

TRANSCRIPT OF PROCEEDINGS

IN THE SUPREME COURT OF THE UNITED STATES

In the Matter of:)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
) Petitioner,) No. 86-1672
)
v.)
)
JESSE C. BOLLINGER, ET AL.)

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WASHINGTON, D.C. 20543

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IN THE SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE, :
Petitioner, :
V. : No. 86-1672
JESSE C. BOLLINGER, ET AL. :
-----x

Washington, D.C.

Wednesday, January 13, 1988

The above-entitled matter came on for oral argument
before the Supreme Court of the United States at 10:05 a.m.

APPEARANCES:

ALAN I. HOROWITZ, ESQ., Assistant to the Solicitor General,
Department of Justice, Washington, D.C.;

on behalf of the Petitioner.

CHARLES R. HEMBREE, ESQ., Lexington, Kentucky;

on behalf of the Respondents.

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

2 (10.05 a.m.)

3 CHIEF JUSTICE REHNQUIST: The opinion of the Court in
4 Westfall against Irwin in No. 86-1672, Commissioner of Internal
5 Revenue v. Jesse C. Bollinger.

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

7 ORAL ARGUMENT OF ALAN I. HOROWITZ, ESQ.

8 ON BEHALF OF THE PETITIONER

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

11 The issue in this case concerns the two-tiered
12 structure established by Congress to govern the tax treatment
13 of a corporation and its shareholders. To briefly summarize
14 that structure, it treats a corporation as a separate taxable
15 entity that must recognize on its own return the tax
16 consequences of its business activities. The shareholders'
17 individual taxes are affected by this business activity only
18 indirectly, that is, in connection with their own dealings with
19 the corporate entity.

20 Corporate income is recognized by the corporation.
21 The shareholders pay tax on corporate income only when they
22 receive a distribution of corporate earnings, either as
23 dividends or liquidating distributions.

24 Similarly, when a corporation suffers net operating
25 losses in a given year, that loss is deductible by the
corporation on its own return and may be carried back to

1 earlier years or carried forward for up to 15 years to be
2 offset against corporate income in future years. Such a loss
3 would be reflected on the shareholders' return, only if they
4 dispose of their interest in the corporation or liquidate it.

5 Back in the 1940s, this Court in the Moline case,
6 considered the question whether this two-tiered tax structure
7 applied in full to so-called dummy corporations. That is,
8 situations where a closely-held corporation's interest are
9 essentially congruent with those of its shareholders or perhaps
10 in many cases a sole shareholder, and where the business
11 activity of the corporation is quite limited.

12 The facts of the Moline case are in many respects
13 quite similar to those of the instant case. In Moline, the
14 Court held that the separate entity doctrine was fully
15 applicable to the facts there. In that case, the mortgagee had
16 required an individual borrower to set up a corporation to hold
17 title to mortgaged property. The corporation engaged in little
18 other business activity, and its expenses were paid directly by
19 the individual shareholder. Despite this limited activity and
20 the undisputed fact that the individual was the beneficial
21 owner of the property, the Court held that the corporation had
22 to pay tax on the gain when the property was sold.

23 The Court summarized its holding, as follows, and I
24 quote: "Whether the purpose be to gain an advantage under the
25 law of the state of incorporation or to avoid or to comply with
the demands of creditors or to serve the creator's personal or

1 undisclosed convenience, so long as that purpose is the
2 equivalent of business activity or is followed by the carrying
3 on of business by the corporation, the corporation remains a
4 separate taxable entity."

5 The Court went on to say that once the taxpayer had
6 chosen the corporate form for his own business purposes, he was
7 bound by the tax consequences of this choice.

8 QUESTION: There the corporation held the title to
9 the property in its own name, the dummy corporation, didn't it?

10 MR. HOROWITZ: That's right.

11 QUESTION: So what this Court said was that the Code
12 simply required the taxpayer to recognize the record state of
13 affairs.

14 MR. HOROWITZ: That's right. The corporation was the
15 owner of the property and the fact that it really didn't do
16 anything other than operate for the individual shareholder
17 didn't mean that that could just be transferred to the
18 individual shareholder. When the property was sold, the gain
19 had to be recognized by the corporation and a corporate tax
20 paid on the gain.

21 Now, this principle of Moline was reaffirmed several
22 years later by the Court in the National Carbide case, and it's
23 now a well-settled proposition, and indeed, a proposition that
24 respondents do not directly challenge, although, as I'll
25 explain later, we think the thrust of their argument here would
seriously undermine the Moline principle.

1 We believe that this case is governed by the rule of
2 Moline. Respondents in this case chose the corporate form for
3 their own business purposes, and now they seek to avoid the tax
4 consequences of that choice. In short, they want to have their
5 cake and eat it too.

6 QUESTION: Mr. Horowitz, do you recognize the
7 exceptions spoken of in dicta in National Carbide for a true
8 agent?

9 MR. HOROWITZ: We do. We do recognize that
10 exception. There's no question that two parties can deal with
11 one another as an agent and a principal, in which case, the
12 actions of the agent are imputed to the principal and the
13 principal would take the tax consequences of that.

14 QUESTION: Well, do you accept the explanation in
15 National Carbide of when a true agency might exist?

16 MR. HOROWITZ: You mean the so-called six factors
17 that are set out in National Carbide?

18 QUESTION: Right.

19 MR. HOROWITZ: Yes, we have no quarrel with those.
20 We obviously quarrel with respondents over what the proper
21 interpretation of those factors are. We do think that that, in
22 the case of a controlled corporation, that was intended to be a
23 fairly narrow exception by the National Carbide Court, which I
24 hope to explain in more detail a little bit later. But we
25 don't back away from National Carbide.

 QUESTION: But here the dummy corporation if you're

1 right in saying, it did follow record state of title. It
2 reported income, did it not, to itself?

3 MR. HOROWITZ: In this case?

4 QUESTION: Yes.

5 MR. HOROWITZ: I don't think the corporation reported
6 any income in this case. All the income that came in and all
7 the expenses that were expended in constructing the apartment
8 complex and the interest paid on the loan was all reported on
9 the partners' individual returns.

10 QUESTION: On the partners' individual returns.

11 MR. HOROWITZ: Now, basically the partners treated
12 the corporation as a non-existent shell. Now, they say in
13 their brief that they concede that under Moline it was a
14 separate taxable entity, and all they are quibbling about is
15 were the particular transactions involved with these apartment
16 complexes should be attributed directly to the partners, or
17 not. But the fact is is that that's all there was in the
18 corporation, that's all that was going on. There was no other
19 income or any other business activity. So essentially, they're
20 saying that the corporations have to be disregarded.

21 QUESTION: What would be needed here in order to make
22 it separately taxable, or reportable on the individuals'
23 returns?

24 MR. HOROWITZ: In order for it to be a true agent
25 relationship? Well, we think where there's a controlled
corporation situation, we think there is a pretty heavy burden

1 to be borne by the taxpayer in showing that there's actually a
2 true agency. The problem that requires this heavy burden, and
3 we think this was set forth in the National Carbide case, is
4 that the relations between a principal and his agent and the
5 kind of control that a principal exerts over his agent is quite
6 similar to the kind of control that a sole shareholder would
7 exert over a closely held corporation, just in the exercise of
8 the normal shareholder-corporation relationship.

9 So it's kind of an easy expedient for avoiding the
10 Moline rule to say, well, we've got this corporation, we set it
11 up, we're controlling it, but we're not controlling it as
12 shareholders, we're controlling it as agents, and we're going
13 to write up a little agreement and call it an agency agreement.
14 That's what the taxpayer tried to do in National Carbide and
15 the Court rejected that.

16 Now, if you use an unrelated agent, then the
17 situation is a lot clearer because there is no other basis for
18 the control that the principal is exerting over the agent, so
19 it's easy enough for the Court or for the Service to credit the
20 agency agreement.

21 QUESTION: Well, the income here was received by a
22 partnership, wasn't it? It wasn't received by the corporation.
23 It was received by Creekside as CNA, whatever that is?

24 MR. HOROWITZ: Well, what happened was the
25 corporation went out and it got a loan from the bank in its own
name, didn't purport to be acting as an agent or anything like

1 that, and then it took the loan proceeds and deposited them
2 into an account that was called a construction account. And
3 that was not denominated as a corporate account, it was
4 denominated as an individual account. And then all the
5 transactions sort of flowed out of that account. Income from
6 the apartments were funneled through --

7 QUESTION: I thought it was Creekside Apartments, a
8 partnership, the account. Am I wrong?

9 MR. HOROWITZ: The account was in the name of the
10 partnership. That's correct.

11 QUESTION: So it wasn't a corporate account?

12 MR. HOROWITZ: It was not labeled as a corporate
13 account, but the property was owned by the corporation and the
14 corporation was the obligor on the loan. So basically the
15 Government's position is that although they called it an
16 individual account, they're basically skipping a step. I mean,
17 that money all rebounded to the corporation.

18 QUESTION: Well, this isn't certainly a direct
19 parallel to Moline?

20 MR. HOROWITZ: I think it is. In Moline, the Court
21 specifically stated that the corporation there had no bank
22 accounts.

23 QUESTION: Yes, but there, the gain was recognized on
24 property to which the corporation held title. Here, this
25 corporation didn't receive the income.

MR. HOROWITZ: Well, in both cases, the income was

1 attributable to the property in which the corporation held
2 title.

3 QUESTION: Why do you say that?

4 MR. HOROWITZ: Because the corporation here owned the
5 apartment buildings and the apartments were rented out and the
6 tenants paid rent to the owners --

7 QUESTION: Well, you say, it was quote attributable
8 close quote. Is that just a descriptive word or is it a word
9 that means something in the IRC?

10 MR. HOROWITZ: No, that's just, I would say that's a
11 descriptive word. The partners because you've got a controlled
12 corporation and the corporation obviously doesn't take any
13 action that's not directed by its officers.

14 QUESTION: Mr. Horowitz, the partnership didn't own
15 the stock in this corporation, did it? Wasn't one of the
16 individual partners the owner?

17 MR. HOROWITZ: Well, I mean, the facts are somewhat
18 confusing.

19 QUESTION: In the other cases, in one more, I don't
20 remember the number, there are five or six cases, one of the
21 cases the sole shareholder is the beneficial owner, and in the
22 other case, some of the other cases, there's a partnership that
23 is treating it as income and the partnership didn't own the
24 corporation, just one of the partners.

25 MR. HOROWITZ: Well, in most of the cases the
corporation was solely --

1 QUESTION: Well, factually, am I correct?

2 MR. HOROWITZ: Yes.

3 In most of the cases, the corporation was solely
4 owned by Bollinger and some of the apartment complexes, the
5 partnerships were solely Bollinger, and some he had other
6 partners who did not nominally own stock in the corporation.
7 Although, as we explained in the brief, and this discussions
8 also reflected somewhat in the National Carbide decision, I
9 think that the partners would be viewed by State law and by
10 Federal Income Tax Law as constructive shareholders in these
11 partnerships. Because they were making payments all along out
12 of their own pockets to pay corporate expenses. That's
13 normally considered --

14 QUESTION: Well, the argument's whether they were
15 corporate expenses, or the corporation was an agent, and
16 therefore they're the principals' expenses. That's the issue.

17 MR. HOROWITZ: That's what you get down to, that's
18 the bottom line, but we believe --

19 QUESTION: And they paid the expenses of a corporate
20 entity that they did not own.

21 MR. HOROWITZ: No, there's no dispute that the
22 corporation was the obligor on the loan.

23 QUESTION: And also that it was personally guaranteed
24 by the partners in one case, and by the individual shareholder
25 in the other, is that not true?

MR. HOROWITZ: Yes.

1 QUESTION: So they were personally liable for the
2 debt?

3 MR. HOROWITZ: In part.

4 QUESTION: And they made the regular payments, and
5 they were looked to as the principal obligors, even though they
6 were even though they were in the form of --

7 MR. HOROWITZ: Well, I think I have to disagree with
8 that statement. I mean even respondents concede in their brief
9 that the principal obligor on the loan was the corporation.

10 QUESTION: Was there a guarantee in the Moline
11 Properties case? I can't tell from the opinion.

12 MR. HOROWITZ: Well, in the Moline Properties case
13 originally the loan was taken out directly by the individual,
14 and then the bank asked them to set up this corporation and so
15 the corporation then assumed the liability, assumed the
16 mortgage.

17 QUESTION: Do you know from the opinion whether the
18 individual, after the assumption by the corporation, remained
19 liable on the note in the Moline case?

20 MR. HOROWITZ: I don't know whether there was a
21 personal guarantee that was reflected in writing, but the
22 Moline case is clear that the corporation had no bank accounts
23 and had no money in its own name, so it's clear enough that the
24 individual was paying the loan and that the lender was looking
25 to the individual for the payment of the loan.

QUESTION: Yes, but the ultimate security was the

1 property whereas here, the ultimate security well --

2 MR. HOROWITZ: No. Here, the ultimate security is
3 also the property, and that is why the corporation had to hold
4 record title to the property. Otherwise, title could have been
5 held by the partners and they could have avoided some of these
6 problems. But a lot of these questions are focused on the
7 income from the apartment complexes. AND of course, this case
8 is really, at least the particular years involved here about
9 the deduction of the expenses and the losses suffered by the
10 corporation or the partners, as the case may be in the early
11 years. Certainly a large portion of those expenses was the
12 interest expense paid on the loan on which the corporation was
13 the obligor and the whole system wouldn't work unless the
14 corporation was the obligor.

15 QUESTION: Was that paid out of the CNA account, the
16 interest?

17 MR. HOROWITZ: It was paid out of this construction
18 account to which the loan proceeds were dumped as soon as they
19 were received. And that gets you back to the original
20 conundrum, I suppose, that we were talking about. The
21 corporation was directed to dump its money into this account
22 that was in the partners' name. Now, if it was an unrelated
23 corporation --

24 QUESTION: Mr. Horowitz, I interrupted you and I
25 apologize, but I didn't give you a chance to answer Justice
Scalia's question.

1 MR. HOROWITZ: At this point, Justice Scalia will
2 have to remind me.

3 QUESTION: Which was what more should the taxpayer
4 have done in order to make it a true agency relationship in
5 your view?

6 MR. HOROWITZ: Well, as I started to say --

7 QUESTION: You know, not ten things. What's the
8 minimum they could have done that would have made you happy?

9 MR. HOROWITZ: Well, with an unrelated agent, it's
10 very simple, I think. In the case of a controlled corporation,
11 we agree that it's a very heavy burden that they have to bear.
12 They have to show that the relationship was equivalent to an
13 arm's length relationship and that is hard to do in a case like
14 this where the corporation was set up for no other purpose than
15 to handle these loans of these particular partnerships that
16 controlled it.

17 QUESTION: Sounds just like an agency, doesn't it?

18 MR. HOROWITZ: Not to me.

19 It doesn't sound like an agency because of the
20 peculiar and special tax structure that Congress has set up
21 between corporations and shareholders in which I think you can
22 say in a certain loose sense that a relationship between a
23 corporation and its shareholders is always like an agency in
24 the sense that you're referring to. The corporation is a legal
25 person, but it's not a real person, and it's always operating
for the benefit of its shareholders.

1 QUESTION: Well, I interrupted you again, and I'm
2 sorry.

3 MR. HOROWITZ: Well, you keep giving me the
4 opportunity to avoid answering this question.

5 We gave an example in our brief of the sort of
6 situation where we think it would be pretty clear that a
7 controlled corporation could still operate as an independent
8 agent, and that is one where it was already established as an
9 agent and was operating not only for the partners that
10 controlled it, but also for unrelated parties.

11 QUESTION: Cases where it's a clear agent, I mean,
12 but what facts in this particular case would be --

13 MR. HOROWITZ: In this particular situation --

14 QUESTION: If you just had to change a couple of
15 facts, what would do the trick?

16 MR. HOROWITZ: No. Well, we don't think they can
17 just change a couple of facts. I mean, in this case, we think
18 it's the fact that they didn't even bother to pay a fee to the
19 Agency we think makes it crystal clear that there was no arm's
20 length relationship. But even if they had paid a fee, --

21 QUESTION: But it has to be a compensated agency. I
22 mean, you can be an agent without getting compensated for it.

23 MR. HOROWITZ: You can be an agent without being
24 compensated but it's hard to describe it as an arm's length
25 relationship, if there's no compensation.

QUESTION: Well, Mr. Horowitz, wouldn't even in an

1 arm's length relationship, the fee for holding bare legal title
2 seems to me could be quite minimal. And I'm not sure I see the
3 significance of --

4 MR. HOROWITZ: Well, I don't think it would be zero,
5 because the corporation is doing things. It's exposing itself
6 to liability, for example, if a tenant trips on the ice in
7 front of the apartment building and then sues the corporation.
8 Now, I mean, here because the corporation was hardly different
9 from Bollinger, that may seem like not a big deal. But that
10 gets you back to the argument that the corporation shouldn't be
11 distinguished from the shareholders because they are all kind
12 of intertwined together, mixed up in the same thing.

13 That's the argument that the Court rejected in
14 Moline.

15 QUESTION: But you'd be satisfied, I take it, if one
16 of these partners had a father who owned a title company and
17 they just went over to the title company and said, would you
18 please hold the title to this property for us, and the company
19 said, sure. And we won't charge you anything either. You'd be
20 all right?

21 MR. HOROWITZ: And the title company doesn't charge
22 any of its clients anything?

23 QUESTION: Well, it doesn't charge this one.

24 MR. HOROWITZ: Well, if it doesn't charge this one,
25 it seems to me, it's not really acting as an arm's length
agency.

1 QUESTION: It's not an agency? So you mean, it won't
2 be enough for you even if it's an independent corporation not
3 controlled at all?

4 MR. HOROWITZ: Well, no. If it's an independent
5 corporation --

6 QUESTION: Well, it's an independent corporation.
7 It's owned by the man's father, but the man's father's not part
8 of the partnership. He's just a good guy, a good dad.

9 MR. HOROWITZ: Well, that's probably all right then.
10 I mean, the whole concern of National Carbide is distinguishing
11 the control of the corporation, that the stockholders exert
12 over --

13 QUESTION: So if they went through these same motions
14 they went through here with this title company that I talked
15 about, it would be all right.

16 MR. HOROWITZ: If it was an unrelated --

17 QUESTION: And the only problem is the controlled
18 corporation, is that it?

19 MR. HOROWITZ: That's the problem under the so-called
20 fifth factor of National Carbide. And I really want to
21 emphasize that that's a serious problem because it's that
22 problem that is what undermines Moline. In Moline, you've
23 established a tax structure in which the corporation and
24 shareholder despite their identity of interest need to be
25 treated as separate taxable entities. And in this case, you
have shareholders that are trying to get around that rule

1 essentially by saying, well, we'll just call it an agent, even
2 though our relationship with the corporation is really no
3 different.

4 QUESTION: You're asking for some special rule.
5 You're saying that what might be enough to establish agency in
6 the ordinary situation where there's not a corporate control
7 relationship isn't enough in the corporate control
8 relationship. That because of the difficulty deciding how much
9 of the control comes from agency and how much comes from the
10 stock ownership, you're going to require a specially high
11 burden of proof, is that principally what you're saying?

12 MR. HOROWITZ: I think that's right. We're saying
13 that there's at least a presumption, a burden that the
14 shareholders have to overcome and they use a controlled
15 corporation as a purported agent that they need to show like
16 it's really like dealing with an unrelated agent.

17 QUESTION: So even if it might be enough if your
18 father did it for you, it wouldn't necessarily be enough if a
19 controlled corporation did it for you because you have no other
20 way of controlling your father, whereas you do have another way
21 of controlling a controlled corporation.

22 MR. HOROWITZ: Well, that's right. And the so-called
23 agency adds nothing to the other ways that you have of
24 controlling the corporation and therefore it doesn't provide a
25 reason to depart from what would ordinarily be the tax
consequences of using your corporation.

1 I really would like to emphasize that although this
2 is a heavy burden that may be difficult to meet, we don't think
3 that that's unfair or unreasonable. If you look at this from
4 the perspective of the shareholders, they have two choices.
5 They can use a controlled corporation, if they really want to
6 use an agent, let's say, they can use a controlled corporation
7 as an agent or they can use an unrelated corporation as an
8 agent.

9 QUESTION: Now, there's another choice, they could
10 use an employee, they could use the secretary in the office as
11 the nominee and give her all the protections, all the
12 guarantees, agree to insure the property and all the rest.
13 Would she be an agent or not?

14 MR. HOROWITZ: Here, they needed to use a
15 corporation.

16 QUESTION: But assume you had a situation for a
17 different reason other than usury that you felt it necessary to
18 use the nominee. You'd say that -- I don't know why that would
19 be any different that you'd then have an individual who'd have
20 to report the income and so on.

21 MR. HOROWITZ: Well, if you're using an individual as
22 an agent, you don't run into any of the problems that you have
23 here. And the concern here is whether the separate tax
24 identity of a corporation is going to be disregarded.

25 QUESTION: You might have different brackets. Maybe
you don't anymore, but depending on who got the income first.

1 MR. HOROWITZ: Well, you might have different
2 brackets, but I don't think we'd be taking -- I mean, it's just
3 not a concern. The concern here is that this is a way of
4 avoiding corporate tax.

5 QUESTION: You don't think there's any tax avoidance
6 motive here do you?

7 MR. HOROWITZ: In setting up the corporation, no.
8 The reason for setting up the corporation was to get the loan
9 and avoid the Kentucky usury laws. But the reason for this
10 litigation is tax avoidance, not tax avoidance in a pejorative
11 sense, but the tax consequences of being treated as a
12 partnership are more advantageous to the respondents than being
13 treated as a corporation. What they wanted to do was they
14 wanted to be able to take their losses immediately and offset
15 them against other income that they have rather than if it's
16 treated as a corporation, they'll have to wait to take the
17 losses until the apartment complexes begin to show profit a few
18 years down the road.

19 So it's an opportunity to accelerate the losses that
20 the take.

21 I'd still like to say one more thing in response to
22 Justice Scalia's question. I think basically at least if
23 you're going to use a corporation as an agent, you've got two
24 choices. You can use a controlled corporation, you can use an
25 unrelated corporation. Now, if it's truly an arm's length
relationship, there's really no reason not to use an unrelated

1 corporation. And therefore we think the fact that these kind
2 of partnerships always use a controlled corporation and the
3 facts in this case and the facts in the Frink case that's also
4 pending before this Court, both reflect that the partnerships
5 were unwilling to enter into these kind of agreements unless
6 they could use a controlled corporation.

7 They reflect that there's more going on than just an
8 arm's length agency relationship. If they're going to choose
9 to use a controlled corporation, there ought to be a
10 presumption that there is a degree of control that's being
11 exercised that's different from the normal principal-agent
12 relationship.

13 QUESTION: What's wrong with the motive that it may
14 be a little cheaper to form a corporation than to ask some
15 national corporation to use one of their subsidiaries or
16 something like that? Isn't that a legitimate business
17 justification for doing it?

18 MR. HOROWITZ: Well, why is it cheaper, Justice
19 Stevens? It's cheaper only because the corporation is related,
20 and therefore --

21 QUESTION: That's right.

22 MR. HOROWITZ: Well, and therefore the agent is
23 giving them a break because of the control that the
24 stockholders exert over it.

25 QUESTION: If all of the legal incidents of the
relationship are identical, whether there's compensation or

1 not, why is one an agency and the other not? I just don't
2 understand. If all of the controls and all of the potential
3 liability and risks of the profit and loss and everything else
4 are the same, I don't understand why the fact you may pay
5 somebody like Corporation Trust Company \$100 a year for
6 performing this service should change the relationship?

7 MR. HOROWITZ: Well, I would agree that \$100 a year
8 here or there should not, that the Court should not come up
9 with a ruling that's going to make it turn on that. But I
10 think I have to go back to the basic principle that there's
11 this entire structure set up that recognizes corporations as
12 separate entities, even though they may be doing things on
13 behalf of their shareholders, they're not very different from
14 the kinds of things that an agent might do for someone. And
15 that's structure is seriously undermined if you can allow the
16 shareholders to treat some of the operations as agency
17 operations, and not treat the corporation as a separate entity
18 for that.

19 If you're using an unrelated agent, then the agent
20 really has no personal interest in what he's doing, and kind of
21 turns it all over to the principal and acts in the name of the
22 principal. But when you've got a corporation --

23 QUESTION: But the case might be different if the law
24 firm that represented these people formed a corporation and the
25 partners in the law firm just served as stockholders and so
forth, and then used this corporation for this purpose. Would

1 that be a different case?

2 MR. HOROWITZ: Well, I think that would be a more
3 difficult issue because you wouldn't have the apparent control
4 there.

5 QUESTION: You'd have exactly the same control.

6 MR. HOROWITZ: Well, I'm not sure what position the
7 Service would take there because I don't think those cases have
8 come up, but it might be that the fact that the partners were
9 paying all the expenses and everything would make them
10 constructive shareholders --

11 QUESTION: No, they'd get reimbursed by their
12 clients. They're not going to do this as a matter of
13 generosity just they'd be sure that all expenses are paid by
14 the people who have an interest in having the business go
15 forward.

16 MR. HOROWITZ: Well, that's what I'm saying, and the
17 fact that they're paying all the expenses, I think, might well
18 make them constructive shareholders of the corporation.

19 QUESTION: Mr. Horowitz, in Arizona when I practiced,
20 it was a very common practice to have subdivision trusts where
21 a title company would hold title to a large piece of property
22 and charge virtually nothing for holding it because they were
23 going to make their money out of insuring titles in the houses
24 that were built ultimately on that vacant land.

25 Now, would the Government feel that the title company
ought to have to recognize income and losses on property, that

1 it held that sort of nominal title to?

2 MR. HOROWITZ: Well, if it's an unrelated corporation
3 that held it clearly as an agent --

4 QUESTION: Well, of course --

5 MR. HOROWITZ: Did it take out the loans?

6 QUESTION: No, no. It's an unrelated corporation in
7 one sense; it isn't the same entity, but it has every reason to
8 cooperate with the subdividers because that's where it's going
9 to get its income from.

10 MR. HOROWITZ: Well, that sounds like an agency
11 relationship to me because you don't have the Moline problem of
12 needing to recognize the corporation as a separate taxable
13 entity, because you don't have a dealing with a controlled
14 corporation. I mean, Moline arises only in the case of or it
15 addressed the relationship between the corporation and the
16 shareholders that control it, and how the tax consequences are
17 to be allocated between those two.

18 When you don't have that kind of relationship, you
19 don't run into the sort of problems that National Carbide
20 dictum is concerned about and the government is concerned about
21 in this case.

22 I guess my time's about expired. I'd like to just
23 make two other quick points. One is that quite apart from the
24 issue we've been discussing here, we think in this case, the
25 respondents fail the sixth factor of the National Carbide test
which is that the corporation's here did not act as agents at

1 all, they acted as principles. It was essential to the success
2 of the whole scheme that the corporation be holding the title
3 in its own name and take out the loans in its own name, not on
4 behalf of the partners because that would not have satisfied
5 the Kentucky usury laws.

6 And second, I'd just like to point out that Congress
7 has dealt with these kind of issues in some detail in
8 Subchapter S of the Code in which they have recognized that in
9 certain situations, businesses should be entitled to operate as
10 corporations and still have the tax consequences flow through
11 to the individuals as partnerships. But Congress did not view
12 this kind of situation as one to which Subchapter S should
13 apply. And because of a specific provision, they are not
14 eligible for Subchapter S treatment. We think Subchapter S
15 would be somewhat undermined if respondents can use this agency
16 mechanism to get around it.

17 I'd like to reserve the remainder of my time.

18 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Horowitz.
19 Mr. Hembree, we'll hear from you now.

20 ORAL ARGUMENT OF CHARLES R. HEMBREE, ESG.

21 ON BEHALF OF RESPONDENTS

22 MR. HEMBREE: Mr. Chief Justice, and may it please
23 the Court:

24 I should like to use my time this morning to
25 concentrate on four areas. That is, the attempt to clarify
what the issue is in this case, to focus on some of the

1 undisputable facts in the case, comment on the Sixth Circuit's
2 holding in the case which held for the taxpayers in holding
3 that they were the taxpayers and that they were entitled to the
4 deductions claim, and point out some of the numerous fallacies
5 that are contained in the petitioner's brief and in
6 petitioner's argument here this morning.

7 First, I think it's very important in this case to
8 understand that the underlying issue is an issue of who is the
9 taxpayer. This I think is a much more ingrained principle in
10 this case than the two-tier tax system. And once you get to
11 the point of looking to who is the taxpayer in the case, and
12 then look at the facts as found by the Tax Court and accepted
13 by the Sixth Circuit, there is no question but what the income
14 was earned and the expenses were incurred by the partnerships
15 and the proprietorships, and not by the corporation which had a
16 very very minor part in this whole picture insofar as its
17 activities.

18 It held nominal legal title and put a mortgage on the
19 property to secure a loan in each instance to secure a loan
20 that was taken out for the benefit of the partnership or the
21 proprietorship.

22 QUESTION: Would you be in great trouble if you went
23 into Court in this tax case in Kentucky and said this
24 corporation that was set up to hold title is just the alter ego
25 for the partnership?

MR. HEMBREE: Yes, Justice White, I believe that we

1 would be in terrible trouble because in five of the six
2 projects, the owners of the partnership were two or three
3 individuals only one of whom was Mr. Bollinger who was the sole
4 shareholder in the corporation and there was a nominee in --

5 QUESTION: Would you be in any trouble under Kentucky
6 usury laws?

7 MR. HEMBREE: No, Your Honor.

8 QUESTION: So Kentucky wouldn't mind. They're
9 willing to go just on the record.

10 MR. HEMBREE: There has not been a case insofar as I
11 know that --

12 QUESTION: So everybody knows the way around the
13 usury law in Kentucky.

14 MR. HEMBREE: The method used here to comply with the
15 usury statute, and I think it was a compliance, we complied
16 with it by having the loan made in the name of a corporation.
17 Now, there was a nominee agreement in each of the eight
18 projects, and the nominee agreement specifically provided that
19 the corporation was to act as the nominee and agent in holding
20 bare legal title and in placing the mortgage on the property
21 for the benefit of the partnerships.

22 The one thing that gets lost in the argument I have
23 to say the catacombs of the petitioner's argument because of
24 the areas that are so unknown is that this principle of the one
25 who earns the income is the proper taxpayer gets completely
lost.

1 QUESTION: Is that really true? I mean, let's
2 suppose I form a corporation in which I'm a sole shareholder.
3 I just decide to incorporate my business. Previously, I've
4 been doing it as just a sole proprietor. I incorporate. I
5 become the chief executive officer, I'm the sole shareholder.
6 It's really me. I'm still making the money, but I formed a
7 corporation. Now, who gets taxed, me or the corporation??

8 MR. HEMBREE: In that situation, Judge Scalia, you
9 have Moline Properties because there you are doing business as
10 a corporation. The corporation is the one which earns the
11 income even though the individual maybe is in the picture.

12 QUESTION: So the reality has nothing to do with it,
13 does it? The reality has nothing to do with it. In that case,
14 I'm really I'm the whole thing. I own all the stock, I put in
15 all the work and I don't get taxed. The reality has nothing to
16 do with it at all. We're dealing with an artificial creation
17 here anyway, aren't we? So we just have to decide what rules
18 govern this artificial creation.

19 MR. HEMBREE: I think that is true, Your Honor.

20 QUESTION: All right. So long as we know we're not
21 talking about reality.

22 MR. HEMBREE: A corporation itself is a fiction, it
23 is a recognized fiction which has separate entity
24 classification for tax purposes, and we recognize that. We
25 never have questioned that. But the question comes back when
the corporation is formed, what does that corporation do and

1 the mere fact that there is a corporation there does not change
2 the fact that an individual who is the sole shareholder can do
3 things on his own, can own property without it being in the
4 corporation, and can transact a completely separate
5 proprietorship operation, or be in, as in this case, a partner
6 in other types of businesses that the corporation is not in.

7 QUESTION: Mr. Hembree, the tax years involved here
8 are some time ago, a decade or so. Has the Kentucky usury law
9 been changed in the meantime?

10 MR. HEMBREE: Yes, Justice Blackmun. The Kentucky
11 usury law was changed in 1972 which was right in the middle of
12 this period, and I think that indicated that the Kentucky law,
13 as most of the laws in various states involving usury became
14 antiquated because of the high rate of increase in the interest
15 rates, and as soon as the legislature could get around to it,
16 it did correct the problem that existed at that time.

17 QUESTION: So you wouldn't have to do this in order
18 to, as you put it, to comply with the Kentucky usury law,
19 rather than to avoid it.

20 MR. HEMBREE: Yes, that is correct, Your Honor.

21 QUESTION: Today you wouldn't have to do it.

22 MR. HEMBREE: Yes.

23 QUESTION: All right.

24 MR. HEMBREE: Now, the issue in this case is not
25 whether the nominee corporations can be disregarded as separate
entities. We have made it clear throughout our brief that they

1 are recognized as separate entities. It's only a question once
2 they are recognized, you do not actually have to attribute to
3 them, income that they did not earn. And this is the principal
4 emphasis that I want to make on that point.

5 The real issue, the one that was tried in the Tax
6 Court, and the one that was considered in the Circuit Court, is
7 whether the proprietorships and the partnerships which
8 generated the income and expenses may have the deductions for
9 the net losses that were generated in the earlier years of
10 construction and operations of the apartment complexes.

11 Now, it's important to understand that there were
12 eight apartment complexes and each of them was owned by
13 separate entities in the terms that two of the projects were
14 owned and operated by Mr. Bollinger, as separate
15 proprietorships. Six of them were owned by the partnerships in
16 which Mr. Bollinger was only one of the partners.

17 As far as the operation of the five partnerships
18 which were using Creekside, Inc. as the corporate nominee,
19 Mr. Bollinger did not have control of four of those in the
20 sense of ownership. He didn't have control of any of them in
21 the sense of voting power, because in the most he had in the
22 five partnerships, the most he had in four of the partnerships
23 was a fifty percent ownership interest, and he had a sixty-six
24 and two-thirds interest in one of the partnerships. But in that
25 one, under Kentucky law in the absence of specifying otherwise,
each partner, irrespective of the percentage interest, had

1 equal vote.

2 So we feel that in those five cases or five
3 situations, there was a lack of control of the partnerships by
4 Mr. Bollinger. Now, the Government makes a comported argument
5 that there should be some kind of a constructive ownership
6 implied which we think is completely without merit.

7 Now, I'd like to just mention briefly some of the
8 very what I consider to be crucial facts that were found by the
9 Tax Court and accepted by the Court of Appeals for the Sixth
10 Circuit, and they are that the proprietorships and the
11 partnerships were the owners of the apartment complexes, and
12 they remained the real and true direct owners upon the transfer
13 of the bare legal title to the nominee corporations. And the
14 transfers to the nominee corporations were for the limited
15 purposes of holding title and placing mortgages on the
16 properties to secure the loans taken out for the benefit of the
17 partnerships or the proprietorships.

18 The proprietorships and the partnerships constructed
19 the businesses of constructing and operating the apartment
20 complexes in proprietorship form or partnership form and not in
21 corporate form. This is a specific finding that was made by
22 the Court. All of these are.

23 The proprietorships and the partnerships constructed
24 the apartment buildings, they operated and managed the
25 apartment buildings, they generated the income and the expenses
from the operations of the apartment buildings. They received

1 the income and they paid the expenses in connection with the
2 construction, the development and operation of the projects.
3 They made all the interest and principal payments on the loans.
4 They paid all expenses otherwise for the projects.

5 QUESTION: Mr. Hembree, maybe they were agents of the
6 corporation. Maybe they were agents of the corporation, I say.

7 MR. HEMBREE: On that point, Justice Stevens, the
8 only way that they could be agents of the corporation would be
9 if the corporation were the owner of the property and they were
10 operating under that type of an arrangement. Here they were
11 not because under the nominee agreement that was present in
12 each one of these projects, the only owner of the project was
13 the partnership or the proprietorship. The only ownership that
14 the corporation had was bare record title, nothing more.

15 By the same token, none of the operations were made
16 in the name of the corporation, and everyone who dealt with the
17 partnership or the proprietorship was dealing with them as
18 such. The corporation was not involved and did not become
19 liable for what the partners were doing. So for that reason, I
20 think just the opposite is true.

21 QUESTION: Well, do you mean to say that, suppose, as
22 your opponent suggests, that somebody slipped on the ice in
23 front of the building and brought suit, and they searched the
24 title records, and found -- I suppose the record title showed
25 in the corporate entity?

MR. HEMBREE: That is true, Your Honor.

1 QUESTION: I suppose if they filed a lawsuit against
2 the corporate entity and then the Statute of Limitations ran
3 before the found out who the real true owner was, you'd say
4 they couldn't recover because they sued the wrong party?

5 MR. HEMBREE: I believe they might be able to
6 recover, but they would be able to recover in the final effect
7 only from the partnership or the proprietorship because --

8 QUESTION: If they didn't name the other people as
9 defendants, just got a judgment against the corporate entity,
10 you don't think they could recover on that judgment and
11 foreclose against the real estate, if they had to.

12 MR. HEMBREE: Any liability that the corporation
13 became liable for, they were indemnified under --

14 QUESTION: They're indemnified but would it not be
15 true that a judgment would be a lien against the real estate,
16 if it was just against the corporation?

17 MR. HEMBREE: I believe that would be the correct
18 result, yes, Your Honor.

19 QUESTION: So you can't totally ignore the
20 corporation.

21 MR. HEMBREE: No, we don't attempt to ignore the
22 corporation. We accept the corporation for what it was, and
23 for what it did. The thing about it is, it did so little. It
24 held bare legal title, operated to get the loans on the books,
25 and that was it. And for that limited purpose, the petitioner
is contending that all of the income generated from the

1 operations of the entire apartment complex should be then
2 treated as if it had been earned by the corporation, the
3 nominee corporation.

4 QUESTION: How do you distinguish Moline?

5 MR. HEMBREE: I don't distinguish Moline, Your Honor.
6 I say that Moline supports us because Moline Properties is a
7 case which the issue to start with in that case was, who is the
8 taxpayer, and the Board of Tax Appeals held that the taxpayer
9 was the sole shareholder and the basis for that holding was
10 that you ignored the separate entity.

11 QUESTION: Yes, but the Board got reversed.

12 MR. HEMBREE: And a very important aspect of that and
13 this gets over to a point that was brought up by Mr. Horowitz.

14 QUESTION: And of course, the Government in that case
15 was on your side.

16 MR. HEMBREE: I didn't --

17 QUESTION: I think the Government's position didn't
18 stand up in the Court of Appeals.

19 MR. HEMBREE: It did before this Court Your Honor.

20 QUESTION: I know, but not the Court of Appeals.

21 MR. HEMBREE: Well, I think the thing that we're
22 interested in here is what this Court held in Moline
23 Properties, and in that case, --

24 QUESTION: Oh, yeah, all right, go ahead.

25 MR. HEMBREE: -- this Court, in reversing, or in
affirming the Circuit's reversal of the Board of Tax Appeals,

1 held that the separate entity must be recognized and that the
2 income of that separate entity must be reported by it. And the
3 big distinction between that case and our case is that there,
4 the income was the income of Moline Properties, the
5 corporation. Here, the income that is sought to be shifted
6 from, or the losses attempted to be shifted from these
7 partnerships.

8 QUESTION: Of course, that solves the whole case.
9 The government says that the income was the corporation's.

10 MR. HEMBREE: That's where that assertion is
11 completely and diametrically opposed to the findings of fact of
12 the trial court which were accepted by the Court of Appeals,
13 and there's no basis being pointed out for contesting those
14 facts.

15 QUESTION: Suppose the stock of this corporation had
16 been sold after it had been set up and the money was coming in
17 from the properties. Do you think the shareholder wouldn't be
18 able to get that money and say it's money from the property my
19 corporation owns?

20 MR. HEMBREE: No, Your Honor. Because the only
21 rights the corporation had was what rights it got under the
22 nominee agreement and the nominee agreement limited completely
23 everything the corporation was insofar as the property to
24 holding bare record title and establishing the loans, the
25 mortgage on the loans.

QUESTION: Counsel, isn't that your distinction with

1 the Moline case, not the fact that they called in the income
2 coming from one or the other, in that case, there was no agency
3 agreement, whereas there was in this case. Isn't that true?

4 MR. HEMBREE: Well, I think that's a part of it, Your
5 Honor. I think we're dealing really with different --

6 QUESTION: I thought the argument in that case was
7 that they should be treated as an agency simply because they
8 were wholly owned by the individual, and that was not enough to
9 establish agency. And here you say a), you're not wholly
10 owned, and b) we've got a separate nominee agreement.

11 MR. HEMBREE: Well, Justice Stevens, I believe there
12 are two aspects over the Moline Properties case, number one and
13 the principal part of it was that the sole shareholder was
14 attempting to say I am the sole shareholder and I have the
15 complete beneficial interest of everything the corporation has.
16 Therefore, we should be treated as one, and the fact that there
17 has been a sale of property by the corporation on which there
18 was a gain, there shouldn't be a separate tax, it should be
19 taxed to me directly.

20 QUESTION: And in other words, the mere fact that I
21 own all the stock is not enough to make me the principal in the
22 corporation an agent. Basically, that's what --

23 MR. HEMBREE: That's true. And the argument was made
24 as an alternative that there was an agency relationship that
25 would bring the money back and the corporation was merely
acting as agent, but there was no agreement. And this Court in

1 affirming the reversal by the Court of Appeals pointed that
2 out, that there was no agency agreement or any other
3 restriction on the title and ownership that the corporation
4 had. So there is I think why the Moline Property case is not
5 from the factual standpoint of any bearing in this case, but
6 the principle that was established there, I think, was an
7 affirmance of the basic principle that whoever earns the income
8 is the one who must report it.

9 QUESTION: Well, they have to do from year to year
10 for one reason or another under the tax laws or because of my
11 peculiar circumstances, it becomes advantageous from one year
12 to another to shift the income to the corporation or to me, all
13 I have to do is write up the nominee agreement with the
14 corporation saying, you know, I'm the sole shareholder. This
15 year, the income will belong to the corporation. The next
16 year, the income will belong to me.

17 Can I do that from year to year, and that's all it
18 takes?

19 MR. HEMBREE: No, Your Honor, not in terms of
20 shifting the income of the type that we're talking about here.
21 Because if you can each year surely you could as a sole
22 shareholder, enter into a new agreement with the cooperation
23 and once you enter into that agreement, then it depends on what
24 the relationship is that's created by that agreement. If you
25 --

 QUESTION: Well, it's the same thing here. It just

1 says, all the income from this property this next year is going
2 to be mine. And you say, so long as I do that before the tax
3 year, it's okay.

4 MR. HEMBREE: If that's the agreement, then, it does
5 not stand up because in that instance because it's nothing more
6 than an anticipatory assignment of income, and that is not a
7 proper relationship under the National Carbide case. The
8 National Carbide case, that would make it really fall right
9 into the category of being solely dependent this relationship
10 under that kind of an agreement would be solely dependent upon
11 the fact that there is the ownership.

12 QUESTION: Well, why isn't this just as much? The
13 only reason the corporation is letting these people have the
14 income is because these people are the sole shareholders. You
15 don't think any corporation in its right mind would say, well,
16 we own the property but other people can have the income. It's
17 the same thing, it seems to me.

18 MR. HEMBREE: Well, I think the big distinction,
19 Justice Scalia, is that the income was not anything that the
20 corporation had any right to under the agreement that is
21 involved. Now, I know this doesn't fully answer your question,
22 but the reason that it doesn't go to the corporation and can't
23 go to the corporation in this instance is because the
24 corporation had no right to it.

25 Now, if there is an agreement that gives the
corporation the right to it, and the corporation earns it, now,

1 the agreement has to be one that reflects a relationship and
2 this is what National Carbide is all about is the relationship
3 that is created by the agency agreement must be one that is
4 reflecting the activities that are involved. And I think in
5 this instance, the Sixth Circuit came up with the right results
6 and that is that you look to the overall situations to see if
7 the normal indices of agency have been satisfied. And if they
8 have been satisfied, then the agency is going to be recognized.

9 The way you determine that is comparing that with
10 whether or not an unrelated entity would be willing to do the
11 same thing that the related entity has done. And you do not
12 get into the consideration, and incidentally, this is the only
13 real basis that the petitioner has pointed out for this failure
14 of the so-called Fifth Circuit on the relationship aspect is
15 that there was no consideration paid. The consideration, as
16 you, Justice Scalia, have pointed out is not necessary insofar
17 as establishing a valid agency relationship consideration is
18 pure black letter restatement agency law. That you don't need
19 the consideration.

20 So that being the only thing that the petitioner is
21 relying on, we get back into an area where we get lost on
22 trying to use a principal that is set up in Moline Properties,
23 and then another principle that is set up in National Carbide
24 they tried to pull together but they don't mesh because of the
25 different situations that were involved, and because of the
different principles.

1 On the one hand, you're talking about a separate
2 entity, and on the other hand, you're talking about the
3 basically an anticipatory assignment of income in National
4 Carbide. I should like to -- I don't like to spend much of my
5 time pointing out errors that have been made in the brief of
6 the petitioner -- but I do feel that it is very important to
7 point out certain misstatements and distortions that are
8 contained in the brief filed on behalf of the petitioner.

9 Petitioner states on page 18 as a fact that the
10 corporation's incurred interest expense on loans. However, the
11 Tax Court specifically found that the partnership made all
12 interest payments and is contrary to the statement by
13 petitioner in the brief. Petitioner also states that the
14 corporation owned the properties. However, the Tax Court
15 specifically found that the corporation owned no assets and
16 also found that the partnership, and not the corporations were
17 the owners of the apartment complexes.

18 Now, those just don't square when you talk about the
19 statement is made in the brief and what the actual facts are as
20 found by the Court. Also, at page 18 of the brief, petitioner
21 states that the Court of Appeals stated, "that this supposed
22 principal agent relationship superceded Moline Property special
23 entity rule." There is no such statement made by the Court of
24 Appeals. I don't know how to deal with statements that are
25 made in the brief, how to respond to them, when they refer to
matters in the lower Court's opinion which just do not exist.

1 Petitioner also states that the Sixth Circuit
2 concluded that even if the corporations were viable separate
3 entities, their income and expenses could be attributed
4 directly to Bollinger and his partners under the agency theory.
5 That was not the holding of the Sixth Circuit at all. The
6 holding of the Sixth Circuit was that the proprietorships and
7 the partnerships conducted the business of constructing and
8 operating the apartments in the partnership and proprietorship
9 forms, and not in the corporate form, and that the income
10 realized was attributable to the efforts and assets of the
11 proprietorships and the partnership.

12 Thus, I think it is completely erroneous and
13 misleading for the petitioner to say in his brief that the
14 income and expenses were considered by the Sixth Circuit to be
15 those of the corporation and that it attributed the
16 corporation's earnings to the partnerships and proprietorships.

17 One other thing which I briefly mentioned before, but
18 this gets to the very heart of it, at page 2 of his reply
19 brief, the petitioner states that respondents note, at page of
20 the brief, that "corporate ownership of properties was
21 specified by the lenders as a prerequisite of making the
22 loans." This is a complete misstatement of what was said in
23 respondents' brief. The statement in the respondent's brief
24 referred only to nominal debtor and that the nominal debtor be
25 a corporate nominee of the partnerships and that record title
to the property be held by the corporate nominee.

1 Now, nominal debtor and corporate nominee do not add
2 up to ownership, and that I think also is a very misleading
3 statement.

4 Recognizing that the time is just about gone, I want
5 to make one statement that clears this whole brings the whole
6 case I think into perspective in terms of what we're dealing
7 with and the interpretation of the National Carbide case.
8 There this Court was attempting to set up certain rules that
9 would be useful in determining whether a valid agency
10 arrangement existed. The reason they were doing it was to try
11 to determine who was the taxpayer with regard to the income
12 that was involved in that case, and the income in that case had
13 been earned by the agents. And because it had been earned by
14 the agent and the agency agreement did nothing more than make
15 an anticipatory assignment of it, the Court held that the
16 agency agreement would not be recognized, because certainly the
17 assignment was based on joint ownership of the two entities and
18 nothing more.

19 What the petitioner is attempting to do in this case,
20 in using the so-called fifth factor and the so-called sixth
21 factors in National Carbide to support --

22 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Hembree,
23 your time has expired.

24 MR. HEMBREE: Thank you.

25 CHIEF JUSTICE REHNQUIST: Mr. Horowitz, you have
three minutes remaining.

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ORAL ARGUMENT OF ALAN I. HOROWITZ, ESQ.

ON BEHALF OF PETITIONER - REBUTTAL

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

I'd like to make two quick points. One is that the essence of the holding in Moline is that a dummy corporation, a corporation that does very little has to be recognized for tax purposes if it engages in business activity. So Mr. Hembree's contention here --

QUESTION: -- took the contrary position there.

MR. HOROWITZ: I'm sorry. I didn't have a chance to check that, Justice White, since you mentioned it before. I don't think that was right. I thought the --

QUESTION: Well, the Tax Court got reversed in the Court of Appeals.

MR. HOROWITZ: That's right.

QUESTION: And the Tax Court agreed with the Government's position because the Government there was trying to stick the taxpayer, the individual, trying to ignore the --

MR. HOROWITZ: My recollection is that the dispute was over whether the corporation would have to pay corporate tax and it was the Government that wanted to collect the corporate tax, but I could be wrong. I'm not sure. I will check.

QUESTION: You may be, you may be.

MR. HOROWITZ: The point I want to make is that Mr. Hembree's statement that the corporation should not be

1 recognized here because it did so little is exactly the
2 contention that was accepted by the Board of Tax Appeals in
3 Moline and reversed by this Court. That's exactly inconsistent
4 with Moline, and the more general proposition that what the
5 Code wants to do is --

6 QUESTION: Well, there wasn't an agency agreement in
7 Moline was there?

8 MR. HOROWITZ: No, there wasn't. That's the second
9 point I wanted to make actually which goes to Justice Steven's
10 question about Moline. Is that I think the precise holding of
11 National Carbide, is that you can't avoid Moline simply by
12 having an agency agreement. There was an agency agreement in
13 National Carbide. That was exactly the argument that the
14 taxpayer tried to make there. And what National Carbide said
15 is that that's not good enough because the agency agreement
16 there didn't reflect anything different than the kind of
17 control that the shareholders exert over the corporation. They
18 just put it on a piece of paper and said that the subsidiaries
19 will do x, y and z as agents. But it's the same thing that the
20 shareholders could have told them to do because of their
21 control. It has to be something different from a shareholder
22 corporation relationship. And that is, I admit, difficult to
23 show where you take the tack of setting it up as a controlled
24 corporation for these purposes. It's better to use an
25 unrelated agent. But that's, you're stuck with it if you need
to set up a corporation for some business purpose as the

1 taxpayer certainly had to do here, then you are stuck with the
2 tax consequences of that.

3 And with respect to the question of whether they
4 complied with the Kentucky Usury laws, they certainly did
5 comply with the Kentucky Usury laws.

6 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Horowitz,
7 your time has expired.

8 The case is submitted.

9 (Whereupon, at 11:05 a.m., the case in the above-
10 entitled matter was submitted.)

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REPORTER'S CERTIFICATE1
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DOCKET NUMBER: 86-1672
CASE TITLE: COMMISSIONER, IRS v. BOLLINGER, ET AL.
HEARING DATE: January 13, 1988
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 United States Supreme Court.

Date: January 13, 1988

Margaret Daly

Official Reporter

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