

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 86-511

TITLE COMMISSIONER OF INTERNAL REVENUE, Petitioner V.
PETER R. FINK, ET UX.

PLACE Washington, D. C.

DATE April 27, 1987

PAGES 1 thru 54



1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

IN THE SUPREME COURT OF THE UNITED STATES

-----x
COMMISSIONER OF INTERNAL :
REVENUE, :
Petitioner :
v. : No. 85-511
PETER R. FINK, ET UX. :
-----x

Washington, D.C.

Monday, April 27, 1987

The above-entitled matter came on for oral
argument before the Supreme Court of the United States
at 10:03 o'clock p.m.

APPEARANCES:

ALAN I. HGRWITZ, ESQ., Washington, D.C.;
on behalf of Petitioner
MATTHEW J. ZINN, ESQ., Washington, D.C.;
on behalf of Respondent

C O N T E N T S

<u>ORAL ARGUMENT OF</u>	<u>PAGE</u>
ALAN I. HOROWITZ, ESQ.,	
on behalf of the Petitioner	3
MATTHEW J. ZINN, ESQ.,	
on behalf of the Respondent	21
ALAN I. HOROWITZ, ESQ.,	
on behalf of the Petitioner - rebuttal	48

1 P R O C E E D I N G S

2 CHIEF JUSTICE REHNQUIST: We will arguments
3 first this morning in No. 86-511, Commissioner of
4 Internal Revenue versus Peter Fink.

5 Mr. Horowitz, you may proceed whenever you're
6 ready.

7 ORAL ARGUMENT OF

8 ALAN I. HOROWITZ, ESQ.

9 ON BEHALF OF PETITIONER

10 MR. HOROWITZ: Mr. Chief Justice and may it
11 please the Court:

12 The issue in this case is whether a
13 shareholder can create immediately deductible tax loss
14 by surrendering a portion of his shares to the
15 corporation he controls.

16 The underlying facts are as follows.
17 Respondents were the principal shareholders of Travco, a
18 company engaged in the manufacture of recreational
19 vehicles. When the corporation encountered financial
20 difficulties in the mid-seventies, Respondents
21 voluntarily surrendered a portion of their shares to the
22 corporation, stating explicitly that the purpose of the
23 surrender was to improve the financial condition of the
24 company.

25 They surrendered slightly less than 200,000

1 shares of their total holdings of more than 1.1 million
2 shares. The result of the surrender was a reduction in
3 Respondents' percentage interest in the corporation from
4 72.5 percent to 68.5 percent.

5 Respondents claimed the amount of their basis
6 in the surrendered shares, totaling about \$389,000, as
7 ordinary loss deductions on their federal income tax
8 returns. The Commissioner disallowed the claimed
9 deductions on the ground that such a voluntary
10 contribution to the corporation to advance its interests
11 must be capitalized and therefore cannot give rise to an
12 immediately deductible loss.

13 The Tax Court upheld the Commissioner's
14 determination, but the Court of Appeals reversed and
15 approved Respondents' efforts to take an immediate loss
16 in the amount of their basis in the surrendered shares.

17 QUESTION: Now, its position had not been
18 consistent over the years, had it?

19 MR. HOROWITZ: The Government's position?

20 QUESTION: The Tax Court's.

21 MR. HOROWITZ: The Tax Court's, no. The Tax
22 Court's cases have been all over the lot. There were a
23 series of cases back in the twenties and thirties in
24 which they pretty much reached different results on
25 similar facts.

1 Since the thirties, up until cases in the last
2 couple of years, the Tax Court had pretty much taken the
3 position that Respondents advance here, which is that
4 one can take an immediately deductible loss for a
5 surrender, non-pro rata surrender of shares.

6 Now, in the Frantz case, which was decided at
7 the same time as this case, the Tax Court reconsidered
8 that line of cases and took the position that the
9 Government is now urging.

10 QUESTION: And it was a reviewed decision?

11 MR. HOROWITZ: Yes.

12 QUESTION: Dissents?

13 MR. HOROWITZ: There were a couple dissents.
14 Judge Parker dissented and was joined by a couple other
15 judges.

16 QUESTION: Would it make a difference if the
17 percentage had been greater than it was?

18 MR. HOROWITZ: We don't think it would make a
19 difference, depending on what the percentage is.
20 Certainly, the greater the percentage is, the weaker the
21 claim for a loss is, because a 99 percent shareholder
22 who makes a surrender or makes a contribution to
23 capital, almost all of that money is coming back to that
24 shareholder who makes the surrender, because they still
25 own a very large percentage of the corporation.

1 Maybe it's important here to focus on the fact
2 that when a shareholder holds a large percentage of a
3 corporation, what looks like a large surrender of shares
4 in an absolute sense really has very little impact on
5 his actual interest in the corporation.

6 To take a pretty extreme example, suppose a
7 shareholder held 99 percent of the shares in a
8 corporation. The corporation has 1,000 shares that were
9 issued at ten dollars a share -- say 100 shares, and one
10 shareholder subscribes to 99 of those shares at ten
11 dollars each, for \$990.

12 The other shareholder, the minority
13 shareholder, holds one share, having invested ten
14 dollars in the corporation.

15 QUESTION: Mr. Horowitz, may I ask, in light
16 of what you are now saying, what advantage did these
17 shareholders think they were achieving in terms of
18 inducing others to invest in the corporation by
19 surrendering these shares?

20 MR. HOROWITZ: Well, their testimony was that
21 the corporation needed an injection of new capital and
22 they hoped to attract outside investors to the
23 corporation. They were going to issue \$700,000 in
24 preferred shares that they hoped a new investor would
25 subscribe to and convert into common stock.

1 QUESTION: They did give up mathematical
2 control?

3 MR. HOROWITZ: No, they did not give up
4 mathematical --

5 QUESTION: They did not?

6 MR. HOROWITZ: They gave up the potential for
7 giving up mathematical control in the event the new
8 investor subscribed to these new shares, which in fact
9 never happened. But the surrender itself just reduced
10 their percentage by this small amount of 72 to 68.

11 QUESTION: But didn't they have 52 plus
12 percent prior to the surrender and less than that
13 afterwards, less than 50 percent? Maybe I have the
14 figures wrong.

15 MR. HOROWITZ: No. They began with 72 and
16 went down to 68.

17 This is a husband and wife who made the
18 surrenders. If you looked at the husband in isolation,
19 for a very small period of time his interest went from
20 above 50 to below 50, during the two-week period before
21 his wife made the surrender.

22 The surrenders were made -- the husband made a
23 surrender in late December of 1976, the wife made her
24 surrender in early January of 1977.

25 QUESTION: But the surrender did not increase

1 any of the assets of the corporation?

2 MR. HOROWITZ: No, it neither increased nor
3 decreased -- it did not increase the total amount of
4 assets of the corporation in the normal accounting
5 sense, that's true.

6 QUESTION: It had just as many real assets
7 afterwards as before, didn't it?

8 MR. HOROWITZ: That's correct.

9 But what the surrender -- all the surrender
10 accomplished was to slightly -- was to make a slight
11 shift in the percentage interest in the corporation, a
12 very small shift. But no money that the shareholders
13 had invested in the corporation was taken out by virtue
14 of the surrender.

15 QUESTION: But it did give the Finks a smaller
16 interest in the corporation than they had had before,
17 didn't it?

18 MR. HOROWITZ: Slightly smaller. They
19 continued to maintain complete control of the
20 corporation, but they had -- maybe I should get back to
21 my example, because I think it might clear some things
22 up.

23 QUESTION: Mr. Horowitz, had there been a pro
24 rata, across the board surrender, we would have no
25 problem at all, I take it?

1 MR. HOROWITZ: That's clear. The Respondents
2 concede that there is no loss in any kind of a pro rata
3 surrender. And one reason that the case is much easier
4 with a very shareholder is that a surrender that has the
5 effect of taking one's percentage interest, say, from 99
6 down to 98.5 is the practical equivalent to a pro rat
7 surrender.

8 And that's one reason that some of the courts
9 have taken the view that the percentage interest --
10 miniscule change in the percentage interest essentially
11 means that it should be treated the same as a pro rata
12 surrender.

13 But even apart from that, even to the extent
14 that there is some change in the interest and that the
15 shareholder in some sense gives something up by making a
16 surrender, it is our position that what he gives up
17 cannot be taken as an immediately deductible loss, but
18 it must be capitalized.

19 QUESTION: There's a lot of talk in the briefs
20 about contribution to capital. There really isn't any
21 contribution to capital here, is there? The corporation
22 is in the same position it was before as such?

23 MR. HOROWITZ: Well, contribution to capital
24 has been used as a shorthand term here. It's just one
25 form of a capital expenditure. Maybe it's more correct

1 to talk about capital expenditure.

2 But what's happening here -- all that the
3 Commissioner is saying is that the Respondents' basis in
4 their shares, which reflects money that they invested in
5 the corporation in real assets, that they contributed to
6 the corporation, all the Commissioner is saying is that
7 that money is still in the corporation.

8 He hasn't taken any of that money out. He
9 hasn't lost any of that money. So there's no reason for
10 him to be taking a loss. All he has done is taken away
11 some shares.

12 So that money which was contributed to capital
13 and which represents the real assets should just be
14 reallocated amongst the remaining shares in the
15 corporation.

16 QUESTION: Well, Mr. Horowitz, the taxpayers
17 wanted to take an ordinary loss deduction.

18 MR. HOROWITZ: That's correct.

19 QUESTION: And the Commissioner is taking the
20 position that they're entitled to no deduction at all.
21 I wondered, since they have reduced their ownership by
22 about four percent of the company, why aren't they
23 entitled to at least a capital loss of that portion of
24 the company that they've permanently lost, that is the
25 four percent?

1 MR. HOROWITZ: Well, the general rule is that
2 a percentage decline in one's interest in a corporation
3 does not give rise to an immediately deductible loss.
4 For example, I was talking to Justice Powell before
5 about this new investor who was possibly going to come
6 in and take over some of the shares of the corporation.

7 If such a new investor had appeared and had
8 bought those shares, he would have reduced the Finks'
9 interest even below 50 percent. It would have been a
10 much larger percentage reduction. But they would not
11 have gotten any loss for that, that's clear.

12 The general rule under the --

13 QUESTION: I'm just curious why under these
14 circumstances they might not be entitled to at least a
15 capital --

16 QUESTION: Well, is there any sale or
17 exchange?

18 MR. HOROWITZ: Well, it's not apparent that
19 there's a sale or exchange, but there's really no loss.
20 If the Court were to find that there were a loss, I
21 suppose some commentators have argued that they would
22 have to impute that there was a sale or exchange. I
23 think that's an issue the Court doesn't have to reach
24 now, whether any such loss would be capital or
25 ordinary.

1 Our position is that there should not be any
2 loss.

3 QUESTION: You say if it's a loss, it should
4 be a capital loss? Don't you argue that?

5 MR. HOROWITZ: Well, I'm not sure we've taken
6 a position on that. I think if the Court were to find
7 there were a loss, the Commissioner would certainly be
8 better off if it were a capital loss.

9 It would eliminate the possibilities for tax
10 avoidance that we talk about at the end of our brief,
11 where shareholders would be induced to make a surrender
12 just before the stock became worthless in order to avoid
13 ordinary loss treatment.

14 But I think we would have to decide whether in
15 fact there was a real argument that it could be a
16 capital loss.

17 I'm not sure I finished answering Justice
18 O'Connor's question --

19 QUESTION: But the question would be whether
20 there's a taxable event?

21 MR. HOROWITZ: That's right. There's no event
22 that happens now that gives rise to the realization of a
23 loss.

24 Now, what you're talking about as far as the
25 reduction in the percentage interest in the corporation,

1 Respondents have pointed out in their brief that that
2 may have some collateral effects down the road. They
3 will have a reduction in dividends, perhaps, down the
4 road, have a reduction in their rights in liquidation.

5 These things are all taken into account when
6 they happen, and the reallocation of basis reflects what
7 the Respondents have given up. It just doesn't give
8 them the right to take the loss right now.

9 QUESTION: So you agree that they're entitled
10 to adjust their basis?

11 MR. HOROWITZ: That's right, they are entitled
12 to adjust their basis. And down the road, that will
13 come.

14 Now, if they were to liquidate the corporation
15 the next day, they would have lost something in the
16 amount of this small percentage that their reduction
17 went down, and they would get credit for that loss at
18 that time because of the adjustment of basis.

19 But it's silly to look at this case from the
20 perspective of whether they would liquidate the
21 corporation the next day. The fact is that they assert
22 that the reason for this surrender is to improve the
23 long-term prospects of the corporation; this is a
24 long-term investment, and that's the way the Code would
25 normally treat it.

1 QUESTION: Well, are you inviting us to look
2 at each of these one by one to see what the purpose of
3 the contribution is? Is that the rule?

4 MR. HOROWITZ: No, no. Every case that comes
5 up like this is going to have the asserted purpose of
6 improving the financial fortunes of the corporation.
7 There's no conceivable purpose that could possibly give
8 rise to a loss.

9 I mean, either they're trying to improve the
10 corporation, in which case it's an investment, or
11 otherwise it's just a gift, I suppose, to the
12 shareholders. In this case everyone agrees that it's
13 not a gift.

14 But if it were a gift, that wouldn't give rise
15 to a loss either.

16 QUESTION: And what would the tax treatment
17 have been if it had been a non-pro rata sale for a small
18 amount of money to the corporation?

19 MR. HOROWITZ: A sale to this corporation?

20 QUESTION: Right.

21 MR. HOROWITZ: Well, a sale of the shares, in
22 other words a transfer of shares in this corporation to
23 the corporation in exchange for money, is what is called
24 a redemption. And as we discuss in our brief, that
25 would not give rise to a loss.

1 And in fact, even if they had sold it to a
2 different corporation, if it was another corporation
3 that was controlled by the shareholders, they also could
4 not get a loss, because there's a special Section 267 of
5 the Code that doesn't allow shareholders to take a loss
6 on sales to corporations that they control.

7 So they're really trying to find a loophole
8 here in a sea of principles that don't allow them a loss
9 for this kind of a transaction.

10 QUESTION: What if they gave a piece of
11 personal property to the corporation, a truck for
12 example?

13 MR. HOROWITZ: Well, our position is that this
14 case is no different from if they gave a piece of
15 personal property to the corporation. If they gave a
16 truck to the corporation, they would in some sense be
17 giving something up, because they had a truck that they
18 owned 100 percent and once they give it to the
19 corporation they only own 72 percent of it, and in a
20 sense they've given 28 percent of it to the other
21 shareholders.

22 So they have given something up. But they
23 don't get a loss for that. What they get is what is
24 called contribution to capital treatment, capitalization
25 treatment.

1 QUESTION: Don't they get a loss -- or suppose
2 the truck had increased in value over what they bought
3 it for and then they gave it to the corporation. Don't
4 they get some tax --

5 MR. HOROWITZ: They don't, no. It's not a
6 taxable event.

7 QUESTION: What if they sold it to the
8 corporation at a "loss," sold it for half its cost or
9 half its fair market value? You wouldn't have your
10 redemption analogy then.

11 MR. HOROWITZ: I'm sorry? If the corporation
12 sold?

13 QUESTION: No, no. Say the shareholder owns a
14 truck and, instead of giving it to the corporation, he
15 sells it to it for half its value. Would that not
16 constitute a loss on the truck?

17 MR. HOROWITZ: Well, first of all, as I said
18 before, under Section 267 he can't take a loss for a
19 sale to a corporation he controls.

20 QUESTION: Of personal property?

21 MR. HOROWITZ: Anything.

22 QUESTION: I see.

23 MR. HOROWITZ: Assets. That's to curb the
24 kind of abuses that can be -- and you have to be very
25 careful when you have shareholders dealing with

1 corporations they control, because there's a lot of
2 opportunity for manipulation.

3 If it were not to a corporation he controls
4 and Section 267 didn't come into play, I still don't
5 think he gets a loss if he sells it to the corporation
6 for below market value. I think some of it would be
7 treated as a gift to the extent that there was a bargain
8 element in there and some of it will be treated as a
9 sale.

10 But we don't have a sale here.

11 QUESTION: Why don't you finish telling us
12 your 100 share example. I was kind of interested in it
13 and you never finished.

14 MR. HOROWITZ: All right.

15 QUESTION: I thought you were finished with
16 it. It was a very simple example. I got the facts, but
17 --

18 MR. HOROWITZ: I didn't quite finish. In
19 fact, I don't remember it any more, so I'm going to
20 start at the beginning.

21 But if you start with a corporation that has
22 100 shares and one shareholder subscribes to 99 of
23 those, say for ten dollars apiece, he's invested \$990 in
24 the corporation and the other shareholder has invested
25 ten.

1 The corporation has got \$1,000 now in assets
2 that these shareholders have put into it. And in
3 accordance with their stockholdings, the majority
4 shareholder really is entitled to 990 of those dollars
5 and the other shareholder is entitled to ten if the
6 corporation were to liquidate.

7 Now, suppose the majority shareholder
8 surrendered more than half of his shares, surrendered 50
9 shares, in a surrender just like the one that we have in
10 this case. Respondents would claim that he is entitled
11 to a \$500 loss there, that he has really lost
12 something.

13 But if you look at what's happened, he has
14 lost very little. He has gone from a 99 percent
15 shareholder, holding 99 of the 100 shares, to a
16 shareholder who holds 49 of 50 shares left in the
17 corporation. He's gone to being a 98 percent
18 shareholder.

19 And the corporation's still got the \$1,000 in
20 it that was originally invested. That hasn't gone
21 anywhere. That hasn't been lost. And if the
22 corporation were to liquidate the next day, he would
23 still take 980 of those dollars out.

24 QUESTION: Yes, but the difference, I suppose,
25 is that in the interval between the time they formed the

1 corporation and the time he decided to make the gift,
2 the \$100 still isn't there, the \$1,000. I suppose the
3 corporation has lost some money or the net worth has
4 gone down, or he wouldn't have any motivation to do
5 that.

6 So you're really merging, it seems to me, two
7 points in time, as though it happened simultaneously,
8 because this stock is not really worth what he paid for
9 it.

10 MR. HOROWITZ: No, this stock -- the testimony
11 is this stock had depreciated.

12 But as far as -- the point that I'm trying to
13 make is that you have to -- when you're talking about
14 what he gives to the corporation, you have to keep in
15 mind that so long as he's the controlling shareholder,
16 most of what he has given to the corporation is really
17 just taking from one pocket and putting it in another
18 pocket.

19 And the only part that's even arguably given
20 up or lost is this small diminution in percentage
21 interest that he gives up. Now, so I think the Sixth
22 Circuit's decision that he's entitled to the entire
23 amount of his basis that he contributes is completely
24 indefensible.

25 I think the only thing that can be argued

1 about --

2 QUESTION: Well, isn't it true that over a
3 period of years he suffered a very substantial economic
4 loss, in the sense that what he now has is worth a great
5 deal less than what he bought originally? He's parting
6 with part of what remains to him and trying to in effect
7 treat for tax purposes --

8 MR. HOROWITZ: That's what's usually called a
9 paper loss. You have to have some event that enables
10 you to realize that loss, which is he could have sold
11 these shares to someone else and then, if they had
12 depreciated, he could take the loss.

13 And he'll still have that loss available to
14 him after the readjustment of basis, and in fact he'll
15 get a greater loss. The effect of the surrender is not
16 loss.

17 QUESTION: So the real issue here is when may
18 he take the loss?

19 MR. HOROWITZ: That's right.

20 QUESTION: Not whether he'll ever take it.

21 MR. HOROWITZ: Respondents at one point in
22 their brief suggest, quoting an opinion by Judge Hand,
23 that this is a now or never issue: Can they ever take
24 the loss if they're giving up a percentage interest, now
25 or never?

1 And that's not right. It's really a now or
2 later issue. And all the principles in the Code --

3 QUESTION: If the corporation does well and
4 recovers and the value of the stock goes up, there may
5 never be a loss.

6 MR. HOROWITZ: No, there may never be a loss,
7 although he'll still get credit for what he surrendered,
8 because he'll have less gain later on, because of the
9 basis adjustment.

10 Now, I think all the general principles that
11 underlie the Code suggest that this should be treated as
12 a contribution to capital. It's really no different
13 from a contribution of any other form of property, and
14 Respondents have conceded that if he had donated a truck
15 or cash or anything else that that would be --

16 QUESTION: But it's different in this sense,
17 that it doesn't change the balance sheet. There's no
18 increase in the net worth of the company, whereas in all
19 these other examples there is.

20 MR. HOROWITZ: Well, that --

21 QUESTION: Maybe that doesn't make any
22 difference.

23 MR. HOROWITZ: It's hard to see why that
24 should make a difference. I mean, that's a real
25 semantic point in calling it --

1 QUESTION: Except that they say here you've
2 got to capitalize this. How do you capitalize this?

3 MR. HOROWITZ: Well, all you're capitalizing
4 is what he had already put into the corporation. After
5 all, we're not suggesting that his basis be increased by
6 some new contribution. All we're saying is that the
7 \$1,000 or whatever that had originally been injected
8 into the corporation and that everyone agrees ought to
9 be capitalized should remain.

10 QUESTION: Yes, but what do you -- I thought
11 there was some discussion of capitalizing this
12 transaction. But there is no change in the capital
13 structure at all, as I see it.

14 MR. HOROWITZ: Well, maybe it's more accurate
15 to say that we don't want to allow Respondents to avoid
16 capitalization of the investment that they made
17 earlier. What they're seeking to do is to take out some
18 of this money that should have been capitalized and to
19 take an immediate loss for it now, even though they
20 invested it in the corporation and it's still in the
21 corporation.

22 And they haven't lost their investment.
23 Normally, if you sell a share to some outside purchaser,
24 the money that you invested in that share is then lost
25 in the sale, and it's appropriate to realize the gain or

1 loss at the time of that transaction.

2 But here they really haven't done anything.
3 All they've done is taken some shares out. Suppose they
4 turned around and bought these shares back the next
5 day. What would really -- say for the same price, for
6 the price that's reflected in the basis that they're
7 trying to take a loss for.

8 Now they have exactly the same interest in the
9 corporation that they had before. The only change would
10 be that they have really made an additional contribution
11 at that point in the amount that they paid for the new
12 shares.

13 Well, under our analysis that's exactly how it
14 would be reflected. They would still have all their
15 entire original investment, plus this new contribution,
16 distributed amongst all their shares.

17 QUESTION: Yes, but instead of giving some
18 relatively valueless stock, they would have given some
19 cash, which is a rather different economic transaction.

20 What does -- does the record tell us what the
21 market value is for this stock?

22 MR. HOROWITZ: Mr. Fink testified that he
23 thought the market value was about five cents a share.

24 QUESTION: And what was the price per share in
25 their basis? I know the total was \$190,000.

1 MR. HOROWITZ: Well, yes. It seems like they
2 surrendered the highest basis shares that they had, so I
3 think they paid 25 cents a share for them.

4 QUESTION: So it was about 20 cents on the
5 dollar. What you're saying, the comparable transaction
6 would have been putting in five times as much money as
7 they put in here, though.

8 MR. HOROWITZ: No.

9 QUESTION: They would have put in real
10 dollars, and here they're putting in stocks.

11 MR. HOROWITZ: It doesn't matter how much they
12 put. I'm willing for them to put in less if you like.
13 But the point is, under their -- if they turned around
14 and bought the shares back the next day, under their
15 analysis they would have gotten a loss somewhere, even
16 though they haven't lost anything.

17 And what they would still have as basis
18 reflected in the shares would be less than what their
19 investment is in the corporation. And you're not
20 supposed to be able to do that. If you make an
21 investment, it's supposed to be capitalized and stay
22 capitalized.

23 And what they're doing here, it's a way of
24 electively taking out money that they had invested in
25 the corporation and that is still there and should

1 remain subject to capital treatment.

2 QUESTION: I suppose that in the unlikely
3 event that the shares had appreciated in value, the
4 company had done well, and in the unlikely event that
5 they made a contribution of some of those shares, you
6 wouldn't try to hit them with a gain either, would you?

7 MR. HOROWITZ: No, that's right. No, our
8 position is just that there's no realization event
9 here.

10 And I should point out that this is not only
11 directed by common sense, but it's also reflected in the
12 treatment of other similar transactions in the Code.
13 There are two other sections of the Code, Section 83 and
14 Section 302, in which Congress, to deal with the
15 particular problem, has separated transactions into two
16 component parts.

17 Maybe I'll just choose one of these and focus
18 on redemptions. A redemption is an exchange by a
19 shareholder of his shares in the corporation in exchange
20 for cash. Congress determined that in some situations
21 that should not be given sale or exchange treatment,
22 where the shareholder remains in control of the
23 corporation, and instead it's divided into two parts.

24 It's treated as a surrender by the shareholder
25 of his shares to the corporation and then a distribution

1 of a dividend by the corporation. Now, the regulations
2 provide -- and Respondents do not dispute -- that the
3 way that this surrender is accounted for is by adjusting
4 the shareholder's basis in his remaining shares in the
5 amount of his basis in the surrendered shares, exactly
6 the treatment that we argue for here.

7 And it's exactly the same thing under Section
8 83, which is a sale of stock from a shareholder to an
9 employee as part of his compensation. Again, the Code
10 breaks that into two parts. It treats it as a surrender
11 by the shareholder of his share to the corporation and
12 then the payment of the stock by the corporation to the
13 employee, for which the corporation is entitled to a
14 deduction.

15 And again, the regulations provide -- and
16 Respondents agree -- that the appropriate treatment is
17 for the surrender to be reflected in an adjustment of
18 basis in the corporation.

19 I actually should note that our brief is
20 inaccurate in describing Section 83. We talk about that
21 the bargain element of the sale should be allocated to
22 the basis, and it should be allocated to the basis in
23 his remaining shares, and it's really the basis in the
24 surrendered shares which should be allocated.

25 I think I'd like to save the rest of my time

1 for rebuttal.

2 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
3 Horowitz.

4 We'll hear now from you, Mr. Zinn.

5 ORAL ARGUMENT OF
6 MATTHEW J. ZINN, ESQ.

7 ON BEHALF OF RESPONDENTS

8 MR. ZINN: Mr. Chief Justice and may it please
9 the Court:

10 In order for the Respondents to prevail in
11 this case, we must establish two points: first, that
12 their surrender of shares resulted in a loss within the
13 meaning of Sections 165 and 1001 of the Internal Revenue
14 Code; and second, that they didn't constitute
15 non-deductible capital expenditures under Section 263.

16 On the first issue, it's important to
17 recognize at the outset that the term "loss" is not
18 defined in the Internal Revenue Code, so ordinary usage
19 applies. And under ordinary usage, it is simply a
20 diminution in amount or value.

21 So if a shareholder buys stock and it goes
22 down in value, that shareholder has a loss. But he's
23 not automatically able to deduct the loss unless he
24 realizes it, unless some event occurs that fixes the
25 loss.

1 The most common type of events that fix losses
2 are sales. But the statute provides "sales or other
3 dispositions" fix losses. Other kinds of dispositions
4 would include exchanges, and in this case would include
5 surrenders.

6 So we disagree with Mr. Horowitz when he says
7 that there was no realization event in this case. There
8 very clearly was a realization event when Mr. and Mrs.
9 Fink surrendered their shares.

10 Those surrenders were substantial, 116,000 of
11 Mr. Fink's 802,000 shares and 80,000 of Mrs. Fink's
12 311,000 shares. We think it's perfectly clear that they
13 lost something when they surrendered these shares. They
14 lost a four percent interest in their stock ownership.

15 If they had sold shares to a third party and
16 had a four percent reduction in interest, there would be
17 no question that they had sustained a loss. We think
18 it's equally clear that they have sustained a loss in
19 this case.

20 Mr. Horowitz has said a good deal in the
21 course of his argument about the amount of the loss.
22 But I would point out to the Court that the Commissioner
23 never raised the issue of the amount of the loss in this
24 case.

25 The sole question presented in his petition

1 for certiorari, and it's repeated in his brief on the
2 merits, is whether there's a loss, not the amount. If
3 he wants to raise that issue in another case, he's free
4 to do so, but it would seem that he can't raise it
5 here.

6 Mr. Horowitz also didn't fully respond, I
7 think, to the question of the nature of the loss in this
8 case. Again, that's not an issue here. If this Court
9 finds that there is a loss, the way we think it should,
10 the loss necessarily is an ordinary loss.

11 On page 21 of the Government's brief in this
12 case, it is stated: "This case does not involve a sale
13 or exchange." If it doesn't involve a sale or exchange,
14 the only kind of loss it can be is an ordinary loss,
15 because Section 1211 and Section 1222 require a sale or
16 exchange in order for a loss to be a capital loss.
17 That's not an issue before the Court.

18 QUESTION: You say that there must be a sale
19 or exchange for it to be a capital loss?

20 MR. ZINN: That's right.

21 QUESTION: But there need not be a sale or
22 exchange for it to be an ordinary loss?

23 MR. ZINN: Exactly. And in this case, the
24 Government has conceded, as I just read from page 21 of
25 their brief, that there was no sale or exchange. And

1 that's really what this case is all about, Mr. Chief
2 Justice.

3 QUESTION: Well, Mr. Zinn, it would seem,
4 frankly, that if any taxable event is recognized at all,
5 that at best it ought to be treated as some kind of a
6 proportionate capital loss. And I just don't understand
7 how the taxpayer can legitimately expect to get to
8 deduct the full 400,000 as an ordinary loss.

9 MR. ZINN: I think, Justice O'Connor, that's
10 precisely what the statute requires in these
11 circumstances. The Government is here arguing the loss
12 rules when it perhaps ought to be arguing the question
13 of capital versus ordinary and the amount across the
14 street in the Congress.

15 There is just no question under the provisions
16 of the Code that you cannot have a capital loss without
17 a sale or exchange, and the Government concedes that
18 there's no sale or exchange.

19 QUESTION: Well, I guess some courts might
20 have thought that it should be deemed a sale or
21 exchange, if anything.

22 MR. ZINN: No court has ever deemed it to be
23 in a situation like this one, Justice O'Connor, where
24 the surrender is made directly by the shareholder to the
25 corporation. That would be a giant leap and one that we

1 don't think this Court should take.

2 The Government has litigated this case,
3 Justice O'Connor, on an all or nothing basis. They
4 argue that you shouldn't allow a loss because the loss
5 is sizable, you shouldn't allow a loss because the loss
6 is ordinary, you shouldn't allow a loss because it's
7 difficult to calculate.

8 We don't think that the conclusion that
9 there's no loss follows from any of those premises. So
10 we think that this --

11 QUESTION: Now, if it had been surrendered in
12 exchange for a payment of some very small sum, clearly
13 there would be no recognized loss.

14 MR. ZINN: We would then agree with Mr.
15 Horowitz that, under Section 302, the taxpayers would
16 not be entitled to any loss. But that's not this case.
17 And as we pointed out --

18 QUESTION: Well, it is kind of odd, though, to
19 think that there would be different results, isn't it?

20 MR. ZINN: As we pointed out in our brief, all
21 sorts of provisions of the Internal Revenue Code go off
22 on the most modest sums. And in most of those cases
23 where there are cliffs and traps, it's taxpayers who go
24 over them or into them.

25 In this particular case, it works the other

1 way. And the Government doesn't like it. But the
2 Government argues cases -- about ten years ago, the
3 Government brought the Foster Lumber Company case here,
4 which was a very -- which was a case that had a very
5 harsh result for the taxpayers.

6 And the Government told the Court in that
7 case: This is the way the Code is written, and this is
8 the way you have to decide it, and you ought to let the
9 chips fall where they map. And we think that taxpayers
10 are entitled to the same result when the chips fall on
11 the other side of the line.

12 Now, we disagree also with Mr. Horowitz's
13 point that this case is the same as Justice Scalia's
14 used truck case. In the used truck case, the
15 corporation has more assets and a greater net worth
16 after the truck is contributed to the corporation than
17 it had before.

18 In this case, as Justice Stevens pointed out,
19 the assets of the corporation are exactly the same
20 before and after. Now, in the truck case it seems to me
21 that it would be a perfectly rational system for
22 Congress or some legislative body to say you would allow
23 the loss even in the truck case, because the taxpayer,
24 to rephrase it, has surrendered the truck and he has a
25 lesser interest in it than he had before.

1 But that's not what Congress did. In Section
2 263 of the Code, Congress said when you have a
3 contribution to capital we're not going to allow you to
4 take the loss right away. If you make a new investment
5 in the corporation, we're going to make you wait and see
6 how that investment turns out.

7 In this particular case, there is no new
8 investment in the corporation. The investment is the
9 same before as it was after.

10 QUESTION: Well, the Government says this is a
11 contribution to capital. Why do you say it isn't?

12 MR. ZINN: Because the capital is the same
13 before and after, Mr. Chief Justice. The capital of the
14 corporation is its net worth.

15 QUESTION: Is there a definition in the Code
16 somewhere of contribution to capital?

17 MR. ZINN: Well, the word "contribution to
18 capital" has an accepted meaning, I think, in an
19 accounting sense, in a legal sense. There is no precise
20 definition in the Code, but I think it's universally
21 accepted that a corporation's capital is its net worth.

22 And we're not adopting any formalistic
23 statement, such as is suggested in the Government's
24 brief, that we're confining ourselves to the stated
25 capital or the par value of the stock. The

1 corporation's capital is what it would have if it
2 liquidated on a particular day.

3 And in the truck case, it's going to have more
4 after the truck. And in the stock surrender case, it's
5 going to have exactly the same amount.

6 So we think that we're relying on exactly what
7 it is that's real. If this -- if the surrender of stock
8 is a contribution to capital, then it seems to us that
9 the words have lost any meaning whatsoever.

10 This goes to the very essence of what a
11 corporation's capital is. What's really involved --

12 QUESTION: Mr. Zinn, granting that, could you
13 still lose the case?

14 MR. ZINN: Well, the Government I think is
15 shifting ground now. I think they recognize that it's
16 not a contribution to capital, and Mr. Horowitz said,
17 well, maybe it's some other kind of non-deductible
18 capital expenditure.

19 But we don't think it is. The real guts of
20 this case, Justice Blackmun, is that in the truck case a
21 shareholder is making an additional commitment to his
22 investment in the corporation, and that's a capital
23 expenditure or a contribution to capital. In this case,
24 when the shareholder surrenders his stock he is
25 shrinking his investment in the corporation. He is

1 reducing it.

2 This is an anti-expenditure. This is not a
3 capital expenditure.

4 QUESTION: Well, he is not reducing it by very
5 much if he still has the majority interest in the
6 corporation.

7 MR. ZINN: Exactly so, Justice Scalia.

8 QUESTION: But you say that goes to the
9 amount.

10 MR. ZINN: This case involves principle, not
11 price. The Government never raised that issue in the
12 lower courts, let alone in this Court.

13 QUESTION: Well, I understand, but I'd be
14 inclined to be pushed in one direction if I thought that
15 the deduction was going to be the whole value of the
16 stock and in quite another one if I thought the
17 deduction was only going to be the two percent reduction
18 in the shareholder's interest in the corporation.

19 MR. ZINN: I could understand that, Justice
20 Scalia.

21 QUESTION: So why don't we talk a little bit
22 about what that amount ought to be, then, if you can
23 understand that.

24 MR. ZINN: I don't think that the Code admits
25 of that interpretation. The Code requires quite clearly

1 that the starting point for determining a loss is the
2 adjusted basis of the shares, and it doesn't go by
3 proportionate interest.

4 And in this particular case, the Sixth Circuit
5 reduced that loss by the increase in value of the
6 retained shares. Now, that ameliorates the problem.

7 QUESTION: That doesn't go together with the
8 argument you were just making, that here there has been
9 a real loss. You say first here there has been a real
10 loss, but then you say but the Code doesn't really
11 matter whether there's been a real loss.

12 MR. ZINN: I say here there's a real loss and
13 the Code says this is the way you value it, and the two
14 do not work together as well as they might. But we
15 don't think that it's open to this Court to make up new
16 rules on how you determine loss.

17 QUESTION: But the loss you're identifying is
18 not the loss that you're valuing. You're identifying
19 one loss and evaluating another one.

20 MR. ZINN: I would say it's part of the same
21 loss.

22 QUESTION: If they don't fit together, that
23 may be a reflection on your earlier, the strength of
24 your earlier sollogism.

25 MR. ZINN: I don't think so. I think that on

1 the first point it's very clear that there's a loss.
2 And the Code has one set of rules for determining
3 whether there's a loss.

4 In this particular circumstance, it has
5 another set of rules for determining the amount of the
6 loss, which are different. And that's simply the way it
7 works.

8 QUESTION: Your assertion that there is a loss
9 is that the value of his remaining shares has gone down,
10 is that it?

11 MR. ZINN: Well, the value of his percentage
12 interest has gone down.

13 QUESTION: Well, what does that mean?

14 MR. ZINN: That means he has less rights to
15 dividends.

16 QUESTION: The value of what he would get out
17 of the corporation is now less.

18 MR. ZINN: Well, except that we're measuring
19 the loss by reference to the adjusted basis. I admit
20 that there's a discontinuity, Justice White, between the
21 question of whether there's a loss --

22 QUESTION: How do you know there's a loss
23 right now?

24 MR. ZINN: Well, they have a reduction in
25 their interest in the corporation. They've surrendered

1 those shares and they haven't gotten any consideration
2 for it.

3 QUESTION: Well, but it may be that this event
4 will -- maybe they'll have a profit.

5 MR. ZINN: That's true.

6 QUESTION: And then they never will have a
7 loss.

8 MR. ZINN: That's true. But they have reduced
9 their interest in the corporation, and it seems to us
10 that fixes a loss.

11 QUESTION: I know it seems to you, but I don't
12 know. What would you do then if you had this loss and
13 then the corporation recovers and --

14 MR. ZINN: There'll be a larger gain when it
15 recovers. But the time for fixing this loss is the time
16 of the disposition of this stock.

17 QUESTION: Well, why do you think the Code
18 requires recognizing this event as a realizing loss?

19 MR. ZINN: Because the Code refers to a sale
20 or other disposition, and we think this fits within the
21 concept of other disposition. And the Code says that's
22 a realization event.

23 QUESTION: May I go back to Justice Blackmun's
24 procedure, which I'm not sure you squarely answered. He
25 asked you, even if we assume that you've convinced us

1 it's not a capital contribution, it does not necessarily
2 follow that you win the case because you still have the
3 burden of persuading us that it's a loss.

4 And the one thing that makes this case
5 superficially at least different from a lot of other
6 loss cases is this is sort of a self-inflicted wound.
7 The owner of the property decided voluntarily to enter
8 into this transaction and incur the economic detriment.

9 MR. ZINN: Well, I would say that whenever a
10 taxpayer has depreciated property and he disposes of it
11 it's a self-inflicted wound.

12 QUESTION: But normally he sells it. Normally
13 in those cases it's sold. Are there any other cases in
14 which a taxpayer disposes for no consideration,
15 voluntarily disposes of property for no consideration,
16 and thereby suffers a loss?

17 MR. ZINN: Abandonment. A taxpayer may
18 abandon property in a particular case and he then gets a
19 loss.

20 QUESTION: I see. But doesn't he have to then
21 establish that it's of no value?

22 MR. ZINN: No. I think he can just walk away
23 from it as long as he does the right things. We cited
24 an abandonment case in our brief as another example of
25 this.

1 QUESTION: Well, what if he burnt a few of his
2 shares?

3 MR. ZINN: Burns the pieces of paper?

4 QUESTION: Yes, burned them up. He says: I
5 don't want them any more. That's just an abandonment?

6 MR. ZINN: I don't think that would be an
7 abandonment, Justice.

8 QUESTION: Well, how do you abandon it?

9 MR. ZINN: Well, in this particular -- with
10 regard to shares, the only way you can abandon them is
11 by surrendering them. I don't think you can abandon
12 them by burning them. I don't think they're bearer
13 documents.

14 QUESTION: And an abandonment is not a loss?

15 MR. ZINN: An abandonment of some other kind
16 of property, where you can abandon it, would be a loss.
17 But in this particular case, I don't think burning the
18 shares would be a loss.

19 One other point that I would like to take up
20 is --

21 QUESTION: Just, if we could go one step
22 further. This really wouldn't be an abandonment,
23 because he is retaining an interest in his other shares,
24 and he's doing it because he looks to --

25 MR. ZINN: But he's abandoning these shares.

1 He's abandoned a part of his interest in the
2 corporation.

3 QUESTION: Yes, but it isn't as though he gave
4 -- if he gave them to a third party or a church or
5 something, that might be, of course, an event. But
6 this, somehow the concept of an abandonment -- is that
7 your closest analogy?

8 MR. ZINN: It is, it is my closest.

9 I'd like to --

10 QUESTION: But again, he's abandoning two
11 percent or whatever.

12 MR. ZINN: Right, he's abandoning two
13 percent.

14 QUESTION: But you want the loss for the whole
15 value of the stock.

16 MR. ZINN: That's precisely what we want and
17 that's precisely what we think the Code requires.

18 QUESTION: Mr. Zinn, I have a complete lapse
19 of memory. You've referred to sale or other
20 distribution several times. Where exactly in the Code
21 is that language?

22 MR. ZINN: Section 1001(a) of the Code,
23 Justice Blackmun.

24 QUESTION: In what?

25 MR. ZINN: 1001(a) of the Code.

1 QUESTION: Thank you.

2 MR. ZINN: One other point that Mr. Horowitz
3 made that I wanted to get into was what the state of the
4 law has been in the Tax Court over the course of the
5 past 60 years. For 50 years, as we discussed in our
6 brief, the rule was clear that stock surrenders of this
7 sort give rise to ordinary losses.

8 And during that entire period, despite the
9 considerations that have been raised about the character
10 of the loss and the amount of the loss, never once, so
11 far as we are aware, did Congress ever think that this
12 was a loophole, as Mr. Horowitz put it, that needed to
13 be taken care of.

14 Indeed, and never once did the Treasury ever
15 suggest that. Indeed, the Treasury acquiesced in this
16 precise rule for 35 years, and Congress and Treasury
17 never ever looked at it.

18 The Government has made no mention of the 50
19 year precedence in its reply brief. And I would point
20 out, in response to the question of where the Tax Court
21 was, Justice Blackmun, that you put, this went to Tax
22 Court conference seven or eight times before this case.
23 And in each of those occasions, the Tax Court held that
24 there was a loss.

25 And the Tax Court has now abandoned its

1 position after so holding in a conference seven or eight
2 times. We think that's highly irregular and that, given
3 that history, again, the best place to get this fixed is
4 not here, but in the Congress.

5 We also think that there's a significant
6 omission from the Government's petition for certiorari
7 in this case. The Government asserts that this is a
8 recurring and important issue, but there is absent from
9 the Government's petition any statement of how many
10 cases like this are pending before the district
11 directors of internal revenue, how many cases are
12 pending --

13 QUESTION: Did you raise that in your
14 response?

15 MR. ZINN: In the brief in opposition?

16 QUESTION: Brief in opposition.

17 MR. ZINN: The point was made, yes.

18 Any --

19 QUESTION: Well, what's the reason for raising
20 it now?

21 MR. ZINN: Well, I raise it now because we
22 don't believe that the tax avoidance that the Government
23 has held up here, Mr. Chief Justice, and in the lower
24 courts is all that clear.

25 I don't think the Government's taking into

1 account human nature in looking at these cases. It's
2 true that people that are involved in close corporations
3 are interested in tax deductions, but they're also not
4 anxious to give away their shares by surrender or any
5 other means when the corporation is in dire financial
6 straits.

7 What they want to do is to turn the
8 corporation around, and that was the purpose of the
9 surrender in this case and the Tax Court squarely so
10 found. And this is a built-in check against the kind of
11 rampant tax avoidance that Mr. Horowitz has suggested.

12 QUESTION: Well, what did these people really
13 have to lose in a business sense by reducing their
14 control from 72 percent to 68 percent?

15 MR. ZINN: Well, if their plan had worked they
16 would have wound up with 33 percent of the stock. And
17 regrettably, it didn't work. They were unable to
18 attract outside capital.

19 But the only way you're going to attract
20 outside capital is to offer the possibility of a change
21 of control.

22 QUESTION: Yes, but here that had not gone
23 this far. What the loss we're talking about here, it
24 went from 72 percent to 68 percent.

25 MR. ZINN: That's correct.

1 QUESTION: What did they lose by that in a
2 practical sense?

3 MR. ZINN: They lost four percent? I mean,
4 that's what they lost.

5 QUESTION: But is this the sort of thing that
6 they're not going to want to do because it means giving
7 up so much?

8 MR. ZINN: I think it does. I think that the
9 record, historical record in this area, undercuts the
10 Government's argument of rampant tax avoidance. I think
11 it doesn't take account of human nature.

12 I would also point out that the Tax Court
13 specifically found as a fact in this case that tax
14 avoidance was not the primary purpose, that there was a
15 valid business purpose.

16 QUESTION: You don't urge that -- I think it's
17 the same question as I asked earlier. That wouldn't
18 matter to you? I mean, you don't urge that each one of
19 these cases has to be examined one by one to see whether
20 the purpose was the same purpose there it was here, to
21 get the corporation back going?

22 MR. ZINN: I think the question of tax
23 avoidance would always be present, Justice Scalia, even
24 if this Court were to affirm the judgment of the Court
25 of Appeals.

1 QUESTION: I don't understand what you mean by
2 tax avoidance. You say you're entitled to it.

3 MR. ZINN: If tax avoidance was a primary
4 purpose --

5 QUESTION: Suppose you abandon other kinds of
6 property, you walk away from it, and you say, I'm
7 walking away from it because, you know, I'll get the tax
8 break. Can you not take it?

9 MR. ZINN: If tax avoidance is the primary
10 purpose of the abandonment or the surrender, then I
11 don't think that you would be allowed the loss even if
12 this Court affirmed the judgment of the Court of
13 Appeals, because the common law tax doctrines always
14 would apply.

15 And that was pointed out. We rely heavily on
16 Judge Parker's dissenting opinion in the Frantz case.
17 She pointed out that that doctrine would be available,
18 as would the step transaction doctrine.

19 Mr. Horowitz gave an example of a surrender
20 followed by putting the money -- putting the shares back
21 in. Now, that would be considered a step transaction
22 and would be disallowed, even if this Court were to
23 affirm the judgment of the Court of Appeals.

24 The principal vice here, as Justice O'Connor
25 pointed out, is a conversion of capital loss into

1 ordinary loss. And if ever there was a case that didn't
2 involve conversion, it's this case, because in this case
3 the surrenders were made in December 1976 and January
4 1977, and this corporation kept going until 1980.

5 This is not a case where the shareholders
6 surrendered stock and turned around and then liquidated
7 the corporation. And that is a conversion case that I
8 think that the Government could get at regardless of the
9 disposition of this case.

10 If there are no other Respondents, Mr. Chief
11 Justice, I have nothing further.

12 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
13 Zinn.

14 Mr. Horowitz, you have six minutes remaining.

15 REBUTTAL ARGUMENT OF

16 ALAN I. HOROWITZ, ESQ.

17 ON BEHALF OF PETITIONER

18 MR. HOROWITZ: Thank you, Mr. Chief Justice.
19 I have several points I would like to make.

20 One is, Respondents continually assert that
21 the loss here is their percentage decline in their
22 interest in the corporation and, as I think we pointed
23 out in our reply brief, in no other situation does a
24 percentage decline in one's interest in the corporation
25 give rise to a loss.

1 If this new investor had come in and, as he
2 says, pushed their interest down to 33 percent by buying
3 all kinds of shares, that would not have given rise to
4 any kind of taxable loss.

5 QUESTION: Mr. Horowitz, can I ask you to
6 comment on the argument that he makes that for 35 years
7 apparently the Treasury Department was satisfied with
8 this rule and didn't challenge it, and there were eight
9 or nine times when the Tax Court went to conference and
10 agreed on it.

11 And is it correct as a matter of fact that the
12 law appeared to be settled for a long period of time and
13 only recently the Government decided to re-examine the
14 issue?

15 MR. HOROWITZ: Well, I think that's somewhat
16 exaggerated, although it is true that we did acquiesce
17 in this case in 1941 and the Commissioner never got
18 around to removing his acquiescence until the
19 mid-seventies.

20 But in fact this issue has been continually
21 litigated during those years. There is the Downer case
22 in the mid-sixties, which is during this period when
23 supposedly the Government was acquiescing in this, where
24 we were litigating the exact issue.

25 QUESTION: In the sixties. Now, there's one.

1 How many cases were -- how long did it take the
2 Government to achieve -- well, how many times did it try
3 to challenge that, what seemed to be settled law, during
4 the interval? You mentioned the Downer case.

5 MR. HOROWITZ: I don't think there are many
6 reported cases between the early forties and the
7 sixties.

8 QUESTION: And there was no Congressional
9 action and no change in Treasury regulations that
10 precipitated this?

11 MR. HOROWITZ: Well, one thing that certainly
12 precipitated the most recent set of events was the
13 enactment of Section 83, where Congress specifically
14 dealt with the situation of sales of stock, bargain
15 sales of stock from a shareholder to an employee. And
16 the regulations thereunder stated that under normal tax
17 principles -- and also there was some legislative
18 history -- that this surrender should be treated as a
19 contribution to capital on the shareholder's part.

20 And that was also litigated in the Tilford
21 case, and the Sixth Circuit in fact upheld the
22 Commissioner's view there.

23 So -- and Respondents have agreed that that
24 treatment there is right. So they agree that a stock
25 surrender, at least from the employee compensation

1 context, can be treated as what we call a contribution
2 to capital or, if you prefer it, to just call it an
3 adjustment of basis.

4 And they really don't explain why the
5 treatment should be any different in this context.

6 QUESTION: Well, except they say this was the
7 law for about 30 or 40 years, and generally speaking
8 citizens can rely on settled law without having to worry
9 about the Government changing its meaning.

10 MR. HOROWITZ: Well, I don't understand them
11 to be making a reliance argument here. I mean,
12 certainly --

13 QUESTION: Not particularly, but there is a
14 certain -- there certainly is an interest in letting the
15 law be understood by people who engage in these
16 complicated transactions.

17 MR. HOROWITZ: Well, I understand.

18 QUESTION: But you don't think that's of any
19 -- the Section 83 that you referred to was enacted
20 when? When was that? Section 83 was when?

21 MR. HOROWITZ: That was enacted in '68, I
22 think, or '69.

23 Now, there were some developments in this
24 Court that made it clear that this should be treated as
25 a contribution to capital after these early Tax Court

1 decisions.

2 QUESTION: Let me just ask you, are you still
3 maintaining it's a contribution to capital, or are you
4 now maintaining the position you take in your reply
5 brief, which it doesn't really matter whether it's a
6 contribution to capital?

7 MR. HOROWITZ: Well, I guess we maintain
8 both. I mean, I don't think it really matters, but I
9 think the proper treatment of it is as a contribution to
10 capital.

11 That's just a shorthand term that is used to
12 reflect this kind of expenditure by, for no
13 consideration in return, an expenditure by a shareholder
14 in order to advance the purposes of the corporation and
15 to enhance the value of his remaining shares. That's
16 the purpose of the surrender, that's the purpose of all
17 these capital contributions.

18 QUESTION: But certainly from the viewpoint of
19 the corporation not a dime has been added to it.

20 MR. HOROWITZ: And not a dime has been taken
21 out of it, Justice Blackmun, also.

22 We're not trying to add anything to his total
23 basis in the corporation as a result of the surrender.
24 He has made a certain investment in the corporation that
25 up until now had always been reflected in the basis of

1 his shares. Now what he has done is just taken some
2 shares out of the calculation.

3 And our position is that his investment in the
4 corporation remains there and it should just be
5 reallocated to the remaining shares.

6 QUESTION: I understand all that, but I think
7 this constant reference to contribution to capital is a
8 little fuzzy, really.

9 MR. HOROWITZ: Well, it's just an accounting
10 semantic point. I mean, I'm willing to call it
11 adjustment to basis if you like. It just seems to me
12 that the effect of what he has done is essentially the
13 same as what happens with any other capital
14 contribution.

15 And I'd also like to talk briefly about this
16 statutory point about other disposition of property. It
17 really proves too much to read the words that way,
18 because under Respondents' theory any contribution to
19 capital, if you will, Justice Scalia's example of a
20 truck, would also have to be treated as a loss.

21 I mean, that truck is disposed of when it's
22 given to the corporation in the same sense that these
23 shares that are surrendered.

24 QUESTION: Well, maybe it would have to be if
25 everything was perfectly logical in the Tax Code. But

1 we've heard both sides argue from time to time, you just
2 read the darn thing and try to make sense out of it.
3 And if there's a long line of cases on stock surrenders
4 and there are no cases on trucks, you just don't have to
5 extend the rule to trucks.

6 MR. HOROWITZ: Well, if you read the darn
7 thing, Justice Stevens, Section 165 requires that there
8 be an actual loss, and our view is, for many of the
9 reasons I've discussed, that there is no loss here. And
10 Section 263 in any event overrides all of these
11 sections. It says if there is a capital expenditure it
12 must be capitalized.

13 And there was a capital expenditure -- if
14 you're not satisfied that the surrender itself looked at
15 it microscopically should be treated as a capital
16 expenditure, there's no question that the amounts
17 involved, the amounts that are being allocated to the
18 basis, were capital expenditures when they were made.

19 And there's nothing that has happened in the
20 interim that should entitle Respondents to take a loss.
21 They just have not lost that investment at all. It's
22 still their corporation and the money is still in
23 there.

24 QUESTION: Well, except the stock's gone down
25 substantially in value and they decided to get rid of

1 some of it.

2 MR. HOROWITZ: Well, they have to sell it.

3 CHIEF JUSTICE REHNQUIST: Thank you, Mr.

4 Horowitz.

5 The case is submitted.

6 (Whereupon, at 10:56 a.m., the above-entitled
7 case 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:

#86-511 - COMMISSIONER OF INTERNAL REVENUE, Petitioner V.

Peter R. Fink, ET UX

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

BY Paul A. Richardson

(REPORTER)

RECEIVED
SUPREME COURT, U.S.
MARSHAL'S OFFICE

'87 MAY -4 P3:14