OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 84-1737

TITLE UNITED STATES, Petitioner V. AMERICAN COLLEGE OF PHYSICIANS

PLACE Washington, D. C.

DATE January 21, 1986

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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, :

Petitioner :

v. : No. 84-1737

AMERICAN COLLEGE OF :

PHYSICIANS :

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Washington, D.C.

Tuesday, January 21, 1986

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:51 a.m.

APPEARANCES:

ALBERT G. LAUBER, JR., ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.

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C O N T E N T S

P R O C E E D I N G S

CHIEF JUSTICE BURGER: Mr. Lauber, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF ALBERT G. LAUBER, JR., ESQ.

ON BEHALF OF THE PETITIONER

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

The question here involves the taxability of profits derived by an otherwise tax-exempt professional association from the publication of commercial advertising in its monthly journal. The subset of the tax world that we're in here is the unrelated business income for UBI tax, which Congress enacted in 1950.

Congress was spurred to enact that tax by the now-notorious acquisition by New York University of the Mueller Macaroni Company. NYU had managed to convince a federal court of appeals that its spaghetti profits should be immune from tax, on the theory that those profits were destined to fund NYU's educational activities.

Congress enacted the UBI tax in 1950 to insure that henceforth charities would pay tax on their profits from such unrelated business ventures. Congress's main objective in doing that was to prevent unfair competition, that is, to prevent a tax-exempt group that

runs a business from getting a competitive advantage in the form of a tax subsidy over its taxpaying competitors in the marketplace.

QUESTION: Which competitors are you -- give me an example.

MR. LAUBER: Well, for Mueller, it was Ronzoni. Here it's all the McGraw-Hill, all the other taxpaying publishers that publish medical journals and pay tax on their profits.

QUESTION: But they are profit-making entities, are they not?

MR. LAUBER: Well, they all make profits. All the publishers of medical journals. Some of the tax-exempt --

QUESTION: Is the American College of Physicans a non-profit-making institution?

MR. LAUBER: It is a non-profit making organization. It's an educational organization under Section 501.

QUESTION: Does that distinguish them from Harpers Magazine and a lot of others?

MR. LAUBER: Well, it does, but not for purposes of this particular tax because an otherwise tax-exempt charity, if it runs a business that's unrelated to its charitable purposes, has to pay tax on

the profits only from that business, not from the dues and so forth, but the profits from that advertising business.

QUESTION: I take it your earlier point was that Congress did not want to subsidize nonprofit organizations in competing against for-profit organizations in a business?

MR. LAUBER: Exactly right. Exactly right.

QUESTION: Now, however, the American College of Physicians has been around a long time, hasn't it?

MR. LAUBER: A lot of them have. AMA's been around since 1848, I think.

QUESTION: Well, I'm not sure, but I think this one might even precede that. And, well -- okay.

MR. LAUBER: It's a new tax on an old organization, put it that way. For this tax to apply, there'd have to be three conditions met. There must be a trade or business. It must be regularly carried on, and the conduct of a trade or business must be unrelated to the accomplishment of the tax exempt purposes of the organization.

Now, the American College here has conceded that its publication of commercial advertising is a trade or business, and that it is regularly carried on by it. The only question, therefore, is whether this advertising

business is substantially related to the accomplishment of the respondent's educational purposes.

Respondent contends that it is related, on the theory that the ads it publishes help to educate the doctors who read the magazine. This contention is based on the fact that respondent does not publish general consumer advertising for things like Mercedes Benzes and margarine; rather, they advertise only products that are of professional interest to the doctors who read its magazine.

These products are mainly prescription drugs, but also include non-prescription drugs like Tylenol and aspirin, medical products like support socks, and classified or help wanted advertisements for doctors in search of employment.

The question is whether the publication of these advertisements is an educational activity. In our view, the answer to this question is clearly provided by regulations promulgated by Treasury in 1967 to deal with this varied commercial advertising problem.

Example 7 to those regulations describes a professional association like respondent, that puts out a monthly professional journal. Like respondent, that organization also avoids general consumer advertising and limits its ads to products of professional interest to

its members in their professional capacity.

Nevertheless, Example 7 of the regulations concludes that the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the tax exemption statute.

Example 7 reasons that such commercial advertising is fundamentally different from an educational activity, both in its governing objective because it aims not to teach but to sell merchandise, and also in its method because its method is the usual method of Madison Avenue which is designed to put the reader in a frame of mind where he wants to buy or to prescribe the advertised product.

QUESTION: Mr. Lauber, do you take the position that commercial advertising can never under any circumstance whatever be substantially related to or contribute importantly to a tax exempt organization within the meaning of the statute?

MR. LAUBER: Our position is that the test is that in the regulation, advertising designed and selected in the manner --

QUESTION: So, do you think the regulations can amend the statute?

MR. LAUBER: Well, the regulations --

QUESTION: Because what I think you are arguing for is an absolutely per se rule which could never be varied, notwithstanding the fact that the statute as far as language is not so phrased?

MR. LAUBER: Well, the regulation was explicitly approved by Congress in 1969.

QUESTION: Well, but Congress didn't change the statute. It never changed the language that says that -- that speaks in terms of "substantially related," or "contribute importantly to the purposes of the tax exempt organizations," so I just wonder whether it's quite fair to say there has to be a blanket per se rule and the statute could never be applied as it's written?

MR. LAUBER: Well, as mentioned in our brief, Jutice O'Connor, there are, one can imagine, examples of what might be called advertisement being deemed related. For example, the IRS has ruled that a company simply list its name with a bunch of other corporate patrons for charitable endeavor on a page in the magazine. That would not be commercial advertising because nothing's being advertised.

Similarly, one can imagine, say, if there's been a favorable laboratory write-up by a scholar of a particular drug, and if the drug company were to have that reprinted in its entirety as it originally was in

another magazine, that could be related, but the regulation says that advertising designed and selected in the manner of ordinary commercial advertising is not educational, and we think that is a species of a per se rule.

There can be other kinds of advertising outside that are not designed and selected in that manner. Judge Kozinsky, for example, hypothesized a couple of ways a group might be able to run its advertising business differently, where it had much more input into the editing and arrangement of the ads.

Conceivably, that might work but if it's designed --

QUESTION: Well, is the critical factor in your view that if the advertising message is simply an accident of the marketplace, that under these regulations it's taxable?

MR. LAUBER: That's a very good point. That is our position, and what respondent seized upon here is this highly technical advertising designed for a highly technical audience, but that is simply a creature of the marketplace.

This is drug advertising which is designed to hit a particular market, and the market is symmetrical with the people who read this magazine, so it is really a

function of the marketplace, that the advertising here takes the technical form that it does.

QUESTION: While I have you interrupted, let me ask you one more question. Do you think the issue of whether something is substantially related to the organization's purpose is a question of fact or a question of law?

MR. LAUBER: Well, normally it is a question of fact, and for the vast universe of tax-exempt groups that run -- arguably run businesses like museums, shops and so forth, it is a factual increase. However, in the particular case of advertising we have a regulation which speaks directly to that, which has given us a narrower question to ask, and the narrower question the regulation prescribes is whether or not the advertising is designed and selected in the manner of ordinary commercial advertising.

It's a refinement of the general factual test, which is simply -- reduces the universe of facts you need to look at to come up with the correct answer, and Congress expressly approved this regulation in 1969.

QUESTION: Mr. Lauber, let me follow through on Justice O'Connor's first question. There is outstanding still a revenue ruling having to do with bar association journals. I think that's Rev. Rule 82, 139, in which the

tax authorities made an allocation between substantially related income and income that wasn't substantially related.

How does that square with your pressing for an absolute ruling?

MR. LAUBER: Well, I think, Justice Blackmun, in the case of the ABA Journal, I think -- well, the bar journals, the allocation is based on divvying up the income between the editorial content which is furnished through subscriptions and dues, and the advertising.

I think all the advertising in the ABA Journal is unrelated business income because they advertise things like computers and trips to Bermuda and that kind of thing. It's clearly unrelated. So, the allocation the ruling speaks of is allocating expenses as between the cost of publishing the editorial matter and the cost incident to the advertising. You have to allocate between those two streams of income.

QUESTION: Well, at issue there, in part anyway, were legal notices in the revenue ruling I'm speaking of.

MR. LAUBER: I think those would be classified just like the ones in the annals, where doctors seeking employment or people seeking to employ doctors, and we contend that those also are not related to the

educational purposes.

QUESTION: That's against the Revenue ruling, and what I'm leading up to is that if you should prevail here on your general thesis, shouldn't we just remand for determination of which is properly allocable to, as substantially related income and that which is not?

MR. LAUBER: Justice Blackmun, I'm not sure of the kind of legal notices that are referred to in that '82 Revenue ruling. It's possible that some legal notices could be exempt from tax on the ground that they're done for the convenience of members.

QUESTION: Well, the Revenue ruling held flatly, ruled flatly that they were exempt from tax.

MR. LAUBER: Well, I think in any event, the legal notices are distinguishable from commercial advertising. I mean, one might say that notices of employment are not commercial advertising because there's no product being advertised, but the best bulk of advertising we have here is commercial advertising for medical products and that is exactly what the regulation speaks to.

As I noted before, this is not a new controversy. Congress explicitly considered this regulation in 1969. Both Houses of Congress held hearings upon it. They heard testimony from many

tax-exempt publishers and from many tax-paying publishers, including respondent and many other tax-exempt and tax-paying medical journals.

After listening for several days to the same arguments respondent and amici are making here, Congress specifically endorsed regulations. The House report stated that the regulations mainly affected the advertising income of publications such as medical journals.

QUESTION: Well, now is this the House report that a company -- some substitute of legislation?

MR. LAUBER: What happened, Justice Rehnquist, is the regulations came out in '67, and there were moves made on the floor to either stop them or to defer their effective date in 1968, and those moves were unsuccessful on the promise that hearings would be held the following year to address this issue in full. And the hearings were commenced in '69 in the House, and the House announced at the beginning of the hearings that the purpose was to decide whether or not advertising should be unrelated to trade or business.

Now, I think the House bill that Mills introduced actually came in after the hearings had begun, but the whole issue had been served up by the Congress the previous year and the hearings had been scheduled, to

respond to attempts to revoke these regulations in bills introduced during the previous year.

QUESTION: Well, how much stronger do you think the Government's position is in view of these hearings and reports than it would be if you simply had to justify the '67 regs on the basis of the statutes as they then stood?

MR. LAUBER: Well, I think we're a little bit stronger. I mean, the regulations are presumptively valid in any event. We have the usual deference to the Commissioners' discretion in promulgating Treasury regulations.

But, I think when Congress has held a week of hearings on them and looked at them in detail and endorsed them explicitly in their reports, it gives an added oomph to the regulations. It shows that Congress did not think they were inconsistent with the statute that Congress had enacted.

Now, it's true, Congress only codified a portion of the regulations respecting fragmentation of a journal into advertising and editorial content. It did not codify the example which speaks about advertising not being related activity, but if they'd approved that part of the regulations in the course of enacting the other thing, so although Congress has not codified the whole

regulation, it has approved the entire regulation.

And, we think that adds to the deference that should be shown to the Commissioners' construction. In short, what Congress said is that, your Committee wants to make clear that such regulations are valid, so we think that this case really presents a very narrow question in view of this regulation which Congress has endorsed, and that is whether respondent's ads were designed and selected in the manner of ordinary commercial advertising.

The Claims Court found as a fact that they were. The Claims Court found that Example 7 closely resembled the situation here. It found that respondent's advertising was typical commercial publicity. It found that many of respondent's ads are identical to those appearing in medical journals published by non-exempt organizations.

It found that any differences between respondent's ads and tax-paying Journal ads reflected the advertiser's marketing strategy rather than their probable importance to the reader. The Claims Court found that respondent's advertising business was operated in material respects like the advertising business of any other publication. Those companies willing to pay for space got it. Others did not.

The Claims Court found that respondent's rates were competitive with those charged by taxpaying medical journals. It found that any educational function of respondent's ads was incidental to their purpose of raising revenue. It found that many of the products advertised, products like Valium, Tylenol. Darvon, Robitussin, insulin, aspirin and support hosiery were for established products and the ads were repeated from month to month following the normal commercial practice.

In short, the factual findings of the Claims Court make clear that respondent's ads, like those in Example 7, were designed and selected in the manner of ordinary commercial advertising. That means, under the regulation, that the publication of those ads can't be educational activity and therefore the ad revenues are subject to tax.

And respondent's main argument in response to all this is that the regulation doesn't apply to it. Respondent notes that in Example 7, the professional association that publishes the journal there is said to be tax-exempt under Section 501-C-6 which provides a tax exemption for business leagues and trade associations.

Respondent, although it is also a professional association, is organized instead as an educational organization under Section 501-C-3. Respondent therefore

argues that Example 7's principles should only apply to groups, to publishers who are tax-exempt under 501-C-6 and not to any other tax-exempt publishers.

As we explain in more detail in our brief, this argument is wrong for at least three principal reasons. First of all, the IRS has always interpreted the principles of Example 7 to apply to tax exempt publishers across the board. There are rulings which explicitly apply to Example 7, to a 501-C-3 group, and this Court has held that the Commissioners' construction of its own regulation is entitled to deference.

QUESTION: Mr. Lauber, I suppose there are instances where the same ad is published in the Annals and in the New England Journal of Medicine, which is a 501-C-6 organization, is that --

MR. LAUBER: Exactly right, Justice Blackmun. There are literally dozens of occasions when it happens every month.

QUESTION: In which case, I suppose you're suggesting that there is a slight element of inconsistency in the result?

MR. LAUBER: I think that's exacty right, because respondent's argument would mean that the same ad run in the AMA Journal on the same day would be subject to tax because AMA is exempt under 501-C-6, but the ad in

respondent's journal appearing the same day would be tax exempt because it's under 501-C-3.

That does not make a whole lot of sense, because it would make the tax elective. As explained in our brief, although there are differences between 501-C-6 and C-3 groups at the margins, in the case of groups like respondent, that is, a professional association drawing its members from one profession, having very broad charitable, educational goals, they have basically an option of being organized either under 501-C-3 or under 501-C-6.

The main practical difference is that 501-C-6 groups can lobby in Congress and C-3 groups cannot, and that's one reason why they picked one rather than the other. And the fact that this option is available is made clear from the amicus briefs filed in this case, the AMA and the Mass Medical Society, both of which are medical associations that have the same purposes, educational purposes as respondent, but both organized under 501-C-6.

And, we think it would make no sense to construe the regulation to apply to one group of publishers and not the other because that would mean that essentially a 501-C-6 group could avoid this tax in its entirety by setting up a charitable affiliate and have it

do the publishing, and Congress could not have meant that the tax could be avoided so easily because that would simply perpetuate the problem of unfair competition between taxpaying and tax-exempt publishers of medical and other specialized journals.

If there are no more questions, I think I've had enough.

QUESTION: I'm not sure I got all through. Would you just repeat for me the three reasons why you say their 501-C-6 argument is invalid. I know you've covered them, but I'm not sure I have them identified.

MR. LAUBER: Well, the first one was that the Commissioner has always interpreted Example 7 to apply to all tax-exempt groups.

QUESTION: With respect to that, had he done any of that before Congress reviewed Example 7?

MR. LAUBER: Indeed he had, at the Treasury, took the position on the bill that it would apply to tax-exempt groups across the board, although witnesses who testified before Congress, which included respondent, respondent said in hearings that this regulation would apply to it.

Now, they retracted that concession, but that's what they said at the time. All the witnesses took the view that Example 7 applied to everybody, would result in

the taxation of their commercial advertising profits.

QUESTION: And what are your other two --

MR. LAUBER: The other two, the second one is that the -- the third I made, in response to Justice Blackmun's question, that it would produce an absurd result.

QUESTION: Not only with the AMA but --

MR. LAUBER: The second one is that the reasoning of the example is what we're relying upon, and the reasoning of the example is that the publication of commercial advertising, advertising designed and selected in the manner of ordinary commercial advertising, is not educational.

Now, that logical conclusion applies to the matter of what the source of the publisher's exemption is. I mean, it's either educational or it's not. It doesn't matter what form you file with the IRS to get exempt, really, and the reasoning of the example is extrapolatable to all kinds of tax exempt publishers.

CHIEF JUSTICE BURGER: Mr. Huffaker.

ORAL ARGUMENT OF JOHN B. HUFFAKER, ESQ.

ON BEHALF OF THE RESPONDENT

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

The way this case started, the question was

whether income from the advertisements in the scholarly journal of the American College of Physicians, organized for charitable purposes, is subject to the unrelated business income tax where the advertisement relates solely to the practice of internal medicine, are uniquely informative and are indisputably shown to contribute importantly to its exempt function.

In this Court the question is narrower. In this Court the government is arguing that the College is precluded by a conclusive presumption with no foundation in the Code, the regulations or the legislative history from showing as a factual matter that its advertising activity contributes importantly to the exempt function.

The Court of Appeals heard this as a factual case. Now, in determining it we have a certain amount of confusion because of the name of the taxpayer, American College of Physicians, as Justice Blackmun understood, is quite old.

The more modern term is internist, and you will find that in the literature they are used interchangeably. Now, an internist is a medical doctor who treats the bodily ailments without surgery, largely, frequently, by the use of drugs.

Now, when we look to the Code we see that the key relationship in the statute is, does the activity

contribute importantly to the exempt function.

QUESTION: You take the position, Mr. Huffaker, if I may inquire, that that is purely a factual question?

MR. HUFFAKER: Yes, Justice.

QUESTION: And in the Court of Claims it was determined as a matter of fact that it does not contribute importantly?

MR. HUFFAKER: We find -- we argued that Judge Kozinsky made a very fundamental error of fact and he was overruled by the Court of Claims as clearly erroneous on that ground, but Judge Kozinsky decided a fact question and he was reversed on a fact question.

QUESTION: Well, the Court of Claims decided the case contrary to your position today, and the Court of Appeals for the Federal Circuit reversed, did it not?

MR. HUFFAKER: That's correct.

QUESTION: And did they find the findings were clearly erroneous?

MR. HUFFAKER: That's correct. May I explain why they were clearly erroneous, and why the statement of the petitioner about the nature of the advertising is misleading. The benefit is not incidental.

The charitable organization that we're concerned with here is organized for the promotion of health care by internists. It conducts a broad range of

programs for the advancement of health care, some going to the concerns of training of internists, others to helping the continuing education of the internists so that they can better deliver patient care.

Dr. Moser, the Executive Director testified, the primary function of the College is medical education of internists with the ultimate bottom-line hope that this will provide better patient care through the efforts of these internists.

The Exempt Organization Handbook of the IRS recognizes that the promotion of health care is one of the classic functions of a charitable organization. It's not new. It's one of the most classic types of charitable organizations.

Now, the Annals is the chief publication that goes to the problem of -- or function of delivering health care. The Annals has two parts, the scholarly articles which push forward the boundaries of medical knowledge. But then it has the advertising activity, and the advertising activity fulfills a very real function.

The advertising activity serves to -- remember it's about 80 percent of drugs, 80 percent pharmaceuticals. The others comprise the other -- but they're all related to the practice of internal medicine.

QUESTION: Well, I suppose if the only ads run

are those of medical economics, you're in a position to be a little more --

MR. HUFFAKER: My position would be, impossible, Your Honor. It is the ads on the drugs that advance, that can give the physician the knowledge he needs. Remember, the physician, when the patient comes in, it is the duty of the doctor to evaluate his ailment. After evaluating his ailment he prescribes.

I think it was very, very well said by the Fifth Circuit in Reyes versus Wyeth Laboratories which we cite, as a medical expert the prescribing physician can take into account the propensities of the drug as well as the susceptibilities of his patient. His is the task of weighing the benefits of any medication against its potential dangers. The choice he makes is an informed one, an individualized medical judgment, bottomed on a knowledge of both patient and palliative.

QUESTION: One is tempted to ask why you charge for the ads.

MR. HUFFAKER: If no charge was made for the ads, or put it more realistically, if the ads were merely self-supporting or no charge was made, I think -- the College has limited resources. The profit that is made from running the ads helps support these other programs that are all in the public interest but which are not

self-supporting.

The fact that the charge is there doesn't detract from the fact that these ads are giving the internist the essential knowledge that he needs to prescribe. Now, he's not going to read an ad --

QUESTION: But he charges for that too, doesn't he?

MR. HUFFAKER: Yes, sir.

QUESTION: I have great difficulty -- I can conceive of your organization being educational and I know this is water over the dam, but I've always had trouble finding out how it becomes charitable. That comes out every time I get a bill from the doctor.

MR. HUFFAKER: The organization is -- maybe the bill is a little smaller if he gets to the root of the evil a little quicker, and maybe you feel better a little quicker for the fact that he is treating you and being well informed rather than a little bit behind.

The ads serve three purposes.

QUESTION: Well, what's wrong with him taking a portion of my bill and paying for the ad? You're not going to say he doesn't have the money.

MR. HUFFAKER: He pays for his subscription to the magazine, either through dues or subscription. The magazine is not handed out free.

It's the College that's the exempt organization, not the doctor.

QUESTION: He doesn't really pay. The patient pays. I know there are very few doctors in business for their health.

MR. HUFFAKER: They're in business for your health.

QUESTION: I don't know. That's my problem. Is it my health or my money? That's my problem.

MR. HUFFAKER: The prescribing physician is the learned intermediary between the manufacturer and the consumer. Now, the advertisements come in and we have four distinguished witnesses, the executive director, the former executive director, the dean of the medical school at the University of North Carolina, the professor of pharmacology, University of Rochester Medical School, all testified that the advertisements perform a vital function in keeping the internist up to date.

The internist is uniquely dependent upon these ads. They tell him not only about the new drugs, they tell him about the old drugs, what new bad things they can do or new good things that they can do.

They remind him of things that he might have forgotten. Now, we have one ad that --

QUESTION: Now, doesn't he get all that from

the pharmacy house's detail men that are at his door constantly?

MR. HUFFAKER: This is not the only source, but I suggest it is a much more efficient way to keep up, and also that if he saw every detail man that came around, his time for practicing medicine would have disappeared completely.

QUESTION: That's true. Mr. Huffaker, let me ask, the College has its own building in Philadelphia, does it not?

MR. HUFFAKER: Yes, sir.

QUESTION: With a very extensive medical library?

MR. HUFFAKER: Yes, sir.

QUESTION: It has been there a long time?

MR. HUFFAKER: About 60, 70 years. We had one ad that got into our brief in opposition to cert, sort of typical. We put it in here because the government had put in its brief the first part of the ad that was to get attention, but the government left out the rest of the ad that tells about what the drug in question does.

Now, the Commissioner of the FDA has written, has stated that the entire ad is subject to FDA approval for overall impact, that these are the most stringently regulated ads in all of commerce, there's the requirement

that they give equal attention to the problems with the drug, as to what the favorable aspects.

QUESTION: Mr. Huffaker, are you basically -- your argument is still describing a publication that would meet Example 7, I think. I appreciate the fact that it's incorporated under a different section of the Code, but are you taking the position that your publication does or does not fit Example 7 insofar as the content of the publication is concerned?

MR. HUFFAKER: We think there are two reasons why Example 7 has no application in this --

QUESTION: That's not my question. My question is, if it does have application, just assume -- I know you argued to the contrary, would your publication be of the same character as the publication described in the example?

MR. HUFFAKER: No, it wouldn't, and the reason it doesn't is that we don't think the advertising that is in the Annals, the advertising of the drugs so carefully regulated, so fully provided pre-publication censorship, if you please, by FDA, that that's ordinary commercial advertising.

QUESTION: Well, wouldn't these products be subject to the same controls if they're published in non-medical publications? Say, the same product -- this

is the ad you called our attention to, say was published in the New York Times. Wouldn't it still have to meet the FDA standards?

MR. HUFFAKER: If it -- the FDA prohibits this type of advertising. There's a moratorium on advertising of prescription drugs in general circulation magazines, and the reason is that they're so susceptible to misunderstanding, they are so incredibly technical, the average --

QUESTION: Yes, but all your advertising isn't of that kind. Support hose, for example, I notice they make a big point of.

MR. HUFFAKER: Well, they are making a big point of things, out of the two or three percent that the average lawyer can comprehend. Most of it, remember, 80 percent of the ads in round numbers, they agree that it's largely but we count about 80 percent, is prescription drugs.

So, the real case here, the basic activity, is the advertising of prescription drugs. Now, a few of these others --

QUESTION: Yes, but using the language of Example 7, they are therefore products which are within the general area of professional interest of the members of the organization, is that right?

MR. HUFFAKER: That's what that says, and remember, they go on to something else.

QUESTION: Isn't that true of your publication's advertising? All of it is within the general area of professional interest of the members?

MR. HUFFAKER: Well, it is much more narrow than that. It's much narrower than -- our advertising, our advertising, our advertising goes to the -- not just the broad area of professional interest. It is specific down -- surely it is of interest to the profession but it is so defined as to make a major contribution to the exempt function.

Now, when Congress came in, let me go back to a point, there's a certain tension between Example 7 and the general rule in the regulations. The incidental -- the regulation says that there's an incidental benefit, that whatever educational value it is, is incidental.

Well, I think the point was made to the Justice a while ago, why wouldn't you publish them for free if it was necessary. I respond, basically it's not necessary. But we come back, the benefit here is not just incidental. The problem, the benefit is that it contributes substantially to making the internist -- making it possible for the internist to better deliver medical care.

Now, so we have one distinction with Example 7, which is whether it relates to the sort, the narrow type of drug advertising we have here. The second, which is extremely important, in spite of what petitioner says, it describes the organization there as a business league, a C-6 organization.

He pretends that there's no essential difference, but this Court has visited this question before, in the Better Business Bureau case 40 years ago. This Court said, there is a clear demarcation for income tax purposes between a C-6 organization which is formed to advance the business interest of its members and a C-3 organization which is designed to serve the public interest.

Professor Bitger, article co-authored by Professor Bitger in the Yale Law Review, distinguishes them by saying that the C-3 is a public benefit organization. The C-6 is, among other groups, a mutual benefit organization.

In National Muffler the Court by Justice Blackmun examined it and said, the exempt function of the C-6 is to advance the common business interest of the members. In this instance the advertising, when it reaches Dr. Jones and serves to alert him when he is trying to prescribe for Mr. Smith, it serves to alert him

to a possible palliative that he might not have known about, might have forgotten. It tends to serve the exempt function by making him more effective.

That's a very vital function, and remember, the tax isn't on every business that's conducted by a charitable organization. It's on an unrelated business. We hear the words "unfair competition," but as the Court remarked in a Louisiana Credit Association case, the draftsmen avoided that word like the plague.

The statute says that if it's unrelated it's taxable, but if it's substantially related to the conduct of the exempt function, it is related. It is exempt. It is not taxable.

In the 1969 Act, Congress did another balancing act. Professor Kaplan in his article in Columbia Law Review points out clearly that the UBIT has no consistent economic underpinning. It's a bunch of political compromises.

The hearing, the announcement of the hearing, was that should all advertising income be taxed. Congress didn't say that advertising activity shall be an unrelated trade or business. We have the two exceptions that we know about that petitioner admitted to, and the third one that Justice Blackmun pointed out.

When Congress came out they said advertising in

a journal will be measured as a separate activity, and the question is, does that activity contribute to the exempt function. Not many advertising activities will meet this standard, but when the House report came out at 26 it says, we have taken this action and under it the tax -- the advertising activity may -- may be taxable.

Thet word "may" fairly has a connotation of "may not." Now, the report goes ahead to say, well, ordinarily, generally, we anticipate that the advertising income will be taxable. I quite agree. It's unusual advertising activity that rises to the dignity of contributing importantly to the exempt function.

But in this Court the petitioner is arguing that we should be precluded by a rule of law, conclusive presumption, from showing that our advertising activity does so contribute. The fact case was tried below. They pretend surprise, being upset by a change. They shouldn't have been.

In the first American College case which was tried before the fragmentation rule came into the statute, we had motions, cross motions for summary judgment in the Court of Claims. Our first position was, fragmentation was not valid. The Journal was conceded to contribute the exempt function. QED, we win. The Court held for us.

But there was a second line, that if they held fragmentation was valid, there was a question of fact. And Chief Justice Kallon, in his -- in the opinion of the Court, states that, we don't get to this issue but it is an essentially factual dispute. Essentially factual dispute is light years away from a conclusive presumption that you're wrong. An essentially factual dispute fairly says that we have the opportunity to prove that our activity did contribute to the exempt function.

QUESTION: Mr. Huffaker, I'm a little puzzled. Maybe you answered this to Justice O'Connor earlier, but do you think that Judge Kozinsky applied a rule of law that deprived you of an opportunity to --

MR. HUFFAKER: No. He did not apply a rule of law. Judge Kozinsky looked at the facts and he over -- he completely overlooked the contribution that this -- the information, the essential nature of the information conveyed in the Annals, the advertising activity in the Annals, to the readers in the practice of their profession.

He treated that as incidental. I think the testimony of record at a hearing before witnesses, the record clearly shows and unanimously satisfied the Court of Appeals that this activity contributed importantly. It was tried in the trial court as a factual case. It

was argued in the Court of Appeals as a fact case.

We never argued that the regulations were invalid. We never get there. A C-6 is so wildly different from a C-3. Now, when a case comes up involving a C-6 there will be an opportunity to decide the vitality of Example 7.

Judge Smith didn't comment on it in his opinion, and it's no wonder.

QUESTION: But the government says that the Commissioner has applied regulation not only to the class for which it was drafted, but to the class you're in, and that is entitled to some deference.

MR. HUFFAKER: The brief of the Commissioner doesn't cite any of those that I can recall. When we went through it to find out where -- the one that we find was issued in December 1983, which is pretty recent, and that was technical advice issued to the American Academy for the Advancement of Science which is cited in their amicus brief.

We see no clearly established administrative policy of applying Example 7 to C-3 organizations. We see nothing to foreclose us from the factual burden that we carried. We had a challenge. We had a challenge, and we met it. The Court of Appeals found we met it.

Now, it's interesting that the government in

its brief at pages 3, 8 and 9, the Court of Appeals, conceded that this was a factual case. It's only now and in this Court that they say that everything we were doing about proving our case was irrelevant.

There were no motions for summary judgment in the trial court. There's this concession in the Court of Appeals that it's a fact case. Now they want to say that there's a rule of law. They find that rule of law in the oddest place. It's buried under another name, C-6, which has a very different exempt purpose.

Now, they make much of the fact that an association can be C-3 or can be C-6. A C-3 is organized and operated exclusively for charitable purposes. One substantial non-charitable purpose and you're not a C-3.

National Muffler, taxation with representation, or all cases, Better Business Bureau -- not National Muffler, Better Business Bureau, are cases in which organizations somewhat like C-3's wanted to be treated like C-3's. The Court denied it.

The government has asked this Court to rewrite the statute, to rewrite its own regulations, to find a test that simply isn't there. We have a facts and circumstances test. We met it.

QUESTION: Mr. Huffaker, did the government rely on Example 7 in the Federal Court of Appeals?

MR. HUFFAKER: Yes, sir.

QUESTION: And that court never really discussed it, did they?

MR. HUFFAKER: I think we argued and pointed out that it was a third cousin of the issue, and third cousins don't have to be invited to the table.

QUESTION: They don't even have to explain to them why they're not invited, I guess?

MR. HUFFAKER: They just leave them out.

QUESTION: Yes.

MR. HUFFAKER: If there are no further questions --

QUESTION: Well, what if we think it's a first cousin? What are we supposed to do?

MR. HUFFAKER: If it's a first --

QUESTION: Suppose that we think it's very much at issue here, Example 7, and that the C-3 organization is close enough to a C-6 that it has great relevance.

MR. HUFFAKER: A C-3 organization simply isn't that close to a C-6, in the first place. The purpose is different.

QUESTION: Well, if we disagree with you, you lose, it's that --

MR. HUFFAKER: Well, not on that, because secondly -- the second issue is whether the advertising

is the sort of advertising described in Example 7. We say there are two important distinctions.

The first one is obvious on the face. The second one becomes obvious after you examine the material and the background, the whole background in which the medical advertising of drugs exists.

If there are no further questions, I thank the Court.

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

MR. LAUBER: A few brief points, Mr. Chief Justice.

ORAL ARGUMENT OF ALBERT G. LAUBER, JR., ESQ.

ON BEHALF OF THE RESPONDENT -- REBUTTAL

MR. LAUBER: I'd like first to address the question, whether this is a factual case or a legal case. The Claims Court made a number of basic findings of fact. Those findings included a finding that any informational function the ads served was incidental to their purpose of raising revenue, and that the advertising was typical commercial publicity.

The Claims Court them cited Example 7 of the regulations and found that controlling because the example says that advertising designed and selected in the manner of ordinary commercial advertising is not

educational and because the Claims Court found as a fact that respondent's ads were typical commercial publicity, it ruled against respondent.

Now, the Court of Appeals, the Federal Circuit accepted all the basic findings of fact of the Claims Court. What the Court of Appeals did was disagree with the legal standards, the standard of commerciality that the Claims Court had applied from the regulation.

QUESTION: It's hard to know what the Court did really, because it said it found the findings clearly erroneous.

MR. LAUBER: It does make it quite confusing. They threw the word in, "clearly erroneous," kind of at the end of the opinion, but they also said that the commercial character of the activities should not be determinative and that the Claims Court had been distracted by the commercial character of the ads and erroneously evaluated them under a more rigorous standard than is supplied by the statute.

So, it looks like what the Federal Circuit was doing sub silencio was rejecting this commerciality standard Example 7 proposes, without mentioning Example 7. Then it threw in "clearly erroneous" at the end for good measure. It was not a great piece of craftsmanship, I grant you that.

QUESTION: Is the argument you're making here the same that you made before?

MR. LAUBER: In every court below. In every court, we argue that Example 7 is controlling and the findings of the Claims Court -- the only relevant facts, we said, for trial are, is this commercial publicity. And those are the facts that were demonstrated and found by the Claims Court.

QUESTION: And if it is -- it's just not open, to show that it's substantially related?

MR. LAUBER: Exactly right, Justice White, because this is the battle that was waged before Congress in 1969. The argument respondent has given you today is what they argued to Congress in '69. Congress rejected that --

QUESTION: And your claim below was that there should -- that that kind of an issue just wasn't open?

MR. LAUBER: It's no longer open. Congress had a chance to do respondent's bidding and disapprove the regulation. Far from doing that, it specifically endorsed the regulation in both Houses of Congress, noting that the regulation mainly applied to --

QUESTION: And did Judge Kozinsky agree with you?

MR. LAUBER: He did. He found the regulation

-- quoted the regulation and ruled in our favor.

QUESTION: And that there was no issue about -- could be no issue about substantial relationship?

MR. LAUBER: As long as it was typical commercial publicity, and he pointed out that it was. And we said, we might be able to design the ads differently.

QUESTION: What did CA Fed. say?

MR. LAUBER: It said that he had evaluated the evidence under an erroneous legal standard by focusing too much on the similarity of respondent's ads to ordinary commercial advertising.

QUESTION: So, did the Court -- the Court jut disagreed that this was commercial advertising, or not?

MR. LAUBER: Well, I think it agreed that it was, because it accepted as findings of fact --

QUESTION: That it was, but it was what, substantially related?

MR. LAUBER: Because it was educational.

QUESTION: And hence, importantly related?

MR. LAUBER: Right, but the Court ignored the regulation that we think governs the case. It says that it's not educational if it's commercial. That's the problem, and the Claims -- the Federal Circuit never even mentioned the regulation we argued was controlling to it.

And the point is that Congress has resolved this controversy in favor of the people who urge that not taxing this publishing activity, this advertising activity, would lead to unfair competition.

Thank you.

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

(Whereupon, at 11:44 o'clock a.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

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

#84-1737 - UNITED STATES, Petitioner V. AMERICAN COLLEGE OF PHYSICIANS

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BY Paul A. Richardson

(REPORTER)