

# OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

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WASHINGTON, D.C. 20540

DKT/CASE NO. 85-554

TITLE UNITED STATES, Petitioner V. HUGHES PROPERTIES, INC.

PLACE Washington, D. C.

DATE April 23, 1986

PAGES 1 thru 54



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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, :  
Petitioner :  
v. : No. 85-554  
HUGHES PROPERTIES, INC. :  
- - - - -x

Washington, D.C.  
Wednesday, April 23, 1986

The above-entitled matter came on for oral  
argument before the Supreme Court of the United States  
at 12:58 o'clock p.m.

APPEARANCES:

ALBERT G. LAUBER, JR., ESQ., Deputy Solicitor  
General; on behalf of Petitioner.  
O. CLAYTON LILIENSTERN, ESQ., Houston, Texas;  
on behalf of Respondent.

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C C N T E N T S

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on behalf of Respondent.	





1 years. And, the meaning of the test is what governs the  
2 time of taking accrued deductions by taxpayers, previous  
3 accrual, accrual basis.

4 I don't think Justice Stone intended it to  
5 have that quality, but it has been seized upon and  
6 elaborated by the Court itself in later years. And the  
7 way the all events test helps to serve the objectives of  
8 tax accounting is to protect the fiscal -- to help  
9 achieve equality of treatment for taxpayers by insisting  
10 upon a high degree of certainty before deductions are  
11 permitted for tax purposes.

12 The relevance test has two elements. It  
13 requires that an item of expense be taken as a tax  
14 deduction, be accrued for the taxable year in which all  
15 the events have occurred that create on the part of the  
16 taxpayer a fixed and unconditional obligation to pay the  
17 expense, and secondly, which permit the amount of that  
18 payment to be determined with reasonable accuracy.

19 This case involves the proper application of  
20 the first component of the test, that is, the  
21 requirement that the taxpayer have at the end of the  
22 year a fixed obligation to make a payment. The taxpayer  
23 here is a Nevada gambling casino that operates, on the  
24 casino floor, gambling devices called progressive slot  
25 machines.

1           A progressive slot machine is like an ordinary  
2 slot machine except that it has, besides its usual  
3 jackpot, an additional progressive jackpot whose amount  
4 is shown on a little meter on the face of the machine,  
5 and every time somebody plays the machine and loses, the  
6 meter goes up and it keeps on going up until somebody  
7 actually wins the jackpot.

8           In order to win a jackpot the player must  
9 gamble the required amount of money, which is the case  
10 of a multiple coin machine is the maximum amount that  
11 can be gambled. And, he must pull the handle and come  
12 up with the winning combination of symbols.

13           The odds of winning a progressive jackpot are  
14 determined by the casino. By adjusting the number of  
15 wheels on the machine, the number of symbols on each  
16 wheel, the number of winning symbols, the casino can  
17 determine the odds of winning the jackpot, and based on  
18 the expected frequency of the machine's play, it can  
19 predict a projected payoff date of any particular  
20 progressive jackpot.

21           QUESTION: Mr. Lauber, can I interrupt you?  
22 Does this case just concern progressive jackpots? Why  
23 wouldn't it also concern regular jackpots, if you had a  
24 fixed amount that would be payable, predictably within --

25           MR. LAUBER: My understanding is that the

1 regular jackpots tend to be in smaller amounts and are  
2 won much more frequently, and I don't believe the Nevada  
3 Gaming Commission regulates regular jackpots, only  
4 progressive jackpots.

5 So, respondents don't have the argument  
6 available to them here, that the Commission's  
7 regulations give them a fixed liability --

8 QUESTION: The regular jackpots, they just do  
9 that on a cash basis, then, presumably?

10 MR. LAUBER: I couldn't be sure of that. The  
11 projected payoff date for these jackpots can range from  
12 several months down the road to several years down the  
13 road. The money corresponding to the jackpots does not  
14 sit physically in the machine.

15 The casinos typically collect the coins out of  
16 the machine a couple of times a week. They are free to  
17 use that money and to earn income upon it, as they see  
18 fit, until a jackpot is actually won. When a jackpot is  
19 won, the winner typically will go and seek payment from  
20 the cashier's cage at the casino.

21 QUESTION: You demonstrate great familiarity,  
22 Mr. Lauber.

23 MR. LAUBER: Well, I have read the record. I  
24 can't claim this is firsthand knowledge, but this is  
25 what is told to me by the record.

1 QUESTION: I'm told that they bring it to you  
2 and pay you at the window, not at the cashier's window  
3 but right at the machine.

4 MR. LAUBER: Oh, did they come back and --

5 QUESTION: So that everybody can see you and  
6 they can take pictures.

7 [Laughter.]

8 MR. LAUBER: Now you know who --

9 QUESTION: That is what I am told.

10 [Laughter.]

11 MR. LAUBER: But it doesn't actually come out  
12 of the machine. It comes over from a human being.

13 There is no dispute here that progressive  
14 jackpots intrinsically are the kind of expense that  
15 qualify for deduction as a proper expense of running a  
16 gambling business. The only question here concerns the  
17 proper time for taking the deduction.

18 And the question is really one of timing. It  
19 is an important question because of the time value of  
20 money, both from government and the taxpayers' point of  
21 view.

22 We contend that the proper year for conducting  
23 a progressive jackpot is a year in which the jackpot is  
24 actually won by the customer. Respondent argues that  
25 the actual winning of the jackpot is irrelevant, and



1       that its liability for the jackpots becomes established  
2       the minute the machine is placed on the gambling floor  
3       to begin with.

4                QUESTION: Mr. Lauber, how does the Internal  
5       Revenue Service treat funds that are set aside by  
6       insurance companies out of premiums to pay off potential  
7       expected claims, and is there some correlation between  
8       the rules for that and the rules applicable here?

9                MR. LAUBER: Well, there is a lot to say about  
10       that. The Revenue Code treats insurance companies in a  
11       unique manner. There's a whole subchapter of the Code,  
12       Subchapter L, that just governs insurance companies, and  
13       Congress allows insurance companies alone of all  
14       taxpayers to claim current deductions for additions to  
15       reserves they establish to pay off life insurance and  
16       disability claims.

17               So, they are allowed to deduct these reserves  
18       anticipatorily through a particular congressional  
19       statute that covers just insurance companies. Ordinary  
20       taxpayers may equally be motivated to establish reserves  
21       on their books, but they can't deduct them because  
22       they're not allowed to by the Revenue Code.

23               There are some reserves, like bad debt  
24       reserves, that Congress has authorized, but generally  
25       speaking reserves are reserved for life insurance

1 companies and casualty insurance companies.

2 QUESTION: Is there any other broad category  
3 of business deductions that would potentially be  
4 affected by a decision here on the application of the  
5 all events test?

6 MR. LAUBER: Well, that could depend on how  
7 the decision was written. This is an issue, as I  
8 mentioned to Justice Rehnquist, that's been around for a  
9 great number of years and there have been an awful lot  
10 of Court of Appeals cases that have construed the old  
11 events test as applied to accruals for Workmen's  
12 Compensation liabilities, tort claims, all kinds of  
13 things.

14 And the principle of what you need to have in  
15 fixed obligations to make a payment is very important in  
16 the tax law generally, and all these other obligations  
17 could be affected by it. Now, Congress has amended the  
18 tax laws in 1984 to take care of some of those problems,  
19 Workmen's Compensation and the like, but generally  
20 speaking the old events test remains the basic judicial  
21 test that Congress has modified in some ways the years  
22 after '84. So, the Court's decision would affect  
23 virtually all deductions claimed by accrual basis  
24 taxpayers.

25 Respondents' argument is that they should be

1 allowed to accrue as a deduction for any year the net  
2 increase in the amounts shown on those jackpot meters  
3 for the year, as of midnight on the last day of their  
4 tax year. That argument is based on the theory that  
5 it's very likely that somebody will eventually win the  
6 jackpot due to the laws of averages, and that when  
7 somebody does win the jackpot the amount they win will  
8 be at least as big as the amount on the year-end meter  
9 because Nevada regulations prohibit casinos from turning  
10 those meters back down to a lesser amount.

11 In analyzing this case we start from the  
12 premise that the type of liability presupposed by the  
13 all events test is not some kind of inchoate or abstract  
14 liability, but the obligation to make a payment. This  
15 is what distinguishes the accrual method of accounting  
16 from the cash method.

17 Under the cash method an item is deductible  
18 when the taxpayer actually pays the expense. Under the  
19 accrual method, it is deductible when he incurs the  
20 obligation.

21 QUESTION: Let me ask just one other  
22 preliminary question. Would you not agree, and I know  
23 you would suggest it's not dispositive, but that sound  
24 accounting practices normally, for example, for  
25 disclosure for SEC purposes and the like would require

1 setting up reserves for this kind of contingent  
2 liability?

3 MR. LAUBER: We agree with that. In fact the  
4 accountants for the respondent required that a reserve  
5 be set up for these contingent liabilities at the end of  
6 the year, and they found that was consistent with  
7 generally accepted accounting principles, but this Court  
8 has often held, most recently in Thor Power Tool  
9 Company, and earlier in Triple-A, that the fact that a  
10 deduction, an accrual is proper for financial accounting  
11 purposes, is not dispositive for tax purposes because of  
12 very different objectives that the two accounting  
13 systems have.

14 In this case we think it is clear that  
15 respondent at the close of its tax year had incurred no  
16 obligation to pay the progressive jackpots to anyone.  
17 Indeed, there is no one in the world who could at that  
18 moment assert any possible claim to those funds.

19 QUESTION: Why should the identity of the  
20 eventual payee matter, as long as it's certain there  
21 will be a payee? What difference does it make that you  
22 don't know specifically who, as long as you know someone  
23 will be getting it?

24 MR. LAUBER: Well, I would agree with the  
25 premise that the ultimate identity of the payee is not



1 important. But we think what precludes the deduction  
2 here is that nobody has won the jackpot. It's not that  
3 someone has won and we don't know who. We --

4 QUESTION: No, but you know that someone will,  
5 under the Nevada gaming regulations --

6 MR. LAUBER: There is a probability that every  
7 time somebody pulls the machine programmed to pay off at  
8 one in 10,000, he has a one in 10,000 chance of  
9 winning. That is true indefinitely into the future. It  
10 is only half years and probability --

11 QUESTION: Well, Congress has made the very  
12 same kind of a determination in its treatment for  
13 insurance reserves. There's a probability that we'll  
14 all die someday and they're going to let you set aside a  
15 certain portion of the premium.

16 Now, why isn't this essentially equivalent to  
17 that?

18 MR. LAUBER: Well, I would agree it is quite  
19 similar in economic terms, but from a tax point of view  
20 they're very different because Congress has authorized  
21 insurance companies to set up these reserves for very  
22 sound reasons.

23 Congress has not authorized taxpayers to set  
24 up their own reserves for contingent liabilities based  
25 on mere probability of occurrence of these future

1 events. And that principle goes back to Justice  
2 Brandeis's opinion in Brown v. Helvering where the  
3 taxpayer was an insurance commission agent and he  
4 received insurance commissions.

5 And, he showed to the Court there was a great  
6 probability that he would have to refund large portions  
7 of those premiums in later years because of  
8 cancellations of the policies. He showed that policies  
9 were always cancelled, every year.

10 The Court denied deduction for that reserve,  
11 pointing out the tax law requires not probabilities but  
12 certainties.

13 QUESTION: Supposing, Mr. Lauber, that in this  
14 case it was demonstrated beyond peradventure, so to  
15 speak, on the basis of past performance how many people  
16 come in, what the machines are set for, but there was  
17 going to be a payoff, a certain number of payoffs on  
18 this jackpot within a given year. Would your case be  
19 much different?

20 MR. LAUBER: I think it wouldn't really matter  
21 if the probability were based on the laws of averages,  
22 and the odds of winning, on past experience. In either  
23 event our position would be that a mere projection that  
24 he likely will incur a liability is not sufficient to  
25 justify tax deduction.

1 QUESTION: Supposing just hypothetically that  
2 the Government, surely mistakenly in your view, had  
3 stipulated in the trial court that it was certain that  
4 this thing would happen within the year. Would you feel  
5 that you couldn't argue the same grounds then that you  
6 are arguing now?

7 MR. LAUBER: It certainly would happen within  
8 the next succeeding year?

9 QUESTION: Yes.

10 MR. LAUBER: We would take the same position,  
11 Your Honor.

12 QUESTION: What happens if you don't have a  
13 jackpot for two and a half years and then you close it  
14 up and throw that machine out?

15 MR. LAUBER: I think, Justice Marshall, that  
16 although the rules of the Commission, Gaming Commission,  
17 don't speak to this, there is a policy that they can't  
18 just retire a machine from service willy-nilly. They  
19 have to transfer --

20 QUESTION: What if it burns down?

21 MR. LAUBER: Then they're off the hook, if it  
22 is stipulated --

23 QUESTION: Then they don't pay any taxes at  
24 all?

25 MR. LAUBER: Well, if they had deducted that

1     amount in the year one, when they shut the casino down  
2     they might have to recognize income under the tax  
3     benefit rule when they got relieved of the obligation.  
4     But you're right, you're absolutely right that they  
5     would be relieved of the obligation, that they're  
6     waiting for bankruptcy, that they've stopped being a  
7     gambling casino, people have stopped playing the slot  
8     machines, they would be off the hook. And that --

9             QUESTION: Mr. Lauber, it seems to me that the  
10     possibility that a corporation or a business will go out  
11     of business or go bankrupt or have a disaster is always  
12     present for any accrual based taxpayer, and that  
13     shouldn't defeat the accrual deduction. It just strikes  
14     me as very extreme position to argue.

15            MR. LAUBER: That isn't our position. Our  
16     position is, what precludes a deduction is not the fact  
17     that they have a liability now, which might be -- they  
18     might be divested of if they go out into bankruptcy or  
19     go out of business, or lose their license.

20            Our position is, they can't deduct it because  
21     they have no present liability to make a payment. It's  
22     not that they have a liability that they might get out  
23     of. Their obligation is to pay a jackpot, and they have  
24     no obligation to pay a jackpot until somebody wins the  
25     jackpot.



1           So, it's the fact that nobody -- at the end of  
2 the year nobody could claim those jackpot funds. They  
3 have not parted with anything. And we think that all  
4 the Nevada regulatory scheme requires is that, in a  
5 casino, keep the machines in play indefinitely without  
6 reducing the meter so that future patrons will have the  
7 opportunity to win a jackpot.

8           But, the Commission's regulations don't  
9 require them to pay a jackpot until somebody wins the  
10 jackpot. It is that winning of the jackpot which  
11 creates the liability to make a payment.

12           Until then, all the casino has is an inchoate  
13 obligation to keep the machines in play on the floor,  
14 pending people's future play and possible future winning  
15 of the jackpot. But, that obligation keeps --

16           QUESTION: As I understand it, they don't even  
17 have that obligation because they could decide to go out  
18 of business.

19           MR. LAUBER: That's right. That would be  
20 another contingency that could relieve them. But we're  
21 not relying on that mere possibility of going bankrupt.

22           QUESTION: Well, I'm not suggesting -- or even  
23 bankrupt. Well, are there other cases where -- well,  
24 let's take the bankruptcy for a minute, where a business  
25 would go bankrupt and have -- of course, if it had a

1 liability, recognized in the bankruptcy proceeding and  
2 have to be paid off, which would not be true here, that  
3 are there situations where a bankruptcy would -- you  
4 could satisfy the test even though at the time of  
5 bankruptcy there would be no liability at all, which is  
6 what I understand to be the case here.

7 MR. LAUBER: I don't think so, and that's a  
8 very good point. That's right.

9 Our position is not that they might go  
10 bankrupt, but if they did go bankrupt no one could even  
11 come into bankruptcy court and assert a claim for these  
12 items. The items would not escheat to the State. They  
13 would go right back to the casino, the part of the  
14 bankruptcy estate. They would not go to the State of  
15 Nevada.

16 And we think that's right. Since no one can  
17 make a claim for these funds in any tribunal at the end  
18 of the year, that shows there is no present obligation.

19 To put it simply, we think an obligation  
20 presupposes an obligor and an obligee. But, there is no  
21 obligee at the end of the year.

22 QUESTION: It seemed to me that the issue --  
23 and I don't know that the case is answered, is whether  
24 the liability is unconditional if it can be avoided by  
25 going out of business. And, it would be avoided here by

1       going out of business, as I understand.

2               MR. LAUBER: It would be. That's right.

3       That's another way of phrasing the issue, but you get  
4       into trouble because you don't want to argue that the  
5       possibility of going out of business prevents an  
6       accrual, because then no one could ever accrue anything.

7               QUESTION: It wouldn't prevent an accrual if  
8       you had a liability?

9               MR. LAUBER: Right. And we think, in fact,  
10       that the going out of business example is kind of  
11       evidentiary, that there is no year end liability,  
12       because if it did go out of business they would be off  
13       the hook.

14              QUESTION: We don't have any real possibility  
15       of casinos going out of business or going bankrupt.

16              MR. LAUBER: Well, they could go bankrupt and  
17       they can lose their license.

18              QUESTION: When last did you hear of one?

19              MR. LAUBER: I don't think they go bankrupt,  
20       but they do lose their licenses sometimes because --

21              QUESTION: I suppose somebody could burn the  
22       place down. That's happened to more than one place.

23              MR. LAUBER: But the point about the  
24       Commission's regulations, the regulatory scheme  
25       respondent relies on, is that they don't require a

1       jackpot to be paid until the jackpot is won.

2               Here is might be useful to compare what life  
3       was like in casinos before 1972 when this rule about not  
4       turning meters back was promulgated. Before that time,  
5       respondents seemed to agree that they had merely a  
6       contingent liability that they could not deduct for tax  
7       purposes.

8               They are resting their case entirely on the  
9       '72 rule saying they can't turn the meters back.

10              QUESTION: That's right.

11              MR. LAUBER: But in our view, that rule saying  
12       you can't turn the meters back doesn't have any effect  
13       at all on the contingent nature of that liability. The  
14       liability remains before and after that rule was issued  
15       in '72 to pay a jackpot if and only if the jackpot is  
16       won.

17              All that rule about, turn the meters back,  
18       goes to -- is the amount of the liability. It enables  
19       the casino to estimate the minimum amount of its  
20       contingent liability because it knows it can't turn the  
21       meter back from the amount shown at midnight on the last  
22       day of the tax year. Which means, if it ever does incur  
23       the liability, it will be in at least that minimum  
24       amount. That rule does not affect the contingent nature  
25       of the pre-existing obligation the casino had to pay the



1       jackpot if and only if somebody wins.

2               We think a good way of analyzing these  
3       progressive jackpots is that they are prizes offered to  
4       the public to induce people to gamble on the slot  
5       machines. The Gaming Commission's rules basically  
6       require the casino to keep that offer open  
7       indefinitely. It required that it make an irrevocable  
8       offer of a prize.

9               But, they don't require the casino to actually  
10       pay the prize until somebody wins it, so while the  
11       casino has an irrevocable offer, that offer is still --  
12       its liability on the offer is still contingent until  
13       some lucky patron in effect accepts the offer by  
14       satisfying the preconditions for payment, which is to  
15       gamble a required amount of money and to come up with  
16       the winning combination of symbols on the slot machine.  
17       It has to be both the offer and the acceptance of the  
18       offer before you have an obligation to make a payment,  
19       and that's what the tax law requires.

20               We think it would be quite a different case if  
21       the Nevada gaming authorities required a casino to pay  
22       an amount corresponding to the year-end jackpot totals  
23       to an escrow agent, or to a trustee, to be held for the  
24       benefit of future jackpot winners. In that event it  
25       would be an obligation to make a payment to an

1 independent party who would hold the money for the  
2 beneficiaries, ultimate winners of the jackpots, with  
3 the money never being able to revert back to the casino.

4 It would also be very different if respondent,  
5 to insure its obligations on the jackpots, were to pay  
6 -- take out insurance policies covering its contingent  
7 liability on the jackpots and paid a premium to an  
8 insurance company. They could deduct that premium. If  
9 they took out a bond to cover their obligation, they  
10 could deduct their bonding fee paid to the third party.

11 What they can't deduct is a reserve they set  
12 up on their own books. They still have the money, still  
13 earn income on the money, on the mere theory they may  
14 ultimately have to pay that money to somebody else.  
15 They haven't externalized their obligation. They've  
16 kept it completely within-house.

17 QUESTION: In that Code case though, that this  
18 thing arose from, where the American Code -- where the  
19 question was the First World War tax liability, now they  
20 said you could accrue that.

21 MR. LAUBER: I think that was the Anderson  
22 case.

23 QUESTION: Anderson, yes.

24 MR. LAUBER: That's --

25 QUESTION: You have the Anderson case. They

1 said you could accrue that, and these people certainly  
2 haven't transferred anything on their books, I don't  
3 think.

4 MR. LAUBER: Well, what the Anderson court  
5 held is that -- there was a munitions tax which was  
6 payable on the manufacturing and sale of munitions  
7 during the year. And what the court held there was  
8 because the manufacturer had by definition finished  
9 manufacturing and selling munitions for the year, at  
10 midnight on the last day of the year, all the events  
11 required to give it an obligation to pay the tax had  
12 arisen by the end of the year.

13 The mere fact the tax was actually paid in  
14 April the following year, the court held was not  
15 relevant.

16 QUESTION: Then it must be that the transfer  
17 of money on your books -- or from your books to  
18 somewhere else, is not one of the events?

19 MR. LAUBER: That's absolutely right. Under  
20 the cash basis the actual transfer of money is the  
21 crucial thing, you have to actually make payment.

22 QUESTION: But for accrual taxpayers, it  
23 surely doesn't make any difference that the taxpayer has  
24 the use of the money in the meantime?

25 MR. LAUBER: But they must have incurred an

1 obligation to pay the money to somebody else. That is  
2 the key thing. But what must -- all of the events must  
3 have occurred to give you an obligation to make the  
4 payment.

5 QUESTION: But then, why would your example  
6 about the escrow make it all that much different?

7 MR. LAUBER: Because there it would be an  
8 obligation to make a payment to an escrow agent or to a  
9 trustee who would hold the money, never come back to  
10 you, is gone irrevocably, to hold the money and  
11 distribute it to the ultimate jackpot winners years down  
12 the road. That would be an externalization, would have  
13 incurred the obligation to pay that money to an  
14 independent third party.

15 That, we think, is the key thing that you have  
16 to have for an accrual for tax purposes.

17 QUESTION: May I just ask a rather simplistic  
18 question, and probably never get a simplistic answer.  
19 Let's assume a taxpayer who agreed at the end of the  
20 year that it owed me \$1,000, and then assume further, I  
21 just disappeared somewhere and he never had a chance to  
22 pay me.

23 Would that liability have accrued?

24 MR. LAUBER: If the taxpayer had signed a  
25 contract obligating himself --



1 QUESTION: Let's say it's a contract  
2 obligation.

3 MR. LAUBER: It would be proper to accrue the  
4 liability, and if you vanished and he never had to pay  
5 it, he would then have income in later years.

6 QUESTION: What would be the tax  
7 consequences? Would the taxes be paid on the basis of  
8 the year in which that liability accrued, or would it be  
9 paid in some future speculative year on the assumption  
10 that maybe I'd disappeared for --

11 MR. LAUBER: No, it would be in the year it  
12 happened. For example, if somebody performed work for  
13 you and you agreed to pay that, the painter or the  
14 plumber, and you didn't pay them during the year but you  
15 are obligated to them, you are an accrual basis  
16 taxpayer. Even if the plumber vanished and never got  
17 paid, you would get a deduction for a proper accrual in  
18 the year you incurred the obligation to pay him.

19 QUESTION: Where would I get the deduction?  
20 When would the taxpayer get the deduction?

21 MR. LAUBER: The year in which you incurred  
22 the obligation to pay --

23 QUESTION: But is there any question about the  
24 fact that the obligation had accrued by the end of the  
25 year, in this case?

1 MR. LAUBER: We think it has not, because the  
2 obligation issue is the obligation to make a payment of  
3 a jackpot and nobody has any claim to a jackpot until  
4 they win it.

5 I mean, your example, Justice Powell, the  
6 painter paints your house, he has a claim to payment  
7 because he painted your house. Here, no one has any  
8 claim to this money until they win the jackpot. That's  
9 the crucial difference.

10 QUESTION: But so far as the casino is  
11 concerned, it owes that money to whoever identifies  
12 himself or herself as --

13 MR. LAUBER: It owes the money to somebody who  
14 succeeds in winning the jackpot. If people stop playing  
15 the machines the next day, it doesn't owe a penny to  
16 anyone. What if people just gave up gambling, some kind  
17 of new amendment that made gambling unconstitutional,  
18 they'd never owe the money to anyone.

19 QUESTION: I sort of like my example of  
20 disappearing. Normally, of course, you take a deduction  
21 the same year you have the income. In other words, you  
22 charge your expenses against the income.

23 MR. LAUBER: That is what is a normal rule for  
24 financial accounting.

25 QUESTION: How does the government benefit

1 from your position?

2 MR. LAUBER: Well, where we benefit is that  
3 the deduction that they wish to have is deferred until  
4 they pay the jackpot, maybe three or four years away,  
5 and because the deduction today is worth more for the  
6 tax period than a deduction five years from now.

7 QUESTION: So, the government gets the use of  
8 the money until --

9 MR. LAUBER: Exactly right. That's always the  
10 issue in all events tax cases, because -- which is  
11 always a proper time for taking deductions. So, all  
12 these cases always involve the time value of money.

13 That's why you're going to get deductions in  
14 year one, you want to have deductions in year ten.

15 QUESTION: But if in a future year the  
16 taxpayer has no money, it loses the benefit of the  
17 liability?

18 MR. LAUBER: I'm sorry, I missed that question.

19 QUESTION: Some year an individual will come  
20 along and pull a jackpot. Then that year happened to be  
21 a year in which the casino lost money.

22 MR. LAUBER: It would have --

23 QUESTION: It wouldn't have any income to  
24 charge it off against.

25 MR. LAUBER: I think with the -- it could have

1 a loss that year which you could then carry back ten  
2 years and carry forward. You must remember that casinos  
3 have dozens and dozens of these machines on the floor  
4 and they all tend -- some are paying off this year, some  
5 are paying off next year, and they result in a fairly  
6 constant flow of income and expense to the casino.

7 It's not like they have a cataclysmic event in  
8 one year that destroys them. There are always other  
9 machines that are not paying off at that time. So, the  
10 likelihood of a casino having to pay a jackpot and not  
11 being able to get a tax benefit from it is extremely  
12 unlikely, because they can carry forward and back their  
13 tax losses.

14 We think that what respondent's position boils  
15 down to is the argument that they have a probability of  
16 incurring a liability in the future to pay these  
17 jackpots. That should be sufficient to justify a  
18 deduction for tax purposes.

19 But this Court has rejected that argument  
20 repeatedly over a 50-year period. Brown versus  
21 Helvering, as I mentioned before, the taxpayer argued  
22 there was a probability it would have to make refunds of  
23 a certain portion of the insurance premiums, but the  
24 Court rejected that argument.

25 CHIEF JUSTICE BURGER: Mr. Lilienstern.

1 ORAL ARGUMENT OF O. CLAYTON LILIENSTERN

2 ON BEHALF OF THE RESPONDENT

3 MR. LILIENSTERN: Mr. Chief Justice, and may  
4 it please the Court:

5 There is one additional requirement which is  
6 necessary in order for us to accrue the deduction which  
7 we seek to accrue in this case, and that is that, quite  
8 apart from the all events test, the accrual must result  
9 in a clear reflection of income.

10 That relates, we believe, to some of the  
11 questions that were asked about the period of time  
12 between the accrual and the payoff. The record of the  
13 case indicates that that period of time was four and a  
14 half months.

15 We're saying this because there are other  
16 cases, generally from the lower courts, in which the  
17 period of time between the accrual and the payoff could  
18 be perhaps as much as 20 years. Those cases, we  
19 suggest, don't deal with the notion of the all events  
20 test, which is what we are talking about here today.  
21 They deal with the concept of the clear reflection of  
22 income.

23 QUESTION: What kind of transactions would  
24 these 20-year deferrals be?

25 MR. LILIENSTERN: I beg your pardon?



1 QUESTION: What kind of transactions would  
2 these --

3 MR. LILIENSTERN: Well, one example, there's a  
4 McCney Aircraft case in which an aircraft manufacturer  
5 gave a bond at the time it sold a plane which was to  
6 mature at the time the plane was retired from service.  
7 The estimate was that the average life of these aircraft  
8 would be 20 to 30 years.

9 The Court, in the Mooney Aircraft case, the  
10 Fifth Circuit, held the all events test is satisfied  
11 because there is an irrevocable obligation in the year  
12 the bond was given, but under Section 446(b) of the  
13 Code, there was no clear reflection of income.

14 QUESTION: That isn't a very common  
15 transaction, is it?

16 MR. LILIENSTERN: No, Your Honor. It is not  
17 common. That is not common. As a matter of fact, in  
18 our case here the government -- neither the government,  
19 nor have any of the lower courts suggested that our  
20 transaction, the way we accrue it, given the period of  
21 time between payoffs, is other than a clear reflection  
22 of income.

23 QUESTION: Is that money that's taken from  
24 these machines every night, is that put in the pool with  
25 all the other money, or is that segregated?

1 MR. LILIENSTERN: Well, Justice Marshall, for  
2 the years in question here, 1973 to 1977, there was no  
3 identifiable fund. In 1979 the Nevada Gaming Commission  
4 passed a regulation which required that that be  
5 maintained in an identifiable form, in cash equivalency.

6 We think, however, that that regulation  
7 doesn't really bear on the issue of our liability here.  
8 We say that under the regulation, and in fact Justice  
9 Rehnquist suggested something about a stipulation the  
10 court below -- in the claims court the Government  
11 stipulated -- this case is here on Cross Motions for  
12 Summary Judgment.

13 In the claims court the government stipulated  
14 that upon the adoption of Nevada Gaming Regulation  
15 5.110, which is the one that is cited throughout our  
16 briefs, the liability became fixed. This is contained  
17 in the Joint Appendix.

18 The government's Motion for Summary Judgment  
19 attaches in support the affidavit of its counsel in the  
20 claims court, and the exhibit to that affidavit. That  
21 exhibit was our pretrial submission in the claims court.

22 And, one contention of fact by us which was  
23 adopted by them, because all of these facts were  
24 stipulated, one contention was that once the increased  
25 jackpot amount is displayed on the machine, the

1 increased jackpot amount becomes a fixed liability which  
2 cannot be avoided.

3 QUESTION: Where do we find that?

4 MR. LILIENTERN: Your Honor, that is at pages  
5 15 and 16 of the Joint Appendix, the Motion of the  
6 United States for Summary Judgment on page 15, the  
7 affidavit of counsel on page 16. Then our pretrial  
8 submission is attached to that. The actual language I  
9 read appears at page 42 of the exhibit.

10 Now, in the courts below the government took  
11 the position, somewhat like the question concerning  
12 bankruptcy. They took the position that, look, even if  
13 you accrue this liability --

14 QUESTION: Before you leave that, I want to be  
15 sure I follow you.

16 MR. LILIENTERN: Yes, Your Honor.

17 QUESTION: You referred us to page 42 which is  
18 Plaintiff's Memorandum of Contentions of Fact and Law,  
19 Contentions of Fact -- this is a government document, is  
20 it?

21 MR. LILIENTERN: Your Honor, no. It is our  
22 document which was incorporated by reference in the  
23 affidavit, the only affidavit they had in support of  
24 their motion for summary judgment in the claims court.  
25 If you look at page 15, the affidavit of counsel in the

1 claims court is there. It says "The Affidavit of David  
2 C. Hickman" in the exhibit there too.

3 QUESTION: So, that the defendant relies on  
4 that?

5 MR. LILIENTERN: Yes, Your Honor.

6 QUESTION: And that's the government's --

7 MR. LILIENTERN: Yes, Your Honor. I mean,  
8 there was really no dispute. We were attempting to  
9 stipulate facts, and there seemed to be at that time no  
10 dispute as to this issue.

11 In the lower courts the government made an  
12 assertion that it no longer --

13 QUESTION: But it says it's a fixed liability  
14 which cannot be avoided. That simply isn't correct,  
15 because if you went out of business it would be avoided.

16 MR. LILIENTERN: Well, Your Honor --

17 QUESTION: Isn't that right?

18 MR. LILIENTERN: No -- well, it is a fixed  
19 liability as of the time it's accrued. Now, there's a  
20 body of case law, as Justice O'Connor said, any --

21 QUESTION: Stick to my question.

22 MR. LILIENTERN: Yes, Your Honor.

23 QUESTION: If you went out of business, say  
24 the place burned down and you totally terminated  
25 business, would the liability have to be paid or not?

1 MR. LILIENSTERN: The liability would not have  
2 to be paid but the tax benefit rule would require that --

3 QUESTION: That's quite a different point.

4 MR. LILIENSTERN: Yes, Your Honor.

5 QUESTION: So, it is not correct that there is  
6 a fixed liability which cannot be avoided. It would be  
7 avoided by going out of business.

8 MR. LILIENSTERN: Well, Your Honor, for  
9 purposes of the all events test, we say -- in fact, the  
10 government -- and this Court conceded in its reply memo  
11 that contention of events like that, remote, speculative  
12 events are not to be considered in determining the  
13 snapshot issue of whether or not there's a fixed  
14 liability.

15 I don't believe they disagree with us on that,  
16 Your Honor. I think they would concede that. In fact,  
17 they have conceded --

18 QUESTION: They may not disagree with you, but  
19 you have just acknowledged to me that it is not correct,  
20 that this is a fixed liability which cannot be avoided,  
21 because it would be avoided by going out of business.

22 MR. LILIENSTERN: Well, we put summary  
23 judgment evidence into the record, Your Honor,  
24 concerning the revenues of the casino. We had  
25 affidavits to the effect that these are ongoing



1 operations and are not likely to go out of business.

2 As the case reaches this Court, that's  
3 unrefuted. I will concede that if we want to speculate,  
4 these casinos or really any other business could  
5 theoretically avoid liabilities by going out of business.

6 QUESTION: Well, can you give me another  
7 example of a proper accrual under the all events test in  
8 which the liability would be avoided by going out of  
9 business or going into bankruptcy? I'm not saying, not  
10 have to pay the liability, but the existence of the  
11 liability would be terminated by terminating the  
12 business.

13 MR. LILIENSTERN: Your Honor, I'm not saying  
14 that the existence of the liability would be  
15 terminated. I'm saying that the requirement that it be  
16 payable would be terminated.

17 QUESTION: If you went out of business, to  
18 whom would the liability be owed?

19 MR. LILIENSTERN: If you go out of business  
20 the liability will not be paid to anyone.

21 QUESTION: To whom would it be owed?

22 MR. LILIENSTERN: At the time it's accrued, it  
23 is owed to a player. If you go out of business before  
24 the jackpot is won, it will not be paid to the player.

25 QUESTION: Would it be owed to anyone at the

1 time you went out of business?

2 MR. LILIENSTERN: At the time you went out of  
3 business, no, Your Honor. That's correct.

4 The regulations, Justice Stevens, which we say  
5 fixes our liability, effectively precludes us from  
6 taking any voluntary action which would result in our  
7 failing to pay the liability when it's accrued. And we  
8 say that out of the all events test, that's really the  
9 test, want to insure that when individuals or entities  
10 take these deductions that there's a degree of certainty  
11 that they will be paid.

12 In fact, the evidence in this case shows that  
13 all of the accrued liabilities were in fact paid. That  
14 remote contingency, I suggest, would exist in any  
15 situation, and any accrual basis taxpayer could be  
16 saddled with that.

17 QUESTION: But you say, in any situation. But  
18 I asked you if you could give me a case in which the all  
19 events test was satisfied, even though the taxpayer  
20 could have avoided the creation of the liability by  
21 terminating voluntarily his business entirely, and I  
22 haven't heard you cite a case.

23 MR. LILIENSTERN: If his assets are -- if he  
24 is in bankruptcy and if his assets are insufficient to  
25 satisfy -- if it's a contractual liability --

1                   QUESTION: I'm not talking about satisfying  
2                   the liability. I'm talking about whether there would be  
3                   a liability on the statement of assets and liabilities  
4                   filed in the bankruptcy court, or whatever it might be.

5                   If he burns down his business voluntarily,  
6                   says, "I want to retire, I'm 85 years old, I don't want  
7                   to run a gambling place any more." He burns down his  
8                   business. In that situation is there any case -- and he  
9                   has no liability when he does it -- is there any case  
10                  you can cite me which says that the all events test is  
11                  satisfied?

12                 MR. LILIENSTERN: But, Your Honor, I am afraid  
13                 I must disagree with your premise, and that is, you said  
14                 there is no liability when he does it. We say there is  
15                 this liability that is imposed by state law.

16                 I think your question goes to what we  
17                 interpret the government's argument as being, that is,  
18                 the only sort of liability which would satisfy the all  
19                 events test is a bilateral contractual obligation. We  
20                 say that's not so, because the all events test doesn't  
21                 require that.

22                 The government is really trying to add to the  
23                 existing all events test the notion that the obligation  
24                 must be payable. Now, in U.S. v. Anderson, the first  
25                 case, the obligation there was not payable at the time

1 the accrual was taken.

2 This was an excise tax case on munitions. The  
3 tax. The taxpayer sought to deduct the excise tax in  
4 the year following the manufacture and sale. In 1916  
5 the munitions were manufactured and sold. The tax was  
6 not due until it was assessed the following year.

7 The taxpayer took the position that the  
8 government is taking here. It said, wait, until this is  
9 payable by the assessment, the tax is not going --  
10 cannot be accrued. The tax is not yet due.

11 The government took the position in Anderson  
12 that we're taking here, and said the liability exists at  
13 the end of the manufacture and sale, similar to the end  
14 of our tax year here by the operation of the machines.  
15 Because at that point, all events necessary to fix the  
16 liability had occurred.

17 The government is trying to turn that around  
18 and say in our situation, we must impose on the all  
19 events test the additional requirement of payability,  
20 and that that payability would exist at the time a  
21 customer pulls the winning handle of the slot machine.

22 So, we say that we are on all fours with the  
23 Anderson case, and that to adopt the government's  
24 position would really reconstrue Anderson in a different  
25 way than it's existed on the books since 1926.

1           As to the question of how other -- so-called  
2 regular slot machines are treated, let me see if I can  
3 illustrate our liability argument in that way. The only  
4 reason we say we're able to accrue the liability for the  
5 progressive slot machines is because of the existence of  
6 the Nevada regulation, statutes and policies which are  
7 discussed in our briefs. Those pertain only to the  
8 progressive slot machines.

9           We also have summary judgment evidence in the  
10 form of affidavits that the reason for the existence of  
11 those regulations is that because the jackpot amount  
12 increases with each play on all the casino customers,  
13 that the Commission views that as being an investment,  
14 if you will, by the players in the jackpot amounts.

15           Regular slot machines don't have any such  
16 regulations. We would say, as to the regular slot  
17 machines, we're not entitled to and we do not accrue  
18 those liabilities. Those could be taken off the floor  
19 at any time.

20           Those could be removed, and any jackpots on  
21 regular nonprogressive machines could be taken off at  
22 any time, but we're not permitted under the regulations  
23 to remove the progressive slot machines. Once they're  
24 on the casino floor and are put into play, they must  
25 stay there until they're won.



1           Now, in this case we're not trying to  
2 anticipate and to accrue as an expense the amount of the  
3 eventual payout. We are simply taking the amount which  
4 exists on the machine at the end of our fiscal year.

5           The winning of the jackpot is the equivalent,  
6 we believe, of the assessment of the tax in Anderson.  
7 The winning of a jackpot doesn't fix the liability. It  
8 does identify a payee, but the record -- and our briefs  
9 are replete with cases which indicate that you don't  
10 really have to be able to identify a payee. We know  
11 that there will be a payee. We don't have to identify  
12 that payee by name.

13           The economic and the practical effect of the  
14 regulation is that we're going to have to pay that  
15 jackpot, and in fact the record indicates that we did  
16 pay all of these progressive jackpots.

17           What the government is trying to do, we  
18 believe, is to impose some of the requirements which  
19 were established in the 1984 legislation, which is the  
20 referred to as the Tax Reform Act of 1984 on the one  
21 hand, or the Tax Deficit Act of 1984 on the other, which  
22 established in addition to the existing law and  
23 regulations on the all events test, it established a  
24 principle of economic performance.

25           We believe the government is trying to -- is

1 asking this Court to judicially legislate in this case a  
2 principle that is the practical equivalent of the  
3 economic performance of the 1984 legislation which is  
4 applicable only to deductions that occur after July of  
5 1984.

6 There is, however, a --

7 QUESTION: Suppose an accrual basis taxpayer  
8 signs a promissory note that, in one year that's  
9 payable, six months later in another year. Does he  
10 accrue that, the first year?

11 MR. LILIENSTERN: If that's an enforceable  
12 obligation in year one, he may accrue that.

13 QUESTION: Well, what if at the time the  
14 payment comes along and he claims that it was a fraud,  
15 and it's determined that he never did owe the money,  
16 he's relieved of his obligation?

17 MR. LILIENSTERN: In the second year the tax  
18 benefit rule, I believe, would require that he would  
19 take any income that --

20 QUESTION: What it means is that it is void ab  
21 initio, he never had an obligation?

22 MR. LILIENSTERN: Well, I'm responding to how  
23 the Internal Revenue Service would construe it.

24 QUESTION: Well, I know, but I would think in  
25 that case, and according to their argument, that you

1 would never be able to accrue that liability because of  
2 the possibility that it might be a fraudulent  
3 transaction and he never had an obligation.

4 MR. LILIENSTERN: Well, as I said earlier --

5 QUESTION: Wouldn't that be their argument?

6 MR. LILIENSTERN: I'm not sure, Your Honor. I  
7 wouldn't want to speak for them. But the law is  
8 absolutely clear that these remote contingencies such as  
9 bankruptcy or a defense for promissory note, those are  
10 not sufficient to destroy accrual at the time the  
11 accrual is taken.

12 QUESTION: Well, there's another one. What  
13 happens if the machine breaks completely, I mean, just  
14 breaks down and has to be replaced?

15 MR. LILIENSTERN: All right. If the machine  
16 breaks down, under the regulations and policy the  
17 machine can be taken off the floor for a brief period of  
18 time and repaired.

19 QUESTION: That's not my question. It's  
20 broken permanently.

21 MR. LILIENSTERN: All right. Then the amount  
22 of that jackpot must be added to another machine. If it  
23 has \$100 on it, that \$100 must be put on an adjacent  
24 machine to give a total of \$200.

25 The liability must remain on the machines, on

1 the floor.

2 QUESTION: How could someone determine that  
3 that is carried out? Who determines that they to make  
4 the transfer?

5 MR. LILIENSTERN: Your Honor, the Nevada  
6 gambling industry is one of the most highly regulated  
7 industries in this country. The affidavit of Mr.  
8 Griffith in the Joint Appendix indicates that they count  
9 the jackpots twice a day. They have to file reports  
10 with the Gaming Commission, I believe weekly.

11 It's very highly regulated, for two reasons.  
12 One, of course, in any industry where there's a lot of  
13 cash exchanging hands, it's to everyone's benefit to  
14 have it highly regulated. But in the case of  
15 progressive slot machines, as I alluded to earlier,  
16 there is a notion -- there is an investment concept here.

17 Since players are putting their money in, and  
18 increasing the amount of the jackpot, the Commission  
19 wants to insure that those jackpot totals remain  
20 available for players to win on the floor. So, I think  
21 there's no question about that, Mr. Chief Justice, that  
22 it's highly regulated and that that duty imposed by the  
23 Nevada Gaming Commission is complied with.

24 The government relies on the Nightingale  
25 case. It's a Ninth Circuit case that preceded ours.

1 It's, in all its material respects, like ours factually.

2 Nightingale cited a number of cases including  
3 this Court's Brown versus Helvering opinion, which  
4 involved cancellation of -- accruing of liabilities for  
5 anticipated insurance policy cancellations. In that  
6 case, we simply say there's no fixed liability. There  
7 is no way to determine in that case whether indeed,  
8 based on estimates or otherwise, the policies would in  
9 fact be cancelled.

10 In our case we don't rely on estimates. We  
11 have the amount we say we can accrue, on the machines.  
12 It's referred to as a meter but it's really a large  
13 display meter. That is the amount of the progressive  
14 jackpot which must be maintained in play and which the  
15 evidence shows will be paid out on the average of four  
16 and a half months.

17 Once the machine is in play --

18 QUESTION: I don't know that your case is so  
19 much different than Brown on that percentage, because  
20 they have a stipulated percentage in Brown of 23 percent  
21 on the basis of past experience. And, isn't that pretty  
22 much what your probability is?

23 MR. LILIENSTERN: Well, Justice Rehnquist, our  
24 probability is 100 percent of the amount shown. We  
25 don't rely on estimates. We know that we are going to



1 pay the total of all the amounts reflected at the end of  
2 the fiscal year.

3 QUESTION: But it's an estimate as to when you  
4 will pay them?

5 MR. LILIENSTERN: Well, we don't estimate when  
6 we're going to pay it. No, the four and a half months  
7 is a retrospective average. That was a computation  
8 made, and is in the Summary Judgment --

9 QUESTION: Well, but supposing it came out  
10 that the retrospective calculation showed 14 months.  
11 Certainly, you couldn't deduct it in the next year.

12 MR. LILIENSTERN: No, Your Honor. You deduct  
13 it in year one. You accrue it in year one.

14 QUESTION: Well, supposing this thing had  
15 showed 26 months. Could you still have deducted it?

16 MR. LILIENSTERN: You deduct it in year one.  
17 Now, the greater --

18 QUESTION: But only the amount that's shown at  
19 the end of year one?

20 MR. LILIENSTERN: Only the amount shown at the  
21 end of year one, that's correct, Justice Rehnquist. In  
22 other words, at the end of year one if it shows \$100, at  
23 the end of your fiscal year, you accrue \$100.

24 By the time it pays off it might have gone to  
25 \$400 and you will in fact pay the \$400. We're not

1 trying to deduct that \$400. We're accruing only the  
2 amount that exists at the end of our fiscal year.

3 And, as the period of time goes into the  
4 future, we recognize -- not in this case but we  
5 recognize in other situations, there may well be the  
6 problem of a clear reflection of income. And the 1984  
7 legislation is in part at least designed to impose an  
8 additional requirement to the all events test which  
9 would prevent the accrual of these liabilities when the  
10 period of time into the future is very great.

11 There is an exception to that, which is the  
12 referring item exception, which imposes an eight and a  
13 half month theory, and we believe we would be  
14 frightfully satisfied in that case.

15 QUESTION: Mr. Lilienstern, as I understand it  
16 the Internal Revenue Service has regulatory authority to  
17 determine whether the accrual of counting system is  
18 properly reflecting income.

19 MR. LILIENSTERN: That's correct, Justice  
20 O'Connor. Under --

21 QUESTION: How does that authority fit into  
22 this question?

23 MR. LILIENSTERN: Well, in our case they have  
24 not challenged that our accrual clearly reflects  
25 income. That really is not an issue here. The

1        Commissioner, however, does have the authority under  
2        Section 446(b) to in effect disallow an accounting  
3        system if he determines that it does not clearly reflect  
4        income.

5                But that -- that authority combined with the  
6        '84 legislation has really given the Internal Revenue  
7        Service some new teeth, we think. We don't know how the  
8        basic legislation there would apply to us. It talks in  
9        terms of property.

10               There is a suggestion that money is not  
11        property, and we really don't know pending the  
12        promulgation of regulations where we're going to come  
13        out on that, but we -- and it's really not involved in  
14        this case, but it seems clear to us that we're talking  
15        about the exception, which means we would be permitted  
16        to continue to accrue the progressive slot machine  
17        liabilities.

18               In its reply brief the government gave an  
19        example of a golf tournament, an irrevocable pledge in  
20        year one by a company to sponsor golf tournaments,  
21        perhaps as long as ten years in the future. We believe  
22        that if the obligation is irrevocable and the tax -- the  
23        all events test is satisfied.

24               Again, though, the longer you go into the  
25        future, the more likely it is there could be a problem

1 with clear reflection of income. But just to set us  
2 where we stand, from their example and their brief, we  
3 believe that -- and the example in which the payments of  
4 the golf tournaments could extend ten years into the  
5 future, we believe there that the all events test was  
6 satisfied but that the taxpayer there might well have an  
7 additional problem.

8 The reason -- really the reason for the all  
9 events test is to insure that taxpayers won't obtain  
10 deductions for expenditures that might not ever occur,  
11 and we think we satisfy that, and we don't just mean you  
12 have to look retrospectively in order to see that we did  
13 pay all of those amounts that were accrued.

14 We think we satisfied, because the sanction  
15 that can be imposed on a casino if it doesn't pay the  
16 amounts on its progressive slot machines are far out of  
17 proportion to the amount in controversy in this case. A  
18 casino can lose its license. It can be fined up to  
19 \$250,000. It is this notion of state law and the --

20 QUESTION: Well, what if a casino does lose  
21 its license for some other transgression? What about  
22 this supposed liability?

23 MR. LILIENSTERN: If the casino is sold, it is  
24 the policy of the Gaming Commission -- that's typically  
25 what happens. One entity will lose the license. They

1        don't heard the casino up. Someone else comes in and  
2        assumes the license.

3                So, it's -- to my knowledge it's always an  
4        instance in which the license is transferred.

5                QUESTION: And then what happens?

6                MR. LILIENSTERN: If it's transferred, either  
7        the jackpots must be paid prior to the transfer, which  
8        it sounds like in your example it would not be, or they  
9        must be assumed by the purchaser of the casino. They  
10       are not extinguished.

11               QUESTION: But -- this may never happen, but  
12       if a casino just decided -- a corporate entity owning a  
13       casino just wanted to liquidate and they just decided to  
14       sell all assets and liquidate, what about the machines?

15               MR. LILIENSTERN: And there's no surviving  
16       entity? Well, in that situation, Judge --

17               QUESTION: Say they put the machines right on  
18       the auction block and they're bought. Does anybody then  
19       assume the liability on that machine?

20               MR. LILIENSTERN: The liabilities are not  
21       assumed on those machines, and the tax consequences  
22       would be, of course, as earlier described, they would  
23       take into income in the year of sale any amounts  
24       previously deducted.

25               We tried to refute that argument --



1 QUESTION: Well, what if a casino buys a bunch  
2 of slot machines and they don't pay for them. They're  
3 going to -- they have an installment payment contract  
4 and they default, and then purchaser -- or the seller  
5 just comes along and repossesses them?

6 MR. LILIENSTERN: So that you can no longer  
7 have them in play?

8 QUESTION: Yes.

9 MR. LILIENSTERN: Well, there's no remedy  
10 available.

11 QUESTION: Well, there's no -- there's  
12 certainly -- why should you accrue in those situations?

13 MR. LILIENSTERN: Because, Justice White --

14 QUESTION: I mean, just --

15 MR. LILIENSTERN: The all events test and the  
16 fixing of liability is not dependent on the kind of  
17 remote contingency you just described.

18 QUESTION: Well, the liability, as Justice  
19 Stevens pointed out to you, what's really contingent is  
20 the liability.

21 MR. LILIENSTERN: Well, Your Honor, the  
22 liability is fixed. Now, it may be avoided. You may  
23 avoid paying the liability. That is my analysis. The  
24 liability is fixed but payment for that liability --

25 QUESTION: You think it's fixed because the

1 state law says that, look, George, you must accrue this  
2 money and pay it out if and when somebody ever wins it?

3 MR. LILIENSTERN: And you may not remove your  
4 machines and you may not sell your casino and avoid the  
5 liabilities.

6 QUESTION: If certain events happen, nobody is  
7 ever going to win it.

8 MR. LILIENSTERN: That's right, but that  
9 affects the payment rather than the imposition of the  
10 liability, under our view of the case.

11 QUESTION: Well, it affects -- surely it  
12 affects both?

13 MR. LILIENSTERN: Well, again, if a company  
14 goes into bankruptcy and has insufficient assets to pay  
15 its liabilities, it's in no different situation than we  
16 are there.

17 QUESTION: Well, except that you -- except  
18 your statement shows that it is. You say, pay your  
19 liabilities.

20 MR. LILIENSTERN: If they can't pay them. We  
21 -- in your example the jackpots are not paid to people  
22 who win them. In the situation in which the company  
23 goes into bankruptcy and doesn't have the money, those  
24 are not paid to the persons to whom they --

25 QUESTION: But everybody agrees there was a

1 liability?

2 MR. LILIENSTERN: But everybody agrees there's  
3 a liability.

4 QUESTION: Well, not here.

5 MR. LILIENSTERN: Well, no.

6 QUESTION: That's the question in the case.

7 MR. LILIENSTERN: I understand, Your Honor.  
8 There are other cases in which state law applies  
9 liabilities. There's a whole series of coal mining,  
10 strip mining cases.

11 The liability there is imposed not by  
12 bilateral contract, but it's imposed by state law which  
13 requires that once strip mining has occurred, the mined  
14 area must be backfilled. That's exactly what we have  
15 here, it's imposed by state law.

16 If the coal companies -- and there's a whole  
17 line of cases that supports our view on that -- if the  
18 coal companies go out of business before backfilling  
19 those, there's no --

20 QUESTION: So, a casino operator could say,  
21 "I'm just dissatisfied with these newfangled progressive  
22 slot machines. I just want to get rid of them and go  
23 back to the old style." And he goes to his next-door  
24 neighbor, "Would you like to buy my progressive slot  
25 machines?" And the fellow says, "Yes, I like these

1 devices." And so they just sell them.

2 MR. LILIENSTERN: A casino operator will  
3 probably lose his license and be fined up to \$250,000.

4 QUESTION: I know, but he wouldn't be liable.  
5 He wouldn't have to pay that.

6 MR. LILIENSTERN: Well --

7 QUESTION: He wouldn't have to pay the accrual.

8 MR. LILIENSTERN: We have addressed that, Your  
9 Honor, by showing how the progressive slot machine  
10 productions are immaterial compared to the total wealth  
11 of -- and revenues of the casino. They're not going to  
12 shut down their casinos in order to save \$433,000 over  
13 four years.

14 QUESTION: I agree with that, but I can  
15 imagine that they'd want to sell their slot machines.

16 QUESTION: If they sold them to an operator in  
17 New Jersey, what liability would remain if they took  
18 their --

19 MR. LILIENSTERN: Before they take the  
20 machines off the floor, they must address the issue of  
21 payment. They must have a free-for all one day and  
22 insure that all those progressive slot machine jackpots  
23 are paid prior to disposing of them, Justice Stevens.

24 QUESTION: They couldn't sell them to a casino  
25 in New Jersey?

1 MR. LILIENSTERN: Not without first  
2 discharging the jackpot liability.

3 QUESTION: Well, how would you find out who's  
4 going to win?

5 MR. LILIENSTERN: I beg your pardon, Justice  
6 Marshall?

7 QUESTION: How are you going to find out who's  
8 going to win? You said you have to pay off.

9 QUESTION: Who do you pay it to?

10 MR. LILIENSTERN: You mean, once someone has  
11 won it? You know that --

12 QUESTION: No, nobody has won.

13 MR. LILIENSTERN: Oh, you have to keep them in  
14 play until they're won.

15 QUESTION: I thought you said that they can  
16 sell them to Atlantic City?

17 MR. LILIENSTERN: That's correct, Justice  
18 Marshall, but --

19 QUESTION: What do they do then on their  
20 federal taxes?

21 MR. LILIENSTERN: If they sell them to  
22 Atlantic City before delivering them to Atlantic City,  
23 they must first make provision for paying those  
24 progressive jackpots to their customers in Las Vegas.

25 QUESTION: How are they going to do that?



# 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:

#85-554 UNITED STATES, Petitioner V. HUGHES PROPERTIES, INC

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Paul A. Richardson

(REPORTER)

1 MR. LILIENSTERN: Keep them in play until  
2 they're won, Justice Marshall. You can't -- in other  
3 words, you cannot sell them and deliver them tomorrow.  
4 You must discharge that liability first.

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

7 [Whereupon, at 1:59 o'clock p.m., the case in  
8 the above-entitled matter was submitted.]  
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