TRANSCRIPT OF PROCEEDINGS

IN THE SUPREME COURT OF THE UNITED STATES

In the Matter of:	)	
	)	
UNITED STATES,	)	
	)	
Appellant,	)	
	)	
v.	)	No. 86-1521
	)	
WELLS FARGO BANK, ET AL.	)	

Pages: 1 through 38

Place: Washington, D.C.

Date: December 8, 1987

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IN THE SUPREME COURT OF THE UNITED STATES

UNITED STATES,

Appellant,

v.

WELLS FARGO BANK, ET AL. : No. 86-1521

Washington, D.C.

Tuesday, December 8, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:36 p.m.

APPEARANCES:

LAWRENCE G. WALLACE, ESQ., Deputy Solicitor General, Department Of Justice, Washington, D.C.; on behalf of the Appellant.

ROBERT H. ROTSTEIN, ESQ., Beverly Hills, California; on behalf of the Appellees.

C O N T E N T S

P R O C E E D I N G S

CHIEF JUSTICE REHNQUIST: Mr. Wallace, you may proceed whenever you're ready.

ORAL ARGUMENT OF LAWRENCE G. WALLACE, ESQ.

ON BEHALF OF APPELLANT

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

In this case, the Appellees are executors of estates that included among their property state or local public housing agency project notes.

The question before the Court is whether testamentary transfer of those project notes is exempt from the federal estate tax.

In urging that the testamentary transfer is not exempt, we have two grounds, either of which would independently support a judgment in our favor.

Our principal contention is that the transfer of such notes never was exempted from the federal estate tax by the Federal Housing Act of 1937, the so-called Wagner Act. Our other contention is that even if they had been so exempted, Congress repealed that exemption in 1984 for taxpayers situated such as the Appellees, and that contrary to the District Court's holding, the application of that repealer provision was not unconstitutional.

There are three reasons why we urge that the Court

should address our principal contention first, that the transfer never was exempt from federal estate tax.

The first is that if we are correct about this statutory issue, it avoids the necessity of addressing a constitutional contention or even the necessity of construing the effect of the 1984 Repealer Provision in light of the constitutional argument.

The second reason why we believe that question should be addressed first is that there are presently pending, the Internal Revenue Service has done a survey on this, 101 cases which would not be disposed of were the decision to rest on grounds of the scope or constitutionality of the 1984 Repealer Provision because there were 101 cases pending, either administratively or in the courts, with a total value of project notes at issue of slightly more than $90 million, in which the returns were filed after the Haffner decision came down in 1984, and no tax was reported as owing on those returns.

They are cases that would be controlled by whether or not Haffner was correctly decided, and --

QUESTION: Was that in the 7th Circuit?

MR. WALLACE: That was the 7th Circuit case.

QUESTION: And did the Government just lie still for that or --

MR. WALLACE: We did not petition for writ of

certiorari for Haffner. We had no conflict in the circuits at that time, and Congress had already enacted a retroactive repealer.

QUESTION: I see. All right.

MR. WALLACE: So, we --

QUESTION: Rested on your expectation that you would win a case like this?

MR. WALLACE: Well, we didn't think that our future course here would be enhanced by tacking certiorari denied on to the 7th Circuit's decision.

So, we did not petition there. Now, this is not in our judgment an issue that should have to be briefed and argued twice in this Court and, therefore, there is some merit in deciding the issue that would dispose of all of the cases.

First, now it is true that we do not presently have a conflict in the circuits on that narrow question, but we do believe that the impetus of decisions has turned in our favor with this recent decision of the Tax Court by an eleven to five vote called Estate of Egger, which is referred to in our reply brief, and which we have furnished for the Court's convenience.

QUESTION: Mr. Wallace, the present case came up from the Tax Court, too, didn't it?

MR. WALLACE: The present case is from a District Court.

QUESTION: From the District Court.

MR. WALLACE: It's on appeal from the District Court for the Central District of California.

QUESTION: And Haffner came out of the Northern District of Illinois?

MR. WALLACE: That is correct.

QUESTION: Is this the first time the issue was reviewed by the Tax Court, by the full Tax Court?

MR. WALLACE: That is correct.

QUESTION: The first time?

MR. WALLACE: It is the first Tax Court decision on the issue.

QUESTION: And you have five dissents or something like that?

MR. WALLACE: There were five dissents, but eleven votes agreeing with our position, and I would add that the Tax Court's opinion seems to us to be the fullest and most persuasive treatment of the issue thus far by any court.

QUESTION: And the Tax Court held that the bonds were not intended to be exempt under the 1937 Act?

MR. WALLACE: Under the 1937 Act, which was the only issue before the Tax Court since the Repealer Provision would not have affected the Tax Court cases.

Now, the third reason why we think that the Court should first consider that question is because we think it is the correct answer that Congress never did have to

retroactively repeal an exemption that never existed, and so far as we can tell, that's what Congress itself thought when it enacted the Repealer Provision less than three months after the District Court decision in Haffner without even waiting to see whether the Court of Appeals would affirm or reverse the District Court.

Now, on this issue, the District Court in our case simply relied on the District Court decision in Haffner. So, we'll turn to the analysis used by the District Court in Haffner.

That decision surely is one of the most remarkable, is one of the most remarked-upon tax decisions of our time, in that it discovered a tax exemption that had lain dormant for almost forty-five years, a tax exemption of very elastic scope, which had gone unnoticed by the Tax Bar, unclaimed by taxpayers, and unrecognized by either the Internal Revenue Service or any court for a period of almost forty-five years, and the Court did so while conceding in its opinion that the language used by Congress in the 1937 Act would not in itself be sufficient to confer this exemption.

That language is set forth in the Appendix to our brief on pages 2A and 3A at the very end of our brief. It's Section 5(e), which provides in the second sentence that obligations issued by these local public housing authorities and then skipping to the end of the paragraph "shall be exempt

from all taxation now or hereafter imposed by the United States".

As the Tax Court recently said in Estate of Egger, that language had been definitively interpreted by this Court as well as other courts by 1937, at the time the Wagner Housing Act was enacted, and it had been definitively interpreted to apply to taxes on the obligations or the income themselves, income or property taxes, and not to taxes on the transfer of the securities, namely estate or gift taxes.

The interpretation of such statutory provisions, and we have collected the cases on pages 18 and 19 of our brief, in a lengthy footnote as well as in the text, the interpretation was closely tied in to the constitutional question of the validity of the estate and gift tax in light of the requirement of Article I, Section IX of the Constitution, that direct taxes must be apportioned among the states, and the reason why nothing comparable to the Sixteenth Amendment to the Constitution authorizing the income tax had to be adopted for purposes of the estate and gift tax is because the Court in the cases we cite had definitely held that the estate and gift taxes are not taxes on the obligations, but are taxes on the act of transfer.

QUESTION: Then, Mr. Wallace, why would there be specific exemption language in Section 20 of the earlier act?

MR. WALLACE: Well, that brings me, Mr. Justice, to

the first ground relied upon, we think erroneously, by the Court in Haffner, the difference in the drafting between this language we just looked at in Section 5 and the language that appears on the next page, which is Section 20(b) of the 1937 Act, a provision which has not existed in the Act since 1949, and that is referring to obligations of the Federal Housing Authority, a federal agency, which was to furnish money to the state agencies.

It says that though it shall be exempt, both as to principal and interest, from all taxation, except sur taxes, estate, inheritance and gift taxes, now or hereafter imposed by the United States or any state or local taxing authority.

The principal difference, and we think the basis of the error in the Haffner case, is that looked upon in historical context, this was a much more limited exemption from income taxation. From 1913 until 1954, the income tax was really divided into two taxes; what was basically the flat rate at a rather low level income tax, and the graduated aspect of it, called the sur tax, and the taxable income was defined slightly differently.

The determination was made with respect to the federal obligations that they, unlike the obligations of the local housing authorities, would be exempted from the flat tax which, in 1937, was a four percent tax, but they would not be exempted from the graduated aspect of the income tax. The sur

tax.

And, therefore, it was necessary in drafting this provision to put in an exception to accomplish the result Congress wanted to accomplish, to say except sur taxes. Once an exception was mentioned, then cautious draftsmanship would call for enumerating all the exceptions to ward off the possibility of an argument that expressio unius est exclusio alterius, as it's sometimes called.

QUESTION: But you just told us that this wasn't an exception, that the language simply didn't cover it.

MR. WALLACE: The language would have covered sur taxes. So, it was necessary to have an exception for sur taxes. This could be --

QUESTION: That is a true exception, but you just told us that the exemption of any transfer taxes --

MR. WALLACE: That is correct.

QUESTION: -- is not really an exemption.

MR. WALLACE: It might not have been necessary, but it was a draftsmanship devise used out of an abundance of caution and it was not something peculiar to this statute.

We have on page 29 of our brief collected a number of references to other federal statutes. This was the standard mode of including exemption from taxation for federal obligations, whereas 5E reflected the standard mode that was used in formulating an exemption from state obligations which

was a broader exemption.

We have in the Footnote on page 29 and in the related text, a number of other examples that use the same standard mode.

The other point to be kept in mind is that these two provisions were not drafted simultaneously. Section 20(b) was carried over from a bill that was first drafted in 1935. It was carried over to another one in '36, and then finally to this one in '37, whereas Section 5E was drafted in 1937, almost surely by different people.

So that it is as we term in our reply brief, fallacious to compare the two as if they were intentionally drafted by the same person to accomplish two different results. Instead, they are reach a standard form of accomplishing what was an established result at the time.

I'd like to turn next to the remaining items in the legislative history that are relied upon either in the Haffner opinion or in our opponent's briefs in this Court. Keeping in mind, however, that relying on these matters, none of which is unequivocal as we shall see, is really contrary to the established principle stated over and over again by this Court, that tax exemptions do not rest upon implication. They have to be unequivocally stated in the text of the statute.

So, the entire inquiry that was undertaken in Haffner once the Court admitted that the language used by Congress

would not support the exemption was really contrary to this Court's decision.

The first thing relied upon was a statement made on the Floor by Senator Walsh in the course of a lengthy statement interrupted by many colloquies, many of which consisted of corrections of things that Senator Walsh had been saying, and the particular paragraph from the Congressional Record, I'd like to read it in full, so the Court will get the flavor of it, was as follows:

"Obligations, including interest thereon, issued by public housing agencies and income derived by such agencies on such projects are to be exempt from all taxation now or hereafter imposed by the United States. In other words, the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, sur tax, estate, gift and inheritance taxes."

It is that appositional clause which means, which is the basis on which the Appellees and the Court in Haffner relied on, Senator Walsh's statement.

Our view is that this is simply a mis-description of what the meaning is for a bond to be exempt from all taxation. What it means to issue a tax-exempt bond that had been clearly established in the Court's cases, and it was stated in a way that suggested that this would be the ordinary tax-exempt bonds, such as municipal bonds, which have never been exempt

from estate and gift taxes, and he was merely parathetically describing the attributes of a tax-exempt bond.

This is not the way that the Congress unequivocally would adopt so pronounced a change from the ordinary way of doing business in conferring tax exemptions on municipal and other local bonds.

QUESTION: Mr. Wallace, which Senator Walsh was this? Massachusetts or Montana?

MR. WALLACE: This was Montana. The Massachusetts. I'm sorry. I'm confused by it. David Walsh of Massachusetts. I thought he was the other one.

There is some confusion about what his precise role was with respect to the bill. I think ultimately that's immaterial. He was not either the sponsor, who was Senator Wagner, the sponsor or floor manager, nor was he the chairman of the committee during the time that the hearings and work were done on the bill.

QUESTION: Maybe he's responsible for getting estate tax exemptions for the bond.

QUESTION: Well, he was not a leader in the tax area in Congress anyway at the time.

MR. WALLACE: Yes, Mr. Justice.

But the point is that Congress, surely the members of Congress, would have been alerted in a more telling way than this if a departure were intended from the ordinary principles

governing the scope of tax exemptions. After all, the House of Representatives did not even have the benefit of Senator Walsh's mis-description in the course of his statement at all, and there was no indication that it came across to the members who were hearing it, anything more than the notion that the ordinary attributes of tax-exempt bonds were being conferred here.

Some question is raised about why no one rose to correct this when other corrections had been made of other errors in Senator Walsh's statement. Well, this is quite understandable when you look at the context in the Congressional Record. As he finished there, he yielded to Senator Davis of Pennsylvania, who raised another point with respect to his statement.

As I understand it, Senator Davis said the local authorities will be granted some $700 million and then there is a colloquy between Senator Walsh and Senator Davis about the size of the initial appropriations and what they expect it will be in the future, and when that finally ends, Senator Walsh says, "Mr. President, I think I am now prepared to submit the few amendments I have to offer." So, they just went on to something else, and one could hardly attribute significance of the sort required for an unequivocal conferral of a tax exemption to the fact that no one happened to rise at an inopportune moment on the Floor of the Senate to correct this

mis-description that occurred in the course of Senator Walsh's remarks.

Now, the two other matters on which the Appellees and the Court relied are, if anything, even less substantial. One is the fact that an alternative bill, the Ickes Bill, had a more comprehensively-drafted exemption provision. That was a bill that differed in many important respects from the Wagner Bill.

A written statement was submitted to the committee on behalf of Secretary Ickes, describing in some detail the differences between the two bills, no mention was made of any difference in tax consequences between the two bills. It was the Wagner Bill that was reported out of committee. There was no indication that anyone on the committee thought that a choice was being made with respect to tax consequences of these project notes, and certainly even less reason to think anyone on the Floor was aware of any difference in the draftsmanship between the two bills.

And, finally, the reference is made to a speech that was made by a federal official after the enactment of the Wagner Housing Act, a speech by Mr. Warren Vinton, which expressed the view that these notes would be exempt from transfer taxes. That speech displayed considerable confusion on the subject.

Mr. Vinton was not a lawyer. He had been helpful in

aspects of the legislative history of the housing law. He was an employee of the Department of Agriculture, the Resettlement Administration there. He knew something about low-cost housing, but he was not definitively interpreting the statute on behalf of either the agency that would be issuing the bonds, which was the state or local agencies, or on behalf of the Internal Revenue Service, which has the responsibility to construe the tax laws.

I would like to reserve the balance of my time, if I may.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Wallace.

We'll hear now from you, Mr. Rotstein.

ORAL ARGUMENT OF ROBERT H. ROTSTEIN, ESQ.

ON BEHALF OF APPELLEES

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

This case comes down to whether the United States Government may refuse to return a citizen's money for no other reason than that the Government has acquired possession of that money and the District Court quite properly answered that question in the negative.

I'll turn first to the question as to whether project notes are exempt from federal estate tax under the 1937 Housing Act.

As the Government recognized, the starting point is

the statutory language. Section 5(e) of the '37 Act, which exempted project notes unequivocally from all taxation now or hereafter imposed by the United States. Section 20(b) contained a much more limited exemption for federal housing obligations, not project notes. These obligations were exempt from all taxation except inheritance taxes relative to estate taxes.

QUESTION: Mr. Rotstein, if all we had before us was the language of Section 5(e) and we didn't have the language in Section 20, would you concede that the Government's position is correct in that we would not ordinarily give that broad language such a broad effect?

MR. ROTSTEIN: Your Honor, I would so concede if there was not also the legislative history. I believe, although it would be a tougher case, if you had the legislative history plus just the Section 5(e) exemption, I would still say that project notes are exempt. Fortunately, you have a simpler case here because you do have Section 20(b).

Now, the Government argues that Section 5(e) doesn't exempt project notes by relying on a line of cases, beginning with Murdock v. Ward, which holds that exemptions for all taxation in certain circumstances relating to bonds don't include an exemption for the estate tax. These cases make a distinction between a direct tax on a bond and a transfer tax.

The courts recognized recently that this is a

formalistic distinction without economic consequences, and significantly none of the statutes considered in the Murdock line contain statutory language like 1937 Act, that has two sections; one with a blanket exemption and one with a more limited exemption.

Similarly, none of the cases in the Murdock line consider statutes as legislative history. So, it clearly shows that Congress intended to bestow an estate tax exemption on the bonds.

Now, we discussed the legislative history in our brief. I won't repeat it here. It is unequivocal. I just want to comment, make the comment that the Government really offers no affirmative history to the effect that Congress intended to subject project notes to the estate tax, and absent such affirmative evidence, there's no reason to disregard the plain meaning of the '37 Act and the legislative history affirmatively showing that project notes were exempt.

And, so, the Government actually resorts to --

QUESTION: Well, the legislative history you rely on is the statement of Senator Walsh, I gather?

MR. ROTSTEIN: Well, it's the statement of Senator Walsh plus the version, the rejected version, of Secretary Ickes, which contained a reference to estate tax and Section 5(e). There's also the Vinton statement, which I realize isn't legislative history with post-enactment, but we believe that

that's also persuasive.

QUESTION: You are combining two of the Government's arguments. It seems to me if you want a plain language argument, you just look to the first provision, not the later one that contains the exceptions, and the plain language of that, it seems to me, does not cover these bonds.

MR. ROTSTEIN: Well, --

QUESTION: You may call it a formalistic distinction, but the fact is when you tax the bonds, you're imposing an annual tax or some other tax on the bonds themselves. This estate tax does not apply until -- unless and until there's a transfer. So, it's really a tax on the transfer.

You may call that formalistic, but that's plain language.

MR. ROTSTEIN: It is a tax on the transfer. We're not denying that, but the plain language argument is simply that when you look at the '37 Act and compare Section 5(e) and 20(b), it couldn't mean anything, 5(e) could not have any other meaning than a congressional intent to exempt project notes from the estate tax, read in light of 20(b) as the statutes are to be read.

QUESTION: In light of 20(b).

MR. ROTSTEIN: In light of 20(b).

The Government falls back on two arguments that we believe are really only attempts to elicit a visceral

antagonism to the District Court's interpretation of Section 5(e).

They first argue that Section 5(e) couldn't have exempted project notes from the estate tax because to do so would have resulted in wholesale avoidance of estate tax.

First, this is merely an impermissible attempt to have the Court rewrite the 1937 Act, but, second, it's inaccurate. In 1937, when Congress passed the 1937 Act, far from being concerned that all taxpayers are going to run out and buy project notes, they were concerned that there wouldn't be a market for them.

So, from the perspective of the 75th Congress, there's no reason to believe that they were concerned and, in fact, there's reason to believe that the estate tax exemption was an incentive to make project notes saleable.

The Government also argues that Section 5(e) exemption couldn't include an exemption from estate tax because the Tax Bar was taken by surprise. With due respect to the Tax Bar, I don't think it would be the first time that they were surprised by a statute.

I'll quote Justice Frankfurter, I'll take the risk of doing it, "wisdom too often never comes, so one ought not to reject it merely because it comes too late". Just because the Tax Bar became wise a little late doesn't mean we should reject the proper interpretation of Section 5(e) of the 1937 Act.

I'll next turn briefly to the question of the proper interpretation of Section 641(b)(2) of the Deficit Reduction Act, which the Government says, irrespective of what Section 5(e) means under the 1937 Act, retroactively taxes the estates here.

As we discuss in our brief, it's a proper construction of Section 641(b)(2) that it should not be construed retroactively. That will avoid the serious constitutional questions raised by retroactive interpretation.

I just want to make two additional points to the ones we make in our brief. Under the Government's interpretation, Section 641(b)(2) by implication repeals an estate's right to sue for refund, and it does so by implication.

This right has been established for decades and given the fact that there was very little, if no, legislative consideration of Section 641(b)(2), it's not plausible that Congress would have had such an intent.

This leads to the next point and that is when, in enacting DEFRA in 1984, Congress wanted to repeal a right to refund, it said so explicitly. They did so in DEFRA Section 2662(g), which, in much clearer language, makes the statute there retroactive and in the legislative history of which Congress specifically said that they wanted to repeal a right for refund.

So, juxtaposing 641(b)(2) with 2662(g), as a matter

of statutory construction and, I believe, logic, would lead to the conclusion that in enacting Section 641(b)(2), Congress didn't intent to make the section retroactive, and that has the presence for a non-retroactive interpretation in the opinions of this Court in Schwab v. Doyle and Hassett v. Welch.

Now, I want to indicate what will happen here if the Government's interpretation of Section 641(b)(2) as being retroactive prevails, and that is that taxpayers are going to be encouraged in doubtful cases to take aggressive positions vis-a-vis the taxability of an item.

That is, in a doubtful case, because Section 641(b)(2) retroactively applied penalizes the reporting taxpayer, the conservative taxpayer, the taxpayers will be more likely not to report a doubtful item.

In other words, taxpayers will be encouraged to play the audit lottery. This goes against mainstream tax thinking and congressional thinking that has been established for years and the concomitant costs to the Government, I think, are evident. There will be unreported taxable transactions --

QUESTION: In an estate tax report, Mr. Rotstein, if something is exempt from the estate tax, do you not even have to list it?

MR. ROTSTEIN: That's my understanding. Project notes were bearer notes. So, it's very conceivable that that could occur.

My understanding is that you do not have to list something if they're not taxable, and the taxpayer can play the audit lottery and the Government, if the interpretation of Section 641 is deemed to be retroactive, is going to lose the audit lottery.

QUESTION: Aren't you taking almost a criminal risk if you don't list something that might be taxable? You don't have to include it, but certainly a conservative approach would be to recite its presence and take a position that it's not includable.

MR. ROTSTEIN: That's true. That's a more conservative approach.

QUESTION: That may not only be conservative. It may be the wise counselling.

MR. ROTSTEIN: It could be wise. It's certainly not inevitable given the fact that even now taxpayers play the audit lottery by not listing something and hoping that they'll get away with it. Not to impede criminal intent, but it happens and this --

QUESTION: This is the get-by doctrine, in other words? I've heard tax attorneys use that.

MR. ROTSTEIN: The get-by doctrine?

QUESTION: Yes.

MR. ROTSTEIN: It's the get-by doctrine, and this kind of conduct will be encouraged. It's not logical that in

the space of about six weeks in a bill that was introduced for the first time in conference and had no Senate debate, no House debate associated with it, Congress would want to effectuate such a bill.

QUESTION: Why couldn't a taxpayer simply list or include it, but say it's not taxable, which would not allow him to take a forward position but still not risk evasion?

MR. ROTSTEIN: A taxpayer could do that. It's the prudent step, but that hasn't been a requirement for about sixty years, and taxpayers haven't necessarily proceeded that way. I can see that that would be a prudent step.

I'll turn now to --

QUESTION: Do you practice tax law exclusively?

MR. ROTSTEIN: I do not. I'm a litigator.

QUESTION: But you do some of it anyway?

MR. ROTSTEIN: In this case, Justice Blackmun.

QUESTION: Because surely if you were in tax law constantly, you would do just that, take the prudent reference of non-includability, but at least of indicating presence, so that there's no question of a fraud tack for an attempt to evade tax.

MR. ROTSTEIN: That's correct, Your Honor, and the more prudent executors and tax lawyers may do just that. The less prudent individuals may be encouraged not to report.

I'd like to turn now --

QUESTION: I really don't think they're encouraged. The statute applies only if it's shown -- it's filed showing such transfer as subject to tax.

MR. ROTSTEIN: That's correct.

QUESTION: Yeah. Okay.

MR. ROTSTEIN: The District Court found that retroactively-applied Section 641(b)(2) violates both the due process clause and the equal protection component of the Fifth Amendment.

I want to emphasize that we didn't raise those constitutional claims lightly below and we don't so here, but retroactively applying Section 641(b)(2) would go far beyond the pale of what the Constitution permits and what this case -- what this Court has allowed in its cases construing retroactive tax statutes.

There are two reasons why Section 641(b)(2) if retroactively applied would violate the due process clause. First, it constitutes a harsh and oppressive retroactive tax that has an arbitrary and capricious effect.

I'll focus on the Stein estate for a moment. Dr. Stein bought project notes in 1980 and 1981.

QUESTION: How long before his death?

MR. ROTSTEIN: From about -- he died in April. The last one was a couple of months before his death, I believe, maybe even a month before his death, six to eight months.

QUESTION: All of them purchased within a year then?

MR. ROTSTEIN: All purchased within a year.

He did so in 1981 and in 1980 and '81. There had been no public ruling at all. For a period of forty years, the project notes were subject to the estate tax. Project notes were issued pursuant to 1977 and 1980 government offering circulars, advertisements if you will, in which the Government used the tax-free nature of project notes as a selling point.

As a general matter,

QUESTION: Was it not true that at the time he made these purchases, there were a lot of tax lawyers during the past forty years or so, forty or fifty years, who had thought they were subject to estate tax?

MR. ROTSTEIN: The Government argues that. There's no -- there's only inferential evidence. There's no evidence in the record of that or no authority. The only inferential evidence is that the tax law reacted in 1984 to the Haffner decision. There is some authority albeit not definitive, but it's certainly indicative that there were taxpayers out there before 1984 who were not reporting project notes as part of an estate.

I refer to a 1955 Housing Authority memorandum that said the matter as to the taxability of project notes as part of an estate will have to be decided by the courts. I also refer to DEFRA Section 628, which, for the first time in 1984,

around the time Haffner was decided, subjected project notes to information and reporting requirements. Before -- certainly when Dr. Stein bought the notes, project notes were bearer bonds and in the legislative history of Section 628, Congress specifically referred to Haffner.

The logical conclusion is that Congress was concerned that there were people out there who hadn't been reporting project notes. So, although the Government argues, and there was a lot of publicity after Haffner, we don't know whether or not the decedents were or were not reporting project notes.

QUESTION: Was Dr. Stein in good health when these notes were purchased?

MR. ROTSTEIN: He was in good health right up till the end. I think he was quite old but he was in good health.

QUESTION: One could almost say it was a purchase, not a transfer, a purchase in contemplation of death otherwise.

MR. ROTSTEIN: It could have been. I have nothing in the record, but it's possible.

Dr. Stein certainly had no way of foreseeing the enactment of DEFRA Section 641(b)(2), which was introduced three years before his death. Three years is a very long period of retroactivity. Most of the cases upholding a retroactive period do so in the income tax situation and do so in the income tax area, and in addition, had Dr. Stein had an inkling that project notes would be retroactively taxed, he had

beneficial alternatives. He could have invested in something else.

QUESTION: In the companion case, do you know how long before death the project notes were purchased?

MR. ROTSTEIN: I do not.

QUESTION: In either of these cases, did the decedents claim exemption for the notes? Did they in their estate tax return?

MR. ROTSTEIN: That's correct, and neither did the executors claim exemptions. Both reported them subject to tax.

QUESTION: Do you know how the Internal Revenue Service discovered their existence? In the probate files or something?

MR. ROTSTEIN: Well, that's why we're here, Justice Blackmun. The executors reported them as taxable after -- in light of a Revenue Ruling that came down in --

QUESTION: In your case, that's correct.

MR. ROTSTEIN: In our case. And, therefore, there was a claim for refund later filed.

Quite simply, there is no case upholding a retroactive statute in which the facts are like this. This case is unprecedented in the scope of the decedent's legitimate expectations as to non-taxability --

QUESTION: But, Mr. Rotstein, certainly Congress made a stab at satisfying decedent's legitimate expectation. People

who claim them as exempt were not subject to the '84 and people who didn't were. That seems to me quite a sensitive adjustment for expectations.

MR. ROTSTEIN: Well, I don't think so, Mr. Chief Justice, because the executors of the estates reported project notes as taxable under compulsion of a Revenue Ruling that came down in 1981, indicating that they were taxable. That didn't exist when the decedents made their purchases. So, the decedents crafted their conduct on the existence of the tax exemption.

When the executors got around to, in our case, when the executors got around to reporting, the executors were under compulsion of a Revenue Ruling, and --

QUESTION: What sort of compulsion is a Revenue Ruling? I mean, may not an executor do anything but follow a Revenue Ruling?

MR. ROTSTEIN: An executor can take other action. However, executors are fiduciaries, and it's certainly prudent to pay a tax and knowing that or believing that a right to refund is preserved in order not to have to subject the estate to possible interest and payment penalties.

QUESTION: What did the Haffner people do?

MR. ROTSTEIN: In Haffner, they apparently paid the tax but listed -- disputed on the return the fact that project notes were taxable.

QUESTION: I take the Wells Fargo executors then knew of the existence of the Rev. Rule?

MR. ROTSTEIN: That's correct.

QUESTION: That's a pretty low form of animal life in the structure of Treasury Rulings of one kind or another, about the lowest there is almost, and you feel they worked under compulsion.

MR. ROTSTEIN: The record indicates that they paid the tax and reported them as taxable by virtue of the Revenue Ruling, and at that point, that was the only public pronouncement of any kind regarding the taxability of project notes.

Section 641(b)(2) retroactively applied also works to violate the due process clause by depriving the estates here of procedural due process. By precluding judicial review of the question whether project notes are exempt from taxation.

The Government in its reply characterizes Section 641(b)(2) as merely a substantive change in the law, but in its opening brief, the Government, I think, more accurately describes Section 641(b)(2) as permitting certain taxpayers who did not report project notes as taxable but not the estates here "to continue to litigate the questions of taxability".

At the same time, the Government describes the effect of Section 641 as permitting the non-reporting taxpayer "to go ahead and have their day in court". These are words of

procedural due process and they're accurate.

The executors have been deprived of their day in court by virtue of the Government's invocation of DEFRA Section 641(b)(2). Effectively, the Government's interpretation of Section 641(b)(2) has caught the estates in a procedural trap. On day one, there were two equally available and well-established alternatives.

One, the estates could have chosen not to pay the tax and to litigate the matter in Tax Court. Two, they could have, as they did, pay the tax, expecting that at least for the statutory period, they had the right to bring a suit in District Court or the Court of Claims for a refund.

It's been established that these two alternatives are equally available and both there.

Now, retroactive interpretation of Section 641(b)(2) would take away that second alternative, the one that the estates here took, yet because the estates chose that second avenue, they can no longer invoke the jurisdiction of the Tax Court, yet there are individuals out there in the Tax Court still litigating the issue of the taxability of project notes.

The due process clause prohibits just that type of procedural trap.

Finally, the District Court found that Section 641(b)(2) retroactively applied violates the equal protection clause and that's accurate. Section 641 sets up a

classification that distinguishes between executors who listed project notes as taxable on a return and those who did not.

This classification bears no rationale relationship to any legitimate government purpose. It taxes the estates here that conservatively paid their taxes and reported project notes as taxable. It exonerates other similarly-situated executors whose decedents died the same days as the decedents here, whose executors filed tax returns on the same day, and yet who, for some reason, didn't report project notes. Perhaps taking an aggressive position, perhaps just forgetting to do so, acting negligently, and Section 641(b)(2) would tax the estates here, but would not tax the common evader who decedent died the same day as Dr. Stein, but who failed to file a return at all for the purpose of evading other taxes.

The only real justification that the Government offers for the classification of Section 641(b)(2) is that it gives its expectations as to the decedents' belief as to taxability. It gives effect to those expectations. In other words, the Government says that reporting position on a return is equivalent to the taxpayer's expectations.

That's flawed for two reasons, and it doesn't set forth the rationale classification. First, it incorrectly focuses on the executor's expectation and it's the decedent who was the individual charged with planning the estate and who relied on the tax laws.

And, second, in our tax system, traditionally reporting hasn't been a gauge of a taxpayer's expectation. It's not a rationale gauge. It's been given in the tax system that a taxpayer may either choose to sue in the District Court and pay the tax, as we did, or to pay in Tax Court, and there are many reasons unrelated to a taxpayer's expectation as to taxability as to why the taxpayer would go ahead and pay the tax and sue in the District Court.

One, just in general, is that a taxpayer may want to invoke the jurisdiction of the District Court or the Court of Claims rather than the Tax Court. Secondly, there may be a case farther along in the system, and rather than risk interest payments, penalty payments, the taxpayer may just file a return, pay the tax, and await the outcome of the litigation.

Here, especially where you have an estate, as we do here, it may be prudent for an executor to pay the tax and file a claim for refund in order to ward off the possibility of interest and penalties in prudent exercise of the executor's fiduciary duty.

That's especially true in a case like this where the Internal Revenue Service has taken a position that project notes were taxable, contrary to what the law is, and even after Haffner, so aggressive was the Internal Revenue Service's position that they indicated they were going to continue to litigate the matter, notwithstanding the Haffner opinion.

On the other side of the coin, the decision not to report is not a rationale indicator of a taxpayer's expectation. The most obvious example is the taxpayer whom, to avoid taxes, fails to file a return at all. Presumably, the failure to file a return, the failure to report any items is because the taxpayer believes the items to be taxable, yet doesn't want to be subject to the tax. So, there's a failure to report.

There is simply no rationale basis for the classifications set forth in 641(b)(2) if applied retroactively, and the equal protection problem stems, we believe, from the hasty enactment and the lack of consideration given to Section 641(b)(2). It was the fertile environment for passing a law that sets forth in a rationale classification.

In the time I have left, I'll briefly summarize why the District Court's judgment should be affirmed.

First, project notes are exempt from federal estate taxation under the United States Housing Act of 1937. This follows both from the statutory structure and the legislative history.

Second, DEFRA Section 641(b)(2) based on the precedence of the Court need not be interpreted retroactively but can be interpreted prospectively only to avoid the constitutional questions yet affirmed.

If interpreted retroactively, Section 641(b)(2)

violates the due process clause, both because it's a harsh, oppressive and arbitrary retroactive tax, and because it deprives the estates here to the right of judicial review on the Haffner claim by virtue of the Government's invocation of Section 641(b)(2).

And, finally, Section 641(b)(2) retroactively applied violates the equal protection component by setting forth an arbitrary and irrational classification between reporting taxpayers and non-reporting taxpayers. Therefore, treating the Appellees' estates less favorably than a common tax evader.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Rotstein.

Mr. Wallace, you have four minutes remaining.

ORAL ARGUMENT OF LAWRENCE G. WALLACE, ESQ.

ON BEHALF OF THE APPELLANT - REBUTTAL

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

Mr. Rotstein has devoted most of his argument to the issues which we have urged that the Court need not reach. I will comment briefly with respect to those.

In both cases, the claim for a refund was not filed until after the District Court's decision in Haffner came down. In the Wells Fargo case, this was two and a half years after the filing of the estate tax return, in the other case, more than one year after the filing of the return.

Presumably, a fiduciary who filed the return

believing that he has over-paid the taxes would act promptly so as to secure the funds and pass them along to the beneficiaries of the estate.

It's quite apparent that they acted not in reliance upon their thoughts at the time of filing the returns, but in reliance upon the Haffner decision. Now, there's nothing wrong with that, but no matter how Congress acted, unless it was going to go into a case-by-case determination, it could not satisfy everybody's expectations with respect to the Haffner case.

Even if the new statute had been completely prospective, not every taxpayer who, after Haffner came down, might have transferred his assets into project notes in reliance on Haffner, would have had the foresight to die before June 19th, 1984, and, therefore, those taxpayers' expectations would have been thwarted notwithstanding their reliance on the Haffner decision.

And as this Court's leading modern case on the retroactivity of tax legislation, United States v. Darismont in 449 US, explains in detail most tax legislation has some retroactive effect. Here, Congress surely could have within the rule of Darismont made the entire repealer retroactive and treated all taxpayers the way they had all been acting for the previous forty years and the way the future ones would have to act, namely paying tax on the transfer.

Instead, Congress chose to mitigate this slightly by selecting a very restricted class of persons that would be confined to those in the same situation as the Haffner taxpayers who had done something in reliance on this, but did make it retroactively applicable to the great bulk of taxpayers, most of whom would be just applying for an unexpected windfall if they happened to fall within the dates properly.

I believe we're ready to submit the case, unless there are further questions.

CHIEF JUSTICE REHNQUIST: Mr. Wallace, if you'd stand there for just a minute, our records show that this is your hundredth appearance before this Court, and that your first argument here was in a case argued March 25th, 1968, for the Government.

On behalf of the Court, we'd like to extend to you our thanks for your able advocacy during this period of time.

The case is submitted.

(Whereupon, at 2:28 o'clock p.m., the case in the above-entitled matter was submitted.)

REPORTERS' CERTIFICATE

DOCKET NUMBER: 86-1521

CASE TITLE: United States v. Wells Fargo Bank, Et Al

HEARING DATE: December 8, 1987

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Supreme Court of the United States,

and that this is a true and accurate transcript of the case.

Date: December 8, 1987

Margaret Daly

Official Reporter

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