-1041

TITLE ESTHER C. DICKMAN, ET AL., Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

PLACE Washington, D. C.

DATE November 1, 1983

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IN THE SUPREME COURT OF THE UNITED STATES

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ESTHER C. DICKMAN, ET AL., :

Petitioners, :

v. : No. 82-1041

COMMISSIONER OF INTERNAL REVENUE, :

Respondent. :

- x

Washington, D.C.

Tuesday, November 1, 1983

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:14 a.m.

APPEARANCES:

FRANK P. RIGGS, Esq., Sun City Center, Florida;
on behalf of Petitioners.

LAWRENCE G. WALLACE, Esq., Washington, D.C.;
on behalf of Respondent.

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C O N T E N T S

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P R O C E E D I N G S

CHIEF JUSTICE BURGER: Mr. Riggs, you may proceed whenever you're ready.

ORAL ARGUMENT OF FRANK P. RIGGS, ESQ.,

ON BEHALF OF PETITIONERS

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

This is a gift tax case, here on a writ of certiorari to the Eleventh Circuit, which reversed a decision for the taxpayers by the United States Tax Court. It involves loans from a father to his son, who worked with him in the family businesses, and from that father to a family-owned corporation.

All loans were non-interest-bearing, and the stated terms of all were repayable on demand, with one exception. A note, while a ten-year note on its face, was determined by the Tax Court as a fact to be repayable on demand.

Therefore, there is only one issue: Are demand loans subject to gift tax on imputed interest? There is no subterfuge involved. The validity of the loans are not challenged by the Respondent. All loans are bona fide and they are what they purport to be.

QUESTION: Would it make any difference in your view if these were term notes, not demand notes?

MR. RIGGS: Yes, Your Honor.

QUESTION: Why?

MR. RIGGS: The major case is Berkman in the United States Tax Court. There they were able to fit into what is now 2512(b). There was an exchange.

As long as the term notes, as in the Berkman and Blackburn cases, were given in exchange, we fit into the exception to the normal definition of gift that's listed by Section 2512(b). I'll come back to that if I may, sir.

QUESTION: Mr. Riggs, when you responded to the Chief's question about term notes, does that imply a term note at no interest?

MR. RIGGS: Yes, Your Honor. I made that assumption.

The son in this case, Lyle Dickman, died in December of 1976. The fater in this case, Paul Dickman -- I'm sorry, the son died in May. The father died in December of 1976, both dying in the same year.

In Lyle's estate, the son's estate, 100 percent of the unpaid balances on the indebtedness at issue here were deducted and that deduction was accepted by the Internal Revenue Service. In Paul's estate, the father's estate, all of the notes at issue here were reported as assets at 100 percent of the unpaid balance,

and that estate tax return was accepted by the Internal Revenue Service.

Our point or our position and what we would like to emphasize here at oral argument can be stated briefly in three points:

One, the Gift Tax Code cannot be reasonably interpreted to include the Respondent's right to use theory. Whis theory that there is a property right to use we submit amounts to no more than the attempt to tax potential income as a gift.

Second, the decision below, if it is upheld, will destroy the reasonable expectations of many taxpayers and will add to an already overburdened judiciary.

Three, if there is a gap in the present law which should be corrected, Congress should act and not the Executive or the Judicial Branches.

QUESTION: Mr. Riggs, were tax lawyers advising their clients that the position you espouse is correct before the Crown case?

MR. RIGGS: Justice O'Connor, I don't know how they were advising their clients. Before Crown, a district court in the Middle District of Texas, if I remember correctly, decided this same issue and decided it in favor of the taxpayer, and the Government did not

appeal that decision. That, before the Crown case, was the only judicial action in the area to my knowledge.

QUESTION: It goes to your second point, about the reasonable expectation of taxpayers, and I wondered whether that is essentially post-Crown decisions effects.

MR. RIGGS: No, ma'am. I really believe that what's at stake here has been common among families as long as there have been families. And a great many of these loans are made with absolutely no tax results in mind at all. That's the reason I was hesitant to respond to you what tax lawyers are doing.

QUESTION: Well, I suppose a great many intra-family loans can be made without tax consequences under the provisions for the annual giving without tax consequences and the cumulative life exemption.

MR. RIGGS: Yes, ma'am. But an awful lot of taxpayers annually make the amount of the annual exclusion as a gift. Then the very next dollar after that either results in a tax or it reduces a one-time lifetime credit.

QUESTION: Do you have to file a return if you make gifts that are within the exclusion?

MR. RIGGS: No, Your Honor.

QUESTION: Now, let me put a hypothetical to

you. Suppose the father, a father, owns a commercial building and the son occupies the commercial building, conducting a business, and he charges no rent. Would the reasonable value of the rent of that property be taxable as a gift in your view?

MR. RIGGS: No, sir, not unless you add something into the Gift Tax Code that has never been there before. Our basic position in regard to the Code, Mr. Chief Justice, is that the 1932 Congress knew what they were doing.

They didn't pass a tax which taxed transfers of property by gift in a vacuum. There already existed a common law of gifts. It was very clear under the common law of gifts that any consideration negated a gift.

In fact, as we cite you to the Zeller case in our reply brief, a loan was the antithesis of a gift. And our position is that the United States Congress knew that. They deliberately took the word "gift" in the taxing phrase that's in 2501 and left it in there. We have, we think, a great many indications that that was deliberate on the part of the United States Congress, that includes many fine lawyers.

QUESTION: Let me carry the hypothetical one step beyond that. Suppose after several years of

allowing the son to use the commercial building rent-free, the father gives him a quitclaim deed. Taxable, the value of the property?

MR. RIGGS: No question about it. There's a transfer of property by gift, the quitclaim deed, yes, Your Honor.

QUESTION: Well, what's the difference in terms of real estate transactions in the law of real estate between a lease which conveys part of the property, the use of the property, and the property itself?

MR. RIGGS: The great difference, Your Honor, is the common law on which the statute is superimposed. A use -- and incidentally, the use doesn't have to be actual under the Government's theory. The mere opportunity is all that's required.

But a use has never been a gift. And our whole point is that the Congress knew how to write this statute. When they used the word "gift" they used it advisedly, because look at Section 2512(b), if you please. There they say that the excess of property conveyed over a consideration received, not is a gift -- the United States Congress knew that a loan was not a gift -- but they said it would be deemed a gift.

That's how the Berkman case came about, Mr.

Chief Justice. The loan in the Berkman case, the term loan, was not a gift, was not a gift as the United States Congress understood. But it fell under 2512(b) and was deemed a gift.

QUESTION: Mr. Riggs, do I correctly understand your argument essentially to be that if Congress had wanted to tax this as a gift it should have said so specifically, expressly?

MR. RIGGS: That's close, Mr. Justice Brennan. I think that the fact that they used the word "gift", that they went on in another area that clearly was not a gift and said this also will be deemed a gift, that they clearly knew what they were doing. There's no question in my mind --

QUESTION: I thought you said among your three -- I gather your third point was that this isn't really any job for either the Court or the Executive, that this is for the Congress to straighten out?

MR. RIGGS: Yes, sirree. Yes, sir.

QUESTION: Well, you know, in preparing for this oral argument I ran across this. I wonder if you'd comment on it.

MR. RIGGS: Certainly.

QUESTION: It's a statement by a very respected authority on federal taxation:

"We have had enough experience with the tax laws to know that Congress cannot do everything and that it is ordinarily a mistake to expect the Congress will formulate precise rules to cover every refinement and detail of human experience so far as its tax results are concerned. Many of the interstices must of necessity be filled in by the courts and by administrative action."

MR. RIGGS: Justice Brennan, I share your appreciation for that authority. I have great respect for him.

That would require, we submit, a little more ambiguity to fall into Dean Griswold's statement. We don't believe the ambiguity is here. We don't question, Justice Brennan, that Congress has the power to tax these uses if it sees fit. But we do submit to you, it clearly didn't see fit.

The experience in Great Britain is a beautiful example of what happens when a legislature wants to tax that far. I think it's very significant that they avoided the use of the word "gift". They passed a capital transfer tax. They knew better.

We submit, though, there's other evidence --

QUESTION: Mr. Riggs, I want to be sure. You're conceding that Congress would have the power to tax this as a gift?

MR. RIGGS: Oh, yes, sir.

QUESTION: Mr. Riggs, back up a minute. You say that a demand note is different from the other note that the Chief Justice --

MR. RIGGS: Yes, Your Honor.

QUESTION: How about an IOU?

MR. RIGGS: Well, I don't understand an IOU, Justice Marshall, to be any more than, without any other facts, than simply an open account loan, which amounts to a non-interest bearing demand loan.

QUESTION: Is there any case on it?

MR. RIGGS: I beg your pardon?

QUESTION: Is there any case on it?

MR. RIGGS: No, sir, I don't know of any of the present litigation that simply referred to the obligation as an IOU. Of course, I believe that a note is nothing but an IOU.

QUESTION: And a note that doesn't have a term specified is due on demand, isn't it?

MR. RIGGS: Yes, Your Honor. Yes, sir. And our whole point is that if your're going to find something is not a gift -- and a loan is not; it's the antithesis of a gift -- then you're going to have to fit under this exchange of property transferred over the consideration received.

But at the moment of that exchange even the Respondent concedes no gift took place. There's an equal exchange.

QUESTION: Let me carry an earlier hypothetical yet a third step. Suppose the father gives the son a 99-year lease on the property. Now, it's still a lease. There's a reversion.

MR. RIGGS: Yes, sir.

QUESTION: Taxable as a gift?

MR. RIGGS: You have now the term. You have, as I understand, no consideration, though. You have a transfer of this term lease, this property, if you will. But without the consideration, you're going tc have to find a gift. You're going to have to find a transfer of property by gift.

I suspect -- I don't know, Mr. Chief Justice, but it may be when you get to 99 years you're so close to fee simple that you have something that can fit into the normal definition of gift.

QUESTION: Let's cut it down to 50 years, then.

MR. RIGGS: I don't know where the line is, Your Honor.

QUESTION: What is the basis for your saying that a lease for a term of years at no rent is not a

gift?

MR. RIGGS: The common law on which the very knowledgeable 1932 Congress superimposed the gift tax, Justice Rehnquist. Under the common law -- we cite the Zeller case to you in our reply brief -- a loan is the antithesis of a gift. A loan simply is not a gift.

QUESTION: And you say that if I own a property in fee simple and give my son or daughter a ten-year lease on it, that that is not a gift?

MR. RIGGS: There's no borrowing involved. I would think that -- quite frankly, I haven't thought of that area. I don't know of any reason that you can't make a transfer of a property interest that would qualify as a gift. But --

QUESTION: Well, that's the whole definition of a gift, isn't it, the transfer of a property interest without any consideration?

MR. RIGGS: The area in which we're in, Justice Rehnquist, is a transfer for consideration. See, that's the problem I'm having with the Justice's question.

QUESTION: But I thought your answer to the Chief Justice's question would have indicated that an execution of a lease by a father to a child of say a very valuable property, commercial property, a lease for

20 years free of any rent, wouldn't be a gift. Maybe I misunderstood.

MR. RIGGS:. No, sir.

QUESTION: Why wouldn't that be a gift of a property interest, as the Justice --

MR. RIGGS: I'm having a tough time, Justice White, Justice Rehnquist, about bringing this into our problem, and that is a loan. I wouldn't be surprised -- I haven't done the research, but I wouldn't be surprised if a gift of a term certain --

QUESTION: But even if it were, you wouldn't think that would govern this case?

MR. RIGGS: Exactly, Your Honor, exactly.

QUESTION: But the Solicitor General has cited a number of cases, has he not, dealing with cases arising out of charitable deductions for contributions to charities, where the right to use property for a given period of time rent-free has been treated as a transfer of property for that purpose? And I think there are a number of authorities in accord with that view, are there not?

MR. RIGGS: In the charitable contributions area, yes.

QUESTION: Yes.

MR. RIGGS: Yes, Your Honor. Of course, the

big difference is, we're talking about another statute entirely. We're talking about a statute that allows a deduction for a contribution to or for the use of. The statute with which we're dealing here defines where there's a gift tax. One place, under 2501, is when there's a gift. Another place, under 2512(b), is where there's an exchange that shall be deemed a gift.

And I apologize to Judge Rehnquist and Justice White. I suspect that if the common law covered leases that your point is well taken, Mr. Chief Justice.

But I have to get back here into this area of a loan.

QUESTION: Well, no analogy necessarily controls a concrete situation. But it's sometimes helpful.

MR. RIGGS: We submit that there's even more indications, Your Honor, that Congress, the 1932 Congress, not only knew what they were doing, but this is a brand new addition into the gift tax. The time elapsing between 1932 and the Internal Revenue Service attack -- the Service has never denied the the statement of the Seventh Circuit in the Crown case that taxation of a use is brand new.

But they're asking you for more than taxation of a use. They're asking you for taxation of an

opportunity to use.

QUESTION: Well, now, would you define how you think the phrase "opportunity to use" is more expansive than the term "use"?

MR. RIGGS: Yes, Justice Rehnquist. I can think of three uses to which borrowed funds may be put: one, investment, earn interest or dividends; another, consume it, pay for an operation or something that you need.

There's a third that I've had a devil of a time getting across, because I guess it's unique to business. But really, funds borrowed and used in a business become at least to a minimum extent as much a fixed asset of the business as a punch press, a tractor, or anything else. You can't run a business without a minimum amount of money that stays in the cycle between receivables, inventory, purchases, accounts payable.

So that's at least three areas in which borrowed funds may be used. Certainly, the imputed interest, the potential income that the Service wants to tax now, is not always there. That's the reason that I say that the opportunity to use is much more expansive.

QUESTION: Well, you say the imputed income isn't always there. But if there is a market interest rate for money at a given time, certainly that would

justify the Service in saying that the value of the use of the money is the going interest rate, wouldn't it?

MR. RIGGS: Yes, sir, and if the Code had taxed that use. However, that's one of the what we call or what I call invisible boomerangs, that I stole from Justice Jackson. The Service position is that you have the normal valuation problems here, that the rate of interest will be determined based on the facts of the case, not on what happens in some general market between major companies and banks.

If that's true, every issue is a new case and you don't even have the protection of collateral estoppel. The credit ratings are not fungible any more than individuals are. So we have that Pandora's box we're looking at.

If I may, I'd like to emphasize a couple more points that give evidence that the statute simply does not include demand loans.

The 1932 committee reports were pretty well identical out of the House Ways and Means Committee and out of the Senate Finance Committee. Both of them used some very broad words that the Respondent likes to quote. But those broad words are followed by some examples of what they meant.

One example is a joint bank account, where A

creates a joint bank account whereby A or B may unilaterally withdraw. Now, if a property right to use were in the thinking of these committees, they would have never held that there is no gift to B until B does withdraw and withdraw for his own use, because once that chose in action is created why isn't there a property right to use created in B?

QUESTION: Was this an account that bore interest?

MR. RIGGS: Sir?

QUESTION: Was this joint account one that bore interest?

MR. RIGGS: In the example, I would assume a demand checking account. But I don't know that it would matter.

There's one more evidence, and I guess the strongest evidence, that the 1932 Code did not include demand loans, and that's the concurring opinion in the case below that we're asking you to reverse. That opinion we submit flat tells you that this Code does not tax demand loans. To quote them exactly, they say taxpayers have "given away no property, no interest, and no rights, but surely they have made a gift."

Our point, Your Honor, is that if you've given away no property, no interest, no rights, under the Code

you have not made a gift and you have not even made, once the exchange is even, you have not even made a deemed gift.

I'm going to save a little bit for rebuttal if there's no further questions.

CHIEF JUSTICE BURGER: Very well.

Mr. Wallace.

ORAL ARGUMENT OF LAWRENCE G. WALLACE, ESQ.

ON BEHALF OF RESPONDENT

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

Let me say a word first in response to some questions that have arisen. The commentary, in response to Justice O'Connor's question, in the journals in response to both the Crown decision and its predecessor district court decision in Johnson -- and we've cited many of these commentaries -- were almost uniformly critical and indicative that well-informed tax lawyers did not believe that the gift tax did not reach demand loans of this kind.

During this early period when interest rates were low, this kind of device in tax planning was not widely encountered. There wasn't litigation on this subject. And the many articles cited -- one amicus brief says there are hundreds of articles since Crown

advocating this device for tax planning -- have arisen since the Crown decision.

This Court in Commissioner against Wemyss, W-e-m-y-s-s, which we have cited in our brief, pointed out that the gift tax law did depart from the common law of what constitutes a gift and instead set up a broad statutory definition.

Perhaps the most obvious way in which it departed from the common law is in Section 2512(b) of the Code, which is cited on pages 2 and 3 of our brief, which says that:

"Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift."

At common law, if there was consideration it wasn't a gift. But the gift tax sets up its own definitions.

In our view, this case presents one of those happy situations in which the correct answer under the statute coincides with the common sense answer. Any person in this courtroom would find it a valuable benefit to be given gratuitously an unrestricted right to use several hundreds of thousands of dollars.

QUESTION: Well, but it applies, your principle applies, to far different situations than that, Mr. Wallace, doesn't it? The example cited by some of the amicus briefs of a parent loaning a child $10,000 to go back to school interest-free, or presumably at even below the market rate, would be a gift in the Government's view.

MR. WALLACE: That is correct, that would be a gift. And the subject of tuition --

QUESTION: So I mean, we're not talking about hundreds of thousands of dollars in tax planning alone. We're talking about some very common transactions that people would have had no thought they were tax planning and no thought that they were making gifts.

QUESTION: Mr. Wallace, responding to Justice Rehnquist, I would appreciate it if you did not confine your response to money. If you are right, it applies also to property.

MR. WALLACE: That is correct.

QUESTION: And when you get into the property area, I'm troubled by where one draws the line. What about a parent lending an automobile? The parents are going abroad for a year. You use the term "a substantial period of time" in your brief. What is a substantial period of time?

Parents or friends lend a summer home or a beach cottage or whatever. Where in the world are you going to draw the line, and when would you know, when would you ascertain what the value of the use of that property is?

It's a Pandora's box, it seems to me. That's why I want you to shed some light on it.

MR. WALLACE: Well, there are many difficult questions under the gift tax law, many of which will remain, however this case is decided. Many of them revolve around the question of what constitutes support for dependents that traditionally has not been subjected to the gift tax, and these questions arise whether what is involved is a loan or the direct payment of a corpus that constitutes support.

The same question arises with respect to a dependent whether you allow that person to have the use of a portion of your residence or whether you supply food and clothing for that individual which is consumed.

And ordinarily, the Congress and the courts and the Commissioner have proceeded on the assumption that when there's a legal obligation to provide support the provision of that support is not a gift subject to the gift tax. What if it goes beyond a legal obligation

to a moral obligation? These are difficult questions.

There is a great difference between providing the ordinary items of clothing, even if they may be provided rather lavishly, and providing a series of diamond bracelets which become a means of transferring wealth from one generation to the next.

QUESTION: Well, how is it theoretically any different?

MR. WALLACE: It has to be looked at in terms of the purpose of the gift tax, which was to supplement the estate tax. And if transfers of wealth are being used in a way that would defeat the applicability of the estate tax or of the income tax, which was also a purpose, then there is more of a problem under the gift tax law than if it's the ordinary kind of consumption of property where the donor could have consumed his estate, obviously, on more frivolous things, but instead he's providing support and tuition benefits for his children, but it's being consumed rather than passed along.

QUESTION: How did the transfers in this case defeat the application of the gift tax -- or of the estate tax?

MR. WALLACE: Of the estate tax. Well, I think this is a fairly graphic example, because what is being transferred here is the ability of wealth to

generate additional wealth. Hundreds of thousands of dollars obviously can be invested to generate additional wealth, and if they were so invested by the donor that additional wealth would be added to the donor's estate.

QUESTION: Well, then it must follow from that that the donor has some sort of a duty to invest, to build up his estate so the Government can get a big tax bite out of it.

MR. WALLACE: That doesn't have to follow, in our view, because our theory of the gift is not that the donor has foregone an accumulation to his estate and that constitutes the gift. The gift is the value of what is given on the market, what you would have to pay for it if it weren't given to you. And the gift here is the right to use that money which the donee has been given.

And it's measured the same way as a gift of stock would be measured. The gift of stock is not measured by the dividends that the donor otherwise may have accumulated in his estate, which is a speculative matter. The value is what the donee would have had to buy the stock for in the market if it hadn't been given to him.

And the same thing is true of the gift here. It's true that the donor might not have made good use of

that money. He may not have even tried to, or he may have been unsuccessful in using it, and the same thing is true of the donee. Whatever income is generated by the gift is a question of income taxation.

But the gift is the right to use the money, and that has its own value, which is what you would have to pay for the right to use that money if it weren't given to you.

QUESTION: Mr. Wallace, how would a taxpayer know when to file a tax return? Consider the hypotheticals that have been mentioned here.

MR. WALLACE: Well, only with good tax advice, the same as --

QUESTION: I'd hate to be his tax lawyer.

QUESTION: No, I'd like to be one.

(Laughter.)

MR. WALLACE: The gifts have to accumulate to a certain sum per person before there is any responsibility to file a gift tax return. And obviously, it is a complex tax matter these days for an estate to be settled when the decedent has had a substantial estate, and that is a time when there's a review of the gift tax history of that taxpayer.

These are complexities that we have under the law that Congress has enacted.

QUESTION: Mr. Wallace, what happens if you give your son $250,000 with a demand note and he keeps it for three years, and then you fall out with him and you tell him, pay up? What about those three years? Was that a gift?

MR. WALLACE: Well, it certainly was a gift in our view.

QUESTION: It was a gift as long as you're a nice boy. But when you became a bad boy it wasn't a gift.

MR. WALLACE: We've never said that the gift is the gift of the principal and that that's the measure of the gift. What the gift was was the right to use that principal for as long as the donor allowed him to use it.

QUESTION: He'd have to pay for the three years.

MR. WALLACE: For the three years.

QUESTION: But not the last year.

MR. WALLACE: For as long as he was allowed the right to use it and to generate whatever income he could from it by whatever means he chose. He might have been unsuccesful and that's another question. But he was given something that other persons did not have and would have to pay for, which was the right to use that

money.

QUESTION: My only point was, if he had been a nice boy he would still -- no gift.

MR. WALLACE: Well, he would still have the same gift. The gift doesn't depend on a termination. We just look at it periodically to evaluate it. The gift is an ongoing gift.

QUESTION: So he gives him this $250,000 every year, under your theory?

MR. WALLACE: He gives it initially, but it's an ongoing gift for as long as he forebears asking for repayment of it.

QUESTION: Not of the principal, just of the reasonable interest, the going rate.

MR. WALLACE: The value of getting the use of that money, the right to use it.

QUESTION: Under the Government's point of view, Mr. Wallace, is there any difference really between -- and I'm now speaking of an adult son, not one who has a claim for support -- between lending $100, we'll say, and lending $100,000, except that IRS has more important things to do than going after gift taxes on the $100 gift?

MR. WALLACE: Well, that's right, and there's a yearly exclusion.

QUESTION: But they could as a matter of principle, from your point of view?

MR. WALLACE: If the rest of the exclusion were consumed with other gifts, they could as a matter of principle say that this is the little bit that put you over the top and there's a gift tax liability for it.

QUESTION: I'm sorry, Mr. Wallace. I don't know whether I heard your answer to Justice Powell's question. When does the taxpayer file a return?

MR. WALLACE: He's required to file a return if he has made gifts during the year that reach the level that is not excluded.

QUESTION: Let me ask you a question based on something of personal experience, perhaps. The place where I spend part of my summers a number of people -- it's kind of a summer colony -- a number of people had originally a cottage, as they call them, near a lake. And as their kids grow and have families of their own, they've built themselves what they call a grannie cottage and turned the main cottage over to one or more kids in the summertime. And they do it summer after summer after summer, so that it's not just a one-shot deal.

I suppose if the value of that cottage that

they turn over to a kid and his family is $1,000 per summer, that sooner or later they're going to have to file a gift tax return?

MR. WALLACE: Well, $1,000 per year is excluded from the gift tax.

QUESTION: But how about -- what's the total you can give to any one?

QUESTION: Mr. Wallace, isn't $10,000 a year excluded per person, and if you're a couple isn't it $20,000 a year that you can give to any child?

MR. WALLACE: That is right, that is right.

QUESTION: So you're talking about big dollars.

MR. WALLACE: We're talking about big dollars before you incur any gift tax liability, unless you have given those big dollars in other ways and this is the amount that would put you over the top. That could happen.

QUESTION: Mr. Wallace, the Service did not seek review in either the Johnson or Crown cases, did it?

MR. WALLACE: Well, we didn't seek review beyond the Court of Appeals level in the Crown case, because we had no conflict in the circuits at that time.

QUESTION: Is that the reason for it?

MR. WALLACE: That is correct. That is our ordinary practice in tax litigation, is to try to develop a conflict in the circuits, although the Crown case was a tempting one because it involved $15 million in interest-free loans.

QUESTION: Well, you finally made it.

MR. WALLACE: We finally -- we developed our conflict in the circuits and we're here.

QUESTION: And there was division both in the Tax Court and in the Court of Appeals.

MR. WALLACE: That is correct, we had dissents in both courts.

But we do find we're inhibited in trying to develop a conflict in the circuits if this Court has denied certiorari on the issue on our petition. So there can be a price to pay for petitioning on the first decision.

QUESTION: Has there been any specific attempt by the Service to get specific legislation on this?

MR. WALLACE: There is recent testimony on the subject which is cited in Petitioner's reply brief. That testimony did specifically indicate that the matter was pending before this Court in the Dickman case for decision on the gift tax question. And we find that

Congress seldom acts before this Court has resolved a pending case.

QUESTION: Mr. Wallace, isn't this a sort of recent learning on the Commissioner's part? For how many years has he taken this position, or how many years was it before he learned about it?

MR. WALLACE: The pertinent revenue ruling was in 1973, although the question was litigated in the Johnson case in 1966. But as we have pointed out, the terms of the regulations adopted both in 1932 and even moreso in 1936 did embrace this kind of situation, even though they didn't refer specifically to loans or demand loans.

QUESTION: But the Commissioner never took any steps in this direction until the sixties, did he?

MR. WALLACE: Not that we're aware of. But during those --

QUESTION: Is that because interest rates were so low that it wasn't worth it to the Commissioner to file or what?

MR. WALLACE: Well, probably so. It's hard to speak authoritatively about this, but interest rates were low. This was not a commonly used and certainly not a trumpeted device of tax planning. There were many other matters to be litigated under the gift tax law, as

the decisions of this Court under the gift tax law indicate.

QUESTION: Mr. Wallace, if your position, if the Commissioner's position, is correct what are the consequences for the Dean income taxability?

MR. WALLACE: Well, we think it's a separate question, although we have explained in our brief why --

QUESTION: Well, will we be back here hearing the Commissioner argue for a different result there?

MR. WALLACE: We have explained in our brief why we think the Dean case and the others that have gone the same way were wrongly decided. But there so many courts have gone against our position that that was really the main topic of the recent testimony before Congress, that they ought to take action because we've been unsuccessful in trying to develop a conflict under the tax laws.

Even though it seems fairly clear to us that when an employer, whether it's a corporation or otherwise, gives an employee an interest-free loan that is a form of compensation which amounts to income for the employee, we've had difficulty getting that position accepted by the courts.

QUESTION: One other question if I may, Mr.

Wallace. Do you think the Commissioner has statutory authority to prescribe certain statutory interest rates in valuing gifts?

MR. WALLACE: I think he does have statutory authority to prescribe at least the method in arriving at the valuation of gifts, including specifying safe harbor rates that would be generally applicable.

QUESTION: And what do you rely on there?

MR. WALLACE: Well, I don't have in the materials before us the provisions of the Code that grant the regulatory authority, but they are in the Internal Revenue Code and they're the same provisions that have authorized the myriad regulations the Commissioner has adopted, including regulations about accounting methods that have to be used in various kinds of business transactions.

There have been different rates specified by the Commissioner in asserting deficiencies in this area, partly reflecting differences in prevailing rates of interest at the time, but also partly reflecting the particular circumstances of the case, because the demand loan varies in its market value depending on the credit status of the borrower.

A borrower who may not be in a good position to relay the demand may have to pay a bank considerably

more for a demand loan if he's likely not to be able to respond promptly to the demand and come across with the principal, than another borrower who is a better credit risk. And these situations vary in the gift tax cases as well.

But we do emphasize the breadth of the statutory language Congress used -- it's set forth on pages 2 and 3 of our brief -- and the comprehensiveness of the 1932 committee reports in adopting that language, referring to the fact that the terms "property", "transfer", "gift", and "directly or indirectly" are used in their broadest and most comprehensive sense, to reach every species of right or interest protected by law and having an exchangeable value.

And the right to use this money for as long as the donor permits is a property right in the sense that it's protected by law. If it's deposited by the donee in an interest-bearing account, he has a legal right against the bank or against any other third party to the use of those funds under the terms of the account, and he has a right to the proceeds even against the donor himself, as well as against all properties. So it is a species of property protected by law.

CHIEF JUSTICE BURGER: We'll resume there at 1:00 o'clock.

(Whereupon, at 12:00 noon the argument in the above-entitled matter was recessed, to reconvene at 1:00 p.m. the same day.)

AFTERNOON SESSION

(1:00 p.m.)

CHIEF JUSTICE BURGER: Mr. Wallace, you have seven minutes remaining.

MR. WALLACE: Thank you, Mr. Chief Justice.

We have set forth the contemporaneous Treasury regulations in our brief, and on page 12 and 13 we have discussed in particular the 1936 regulation which refers to the enjoyment of property which is not itself fully transferred, but the right to enjoy it is transferred and subject to the gift tax, which fits the concept of what we have here even though there was no specific reference to a loan here.

The principal is a loan rather than a gift, but the enjoyment in this case is the right to use that money during the time in which the donor doesn't require the principal to be repaid.

QUESTION: Mr. Wallace, what if, instead of being an interest-free loan in this case, the loan were made at the rate of six percent and the Commissioner felt that the going rate at the time was 14 percent for an unsecured loan. Could he attack that transaction in your view the same way he attacks this one?

MR. WALLACE: He certainly could. Whether or not successfully would depend on whether he could prove

that it came within the statutory criterion of property transferred for less than an adequate and full consideration in money or money's worth. That is the criterion Congress has specified, as set forth in our brief.

QUESTION: Mr. Wallace, as I understand it the dimensions of this problem have been changed with the increased exemption to $10,000 and $20,000.

MR. WALLACE: Well, yes, the applicability has been changed, that is correct. There's exclusion of the value of the gift, but the principal could be much larger.

QUESTION: But the donee would have to receive a very substantial sum of money before we'd have any application of this.

MR. WALLACE: That is correct.

QUESTION: About how much?

MR. WALLACE: Well --

QUESTION: Hundreds of thousands?

MR. WALLACE: It would be many hundreds of thousands.

QUESTION: It would depend on whether he had already exceeded his allowance.

MR. WALLACE: For the year.

QUESTION: Yes.

MR. WALLACE: For the year. If there were other gifts that year, you know, they too add up.

QUESTION: Under your position, in figuring out whether you've exceeded your allowance you have to include these things?

MR. WALLACE: That is correct. And they seem to us squarely to come within the statutory definition and the definitions in the committee reports and in the regulations, and they are obviously a means of transferring wealth to one's intended beneficiaries in a way that would exclude the likelihood of additional estate tax liability, in a way that transfers income tax liability on any further income that's generated from the donor, who is likely to be in a higher income tax bracket, to the donee.

So they come squarely within the purpose, as well as the broad language, of the gift tax law.

And I would like to be sure that the theory of the Government is well understood here, because it has erroneously been argued that we are in some way doubling the taxation of income that's generated. The value of the gift is not the income that is generated by that property.

The way we value and tax the gift is precisely the way we would with a gift of stock, by its market

value, here the market value of the right to use the money. If the stock does in fact generate dividends, that is a separate matter that is taxed under the income tax law. If the donor had retained the stock he would pay income tax on dividends that are generated, and if the stock is given to the donee he pays income tax on any dividends that are generated.

And the same thing is true of any income generated by the use of the money. It in no way duplicates the tax on the gift, which is the transfer of the right to use that money.

QUESTION: If the affluent father should put up $100,000 worth of Government bonds or market value securities to secure the son's loan at a bank, would there be any gift?

MR. WALLACE: There would, in the use of that money, of that security that would otherwise be available, whatever the market --

QUESTION: What's the value of the use of the security?

MR. WALLACE: Whatever it would cost someone to get it if it weren't given to him, the same as the value of any other gift.

QUESTION: Well, how would you measure it?

MR. WALLACE: By what it would cost you to get

someone to put it up for you if you didn't have somecne willing to give it to you. It might -- it would take expert testimony.

QUESTION: How do you measure the value of a demand note the day it's given, where it's just on demand?

MR. WALLACE: Well, we have talked about the method of valuing it. It can only be valued periodically and in retrospect.

QUESTION: But aren't all gifts normally valued at the time the gift is given?

MR. WALLACE: And so is this. But this is an ongoing gift. It's not just a gift that takes place at the one time when it's first given, because the extent of the gift can only be known by how long the donor forebears in asking for it to be returned.

QUESTION: Let me change the hypothetical. Father guarantees the loan at the bank. Any gift?

MR. WALLACE: Probably not in that situation, although it could be argued that there's a market value. There would be a gift, however, if father paid the interest for the loan, which is --

QUESTION: No, I'm just -- I'm limiting this to guaranteeing payment. Until he had to act on that to fulfil the guarantee, there'd be no gift?

MR. WALLACE: There's no property being transferred to the donee in that situation. But as we pointed out in footnote 24 on page 18 of our brief, in that dissent in the Tax Court in the Crown case, Judge Simpson, joined by Judges Romm and Tamm and Wald and Wilbur, did equate this situation with the situation where the donor arranged for a bank to provide the use of these funds to the donee and paid the interest. And it's an economically equivalent situation and there is the same gift under contemplation of the gift tax.

CHIEF JUSTICE BURGER: Mr. Riggs, do you have anything further?

REBUTTAL ARGUMENT OF FRANK P. RIGGS, ESQ.,
ON BEHALF OF PETITIONERS

MR. RIGGS: Thank you, Mr. Chief Justice.

I'm concerned primarily with the big dollars connotation that I have been listening to some here. I would be less than candid with you if I didn't admit that the whole area of estate and gift taxes affects only the relatively affluent. But it seems to me like that the question is, how shall we affect this group of people, by the use of statutes or by new interpretations?

I can only now try to report to you that much of the effect of affirming the decision below. I

believe Justice Powell foresaw it when he asked, how do you know if you made a gift? I would just add, how do you know if you've used your annual exclusion, which seems to have some effect on the feeling in this case?

If you can't know when you've used your annual exclusion, and if you will, one more thing -- two more things: One is, since 1976 we don't have separate gift tax and estate taxes. They're combined. The estate is simply the last gift. But since 1976 and before 1976, all the way back to 1932, if you did not file a 709, a gift tax return, there's no statute of limitations. If this Court allows a brand new concept of gift to come into the taxing picture, there literally is no limit, until you get back of 1932, that this tax can place.

QUESTION: May I ask, Mr. Riggs --

MR. RIGGS: Yes, sir, Justice.

QUESTION: The Chief Justice asked Mr. Wallace about the loan of securities as collateral for the donee's loan. What do you think about that?

MR. RIGGS: Your Honor, I know there's a case that's held exactly that it is not a gift, and I was trying with my co-counsel desperately to find it when it came up, but I cannot recall it. But I do know there's a case in the Tax Court ruling it was not a gift.

QUESTION: Would you take the position that,

say, a taxpayer in a high income bracket could turn over a portfolio of securities to someone else and say, I'm just loaning these to you and you just keep the income, and then when I want them back you give them back tc me, there'd be no gift?

MR. RIGGS: Well, may I add one more thing? Is it returnable on demand?

QUESTION: Returnable on demand, yes. But it's to their tax advantage to have the donee, you know, being in a lower bracket --

MR. RIGGS: Yes, Your Honor. I think, first, Lucas v. Earl would tax the income still to the grantor of the loan. Second, again --

QUESTION: You say the income would be taxable tc the dcnor?

MR. RIGGS: Yes, sir, under the Lucas versus Earl case of this Court many, many years back.

As to whether or not it's a gift, again, I've been concentrating sc hard cn these loans, I would only be speculating, Justice Stevens, and I've learned not to do that already this morning.

QUESTION: Well, what if you turned over $200,000, said, you keep in a savings account. Would the income on the savings account be taxable to the grantor in your view? And if so, why isn't the income

on these loans taxable to the donor?

MR. RIGGS: Yes, sir. Let me layer in some more facts into your question, please. One, if you let me layer in the premise that we have here a genuine demand situation.

QUESTION: Right.

MR. RIGGS: Not a sham, but a genuine demand proposition.

QUESTION: Well, there's no sham in my hypothetical.

MR. RIGGS: Okay, sir.

QUESTION: He's entitled to the money whenever he wants it.

MR. RIGGS: Then the fact of what the grantee does with the funds is irrelevant under the Government's theory. And my answer to you is no, sir, that theory is not sound and it is not in the statute.

The thing that worried me about your hypo is that, if you had a secret agreement that this would be done, that it would be allowed to stay out, then you're into the sham transaction theory, Gregory versus Helvering. And the Government already has that tool to fight the type of sham --

QUESTION: Well, I'm not assuming a sham. I'm assuming it is, you keep it and when I want it back I'll

take it back, and then the son or the corporation says, okay. There's no gift?

MR. RIGGS: No, sir, our position is it is not a gift.

Let me --

QUESTION: Let me take you back to the father's letting the son use a commercial rental property that's worth $48,000 a year, we'll say. The father's income and his taxable base is reduced by that amount if he's not receiving that rent from some independent source, isn't that right?

MR. RIGGS: Yes, sir.

QUESTION: And what about the son? Does he have to pay any income tax on that?

MR. RIGGS: You're getting awfully close to the Clifford case, Your Honor. I don't know, though, of a decision applying the theory of Clifford under income tax rules. But again --

QUESTION: Well, this would be a nice -- this would be an interesting way to have this value, $48,000 a year or whatever, escape taxation altogether.

MR. RIGGS: If it would not be subject to income tax. Our problem here is the gift tax. I'm not that sure -- fact is, in the Crown case it's pretty clear that the Government was arguing that was subject

to income tax as well as gift, and somehow or another I think they settled it, it was indicated in a footnote in Crown.

CHIEF JUSTICE BURGER: Very well. Your time has expired now, Mr. Riggs.

Thank you, gentlemen. The case is submitted.

(Whereupon, at 1:14 p.m., argument in the above-entitled case was submitted.)

* * *

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:

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BY Diane Hammond

(REPORTER)