TRANSCRIPT OF PROCEEDINGS

IN THE SUPREME COURT OF THE UNITED STATES

In the Matter of:	)	
	)	
ARKANSAS BEST CORPORATION	)	
	)	
Petitioner	)	No. 86-751
v.	)	
	)	
COMMISSIONER OF INTERNAL REVENUE	)	

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IN THE SUPREME COURT OF THE UNITED STATES

ARKANSAS BEST CORPORATION,

Petitioner,

v. : No. 86-751

COMMISSIONER OF INTERNAL REVENUE

Washington, D.C.

Wednesday, December 9, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:57 a.m.

APPEARANCES:

VESTER T. HUGHES, JR., ESQUIRE, DALLAS, TEXAS, on behalf of the Petitioner.

ALAN A. HOROWITZ, ESQUIRE, ASSISTANT TO THE SOLICITOR GENERAL, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, D.C., on behalf of the Respondent.

C O N T E N T S

PROCEEDINGS

CHIEF JUSTICE REHNQUIST: Mr. Hughes, you may proceed whenever you are ready.

ORAL ARGUMENT OF VESTER T. HUGHES, JR., ESQUIRE

ON BEHALF OF PETITIONER

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

This case is here on writ of certiorari to the Eighth Circuit, which denied Arkansas Best Corporation an ordinary loss treatment on the sale of National Bank of Commerce stock it had purchased after 1972, stock that, as the Tax Court expressly found, Arkansas Best purchased solely for business purposes.

The decision of the Eighth Circuit is in direct conflict with a number of other decisions of the Circuit Court, Court of Claims, Tax Court, and, indeed, is inconsistent with past decisions of this Court as well.

The Eighth Circuit's Opinion challenges the fundamental premise of what is known in the tax world as the Corn Products Doctrine. That is, that it is the purpose for which an asset is purchased, and not the nature of the asset, that determines whether it is a capital asset or a non-capital asset.

In doing so, it presents a rather fundamental question of the entire application of the tax law. The

question of whether taxpayers can rely on the words of this Court, the rulings of the Internal Revenue Service, the words of the Congressional committees interpreting what the state of present law is, and numerous other courts which also have interpreted the language of this Court.

Consistency has long been a cornerstone of our tax system.

QUESTION: You are not saying the Internal Revenue Service has always been consistent, are you?

MR. HUGHES: No, Justice Blackmun. I don't believe I could say that. But I do believe that the application of the tax law, and consistency in the application of the tax law has been a desideratum that has been announced both by scholars and by this Court and by other courts.

QUESTION: Now that I have you interrupted, am I correct in assuming the Tax Court decision here was not reviewed by the full Court?

MR. HUGHES: It was reviewed by the full Court.

QUESTION: It was?

MR. HUGHES: It was a regular Tax Court decision, as contrasted with a memo decision. It was a regular decision.

QUESTION: Yes. But it was not reviewed, in the technical use of that term, by the Tax Court?

MR. HUGHES: My understanding, Justice Blackmun, is that it is not a memo decision. It is reviewed by the rest of

the Court.

QUESTION: That is out of my line with my understanding of long standing. But then, go ahead.

MR. HUGHES: The Corn Products decision actually was a development in a much older line of thinking on the nature of a capital gain.

You go back to the 1932 and the Opinion of Justice Stone, in Burnet v. Harmel, and there was interpretation of the 1921 Act, as modified in 1924. The 1921 Act, Congress decided that sales of what had been denominated as capital assets would be treated differently than the sales of other assets, and in defining what a capital asset was, assets acquired and held by the taxpayer for profit and investment, were to be treated as capital assets, for profit and investment, and taxed at preferential rates.

In 1924, that language was modified so that it would become clear at that point that a taxpayer's personal assets could have the same treatment. But business assets continued to be treated as in the 1921 Act, and, indeed, in Burnet v. Harmel, the Supreme Court said that there had been no material change when the 1924 Act modified the 1921 Act.

Consistent with this purpose, in 1936 then, the Treasury, in GMC 17322, determined that hedging transactions really were, in essence, insurance, and that they would be treated, when they were entered into for protecting a

taxpayer's manufacturing process, they would be treated as ordinary assets. That ruling was very clear to announce that hedging transactions of a speculator would be treated as a capital asset.

Therefore, you have the situation that the same transaction, precisely the same transaction, had either capital or ordinary treatment, depending on the motive, depending on the motive of the person engaging in the transaction.

This was consistent with what the Supreme Court had decided in Burnet v. Harmel, and of course was the prelude to the Court's decision in Corn Products.

In the Opinion authored by Justice Clarke, the question was whether Corn Products Corporation, which used corn products in various manufacturing operations, would, by reason of hedging transactions, realize a capital or an ordinary gain.

In that case, as the Court will recall, the taxpayer had entered into the hedging transactions in order to protect itself from price increases in corn. If the price of corn escalated, there was protection. That was not a true hedge. And so, technically, it was not under the 1935 GCM. But the Court said that didn't matter, that the transaction was one of a prudent manufacturer, not one of an investor, not a transaction entered into with an investment or profit motive, if you will, but one directly related to the taxpayer's business.

In 1958, then, the Internal Revenue Service issued another ruling, the three examples, Revenue Ruling 58-40, where it rules that stocks, bonds, or other securities that were purchased solely for the purpose of obtaining inventory, or for other business purposes -- for example, the Government securities that were purchased in order for a bonding requirement to be met -- would give rise to ordinary treatment, not to capital treatment. And at this point it is clear that Revenue Ruling 58-40 is in direct conflict with what the Service, the Commissioner of Internal Revenue is urging on this Court today, and is in direct conflict with what the Eighth Circuit determined in this case.

Since the decision in Corn Products, a quick noting of the CCH Citator indicates that it has been cited more than 260 times.

QUESTION: That is Rev. Rule 58-40?

MR. HUGHES: No, Your Honor, the Corn Products Decision.

QUESTION: Did you cite 58-40 in your original Brief?

MR. HUGHES: I believe we did, Your Honor.

QUESTION: It isn't in the Index, and hence, if you didn't, of course, then the Government doesn't have an opportunity to respond to it. You do cite it in your Reply Brief.

MR. HUGHES: I am certain that it was cited either in

one of the Amicus Briefs or in our Brief.

QUESTION: It's in the Reply Brief. In your Reply Brief.

MR. HUGHES: In the Reply Brief. The Revenue Ruling, again, clearly indicates that stock can be an ordinary asset if the principal purpose, if the principal purpose had to do with the business of the taxpayer.

QUESTION: Mr. Hughes, may I inquire about this particular case?

MR. HUGHES: Yes, Justice O'Connor?

QUESTION: I take it that the stock acquired after 1972 was listed or referred to in the financial records of the company as an investment.

MR. HUGHES: Yes, Justice O'Connor.

QUESTION: As an investment.

MR. HUGHES: I think that in terms of where it fitted on the balance sheet, that that would inevitaby be true.

QUESTION: What if the price of that stock had gone up, and it had been sold? I suppose the company might have wanted to get capital gains treatment of it?

MR. HUGHES: Yes, Your Honor. We might very well have been here today discussing the propriety of that treatment.

QUESTION: And the IRS would be in the position of saying no, it ought to be an ordinary gain, do you suppose?

MR. HUGHES: It would be if it followed its rulings.

QUESTION: As in Corn Products.

MR. HUGHES: As in Corn Products, or as in Revenue Ruling 58-40 or as in Revenue Ruling 75-13.

QUESTION: This is a bit of a twist. Because normally, had there been any kind of a gain, the situations would be exactly reversed, or the positions taken, perhaps.

MR. HUGHES: And of course, the Internal Revenue Service did prevail in the Mansfield Journal case, where it was exactly the reverse of the situation. They had contracts.

QUESTION: So it can cut two ways.

MR. HUGHES: Yes, Justice O'Connor.

QUESTION: Do you think this is of diminishing importance in light of the Tax Code changes and the withdrawal of capital gains treatment altogether?

MR. HUGHES: I don't believe so, Your Honor, for two or three reasons.

You will notice that, both in the Petition for Certiorari and in the Brief, of both parties, the importance, the continuing importance was indicated to this Court, indeed, that being, for asking, for at least two reasons. When the capital gains system was set up, it was not solely a benefit to taxpayers. Capital losses are offset only against capital gains. And indeed, if the capital loss can be taken only against a capital gain, there is no help. That system is left

in place. That will be in place next year when we have a 28 percent tax rate. And so taxpayers will have the detriment of the capital loss situation. My understanding is that this was considered in the 1930s, in the early 1930s, when there was some thought of elimination of capital gains, and it was thought that the revenue, because of the stock market crash, the Federal revenues could not stand the loss of revenue which would be incident to allowing capital losses against -- what had been capital losses -- against ordinary income. And of course, at any time of a stock market decline, that would be true.

The second reason I would say so, the Committee Reports relating to the 1986 Act specifically left the capital gains system in place, because Congress was not clear whether it could maintain the 28 percent rate. And if the 28 percent rate changed, then indeed there should be some kind of modification.

The situation is not just that the Courts have followed Corn Products and have developed the reasoning of the profit motive, the importance of the profit motive, a dominant business motive, as contrasted with a profit motive being the distinction. The Congress has followed that approach. In 1975, Treasury suggested to Congress that all capital stock be treated as capital assets. And had that been enacted, of course, this taxpayer would not have had a basis for bringing

this case.

Both Houses of Congress considered Treasury's proposal. Both Houses of Congress rejected the Treasury proposals. They enacted, each House enacted instead a provision that said that 30 days after the purchase of stock, that a taxpayer would have to market as either a business asset or as a capital asset. However, it was in the last days of the session. And so, at that time, they never had a Conference Committee on it and Congress never went back to a decision as to whether or not there should be legislation, or never made a decision saying that all stock would be capital assets.

QUESTION: Did that proposal that you last described pass the 30-day proposal?

MR. HUGHES: No, Chief Justice, it did not. A type of 30-day proposal passed each House. But there was never a Conference of the Senate and the House. And so it never became law.

The Treasury proposal is essentially what the Eighth Circuit said. The Eighth Circuit, in essence, said capital stock is always a capital asset unless of course it is held by a trader. You can have a trader who has stock as inventory, and that is clear from the law. But it is also clear from the law that Congress, in the Committee Reports, talked about what the present state of the law is.

As is always true in Congressional hearings, there

will be a Committee Report. There was a House Report, and there was a Senate Report. And it said, under present law, the treatment of gain or loss on sale or exchange of stock or other security depends on whether the security is a capital asset in the hands of the taxpayer.

It seems absolutely clear that Congress understood the law. Then it says, if stock or security is held for business purposes, generally it would not be treated as a capital asset, and therefore, any gain would be treated as ordinary income and any losses would be treated as ordinary losses, which could be deducted in full in the current year.

That is our fact situation here.

This taxpayer had a bear by the tail, in a manner of speaking. It had to divest itself of the stock. Congress passed the One Bank Holding Company Act. And either the taxpayer, which owned a trucking company, a furniture manufacturer, a tire sales company, a retreading company, a computer company, and then it had the interest in the bank, which it had acquired in 1968, it could expand no further in its other businesses unless it divested itself of the stock, because of the Bank Holding Company, which became effective December 31, 1970.

And then in 1971, in August, this taxpayer filed with the Federal Reserve a statement that it would divest of its stock. So it is clear that the taxpayer had no interest in

acquiring more stock. Indeed, it was trying to get rid of the stock it had.

As the Tax Court found, the stock that it bought, after 1972, was solely -- and I reiterate the word "solely" -- for the protection of its reputation, for its business purposes, because by that time, it was clear that the bank was in financial trouble, and that the taxpayer was going to have trouble selling the stock it already had, much less any other stock that it purchased.

The fact that the taxpayer sold the stock solely for business purposes then accords with what had been the traditional rules as set forth in this Court. First, you take a look at the Burnet v. Harmel, then Corn Products, then P.G. Lake.

The Eighth Circuit was very concerned about where in the statute you found the definition of a capital asset and an exclusion that would fit this particular situation, or fit any capital stock situation.

QUESTION: Now you are getting down to it.

MR. HUGHES: Justice White, I am down to it.

The question of the literal exception, like Justice Clark said in Corn Products, those futures contracts are not within any of the exceptions. You could stretch and say that it was held primarily for sale to customers in this case, because we had to sell it. We had already agreed to. But that

is not within the traditional meaning of "held primarily for sale to customers," because we were going to sell the stock to whoever we could sell it to, because we had to. We couldn't expand any further. We had agreed to sell the stock. So we had no choice.

However, we had the situation where if we didn't pour more money into the bank, the regulators were threatening to close it. It was at the time of the real estate depression in Dallas -- I should say the first real estate depression, because we are in another one right now -- but the first big real estate depression that followed the tightening of money in the early days of President Nixon's Administration. So every indication was that things were getting worse and worse. Texas Commerce Bank had agreed to buy, or at least we thought they had agreed to buy the bank. In 1971 they started doing their due diligence and they found a lot of bad loans. As we moved on, we found a lot more bad loans. And so the regulators came in. The Texas Commerce Bank pulled out the bank examiners. We were put on the problem bank list, and they said you had to raise more money.

Of course, we didn't have to buy the stock. We could have walked away. But a holding company that had just gone on the New York Stock Exchange, that planned to be raising money through stock sales, that planned to be borrowing money in its various operations, would have been -- well, it would have been

very courageous, if not foolhardy, had it backed off at that point and not bought stock.

And of course, that is what the Tax Court found, that at that point it bought the stock, but it didn't buy the stock as an investment. It bought stock as required by the regulators, solely, solely for its business purposes.

QUESTION: Well, yes, you can, but the Government says that, so what? It is still a capital asset.

MR. HUGHES: Justice White, that is what the Government says. But that is not what this Court said in Corn Products, because a futures contract is clearly not inventory.

QUESTION: Your argument would be the same if there weren't any exceptions to the capital asset definition.

MR. HUGHES: The argument is based, really, on the 1921 Act, yes, Justice White, the same way that the Court held in Burner v. Harmel, and P.G. Lake. Those were clearly sales of properties.

QUESTION: I take it your answer to me is well, Corn Products would have come out that way if there were no exceptions?

MR. HUGHES: That's right.

QUESTION: Mr. Hughes, it might not be totally unreasonable to take the position that assets acquired to preserve existing assets necessarily acquire the same characteristic as the assets sought to be preserved. That kind

of concept isn't unknown in the law.

MR. HUGHES: Certainly, Justice O'Connor, that is a concept not unknown in the law, but there was a specific finding here, unchallenged by the Eighth Circuit, unchallenged by the Government, that the purchase after 1972 was not to preserve another asset. It was solely, solely to preserve a reputation. And expenditures for good will have been, and in my judgment and hope should continue to be, fully deductible.

Mr. Chief Justice, I would like to retain the rest of the time for rebuttal, please.

CHIEF JUSTICE REHNQUIST: Very well, Mr. Hughes. We will hear now from you, Mr. Horowitz.

ORAL ARGUMENT OF ALAN I. HOROWITZ, ESQUIRE

ON BEHALF OF RESPONDENT

MR. HOROWITZ: Thank you, Mr. Chief Justice, and may it please the Court:

The question in this case can be stated very simply. The Internal Revenue Code sets forth limitations on the deductibility of what are called capital losses -- that is, losses suffered on the sale or exchange of a capital asset. And the question here is whether the losses suffered by Petitioner on the sale of all of its shares of bank stock in 1975 are subject to those limitations.

In other words, the question boils down to whether those shares were capital assets.

QUESTION: This is just the stock purchased after 1971 that is at issue here?

MR. HOROWITZ: Well, originally Petitioner took the view in the Tax Court that all the shares were ordinary --

QUESTION: I know. He only brings here the post-1971 purchases.

MR. HOROWITZ: Right. Now, it is post-1971. In other words, it is conceded that the earlier ones were capital assets.

QUESTION: Mr. Horowitz, it seems to me that until the 1986 changes to the Revenue Code, that it was often to the advantage of the IRS to adopt the very view that Petitioner does here, that we ought to preserve the Corn Products Doctrine and prevent things from being treated as capital gains. And is the Government changing its position simply because the tax law changed in 1986 and now it cannot work to the IRS's advantage any longer to maintain the Corn Products rule?

MR. HOROWITZ: Let me give a couple of responses to that. First, this is not a case where the Government has changed its position. There are Revenue Rulings out there, and after the Court denied certiorari in 1971 when we sought to have the so-called Corn Products Doctrine reviewed, where the IRS was forced to give some guidance in light of the lower court decisions that have developed, but the IRS has never embraced and has always continued to challenge what is called

the Corn Products Doctrine. So I don't think we are changing our position at all.

QUESTION: Do you think the IRS has been wholly consistent in its approach to the Corn Products Doctrine all these years?

QUESTION: You asked for the Corn Products.

MR. HOROWITZ: I would like to separate what is called the Corn Products Doctrine --

QUESTION: I don't blame you.

MR. HOROWITZ: -- from what the Commissioner is relying on from the Corn Products Decision which we did argue for and which we continue to think is correct.

The Corn Products Decision did not create this kind of amorphous judicial exception which throws the terms of Section 1221 out the window. It was a finding that so-called hedging transactions which had always been recognized administratively as inventory transactions, not as speculative capital transactions, fell within the inventory exception to Section 1221.

QUESTION: But the Court in Corn Products said this wasn't true hedging.

MR. HOROWITZ: The Court said it wasn't true hedging. That was the issue that came before it, whether what was called true hedging in the IRS' interpretation was the only thing that could follow from the inventory exception or whether the sort

of hedging that was involved in Corn Products could also fall within the inventory exception. That is what the Court held, and the Second Circuit held there.

The only difference between the so-called true hedging and what actually happened in Corn Products was that the -- well, maybe I should back up and talk about the facts of Corn Products a little.

There, the Corn Products Company was engaged in, made a lot of contracts for selling its corn products at fixed prices. It did not have a lot of storage capacity for raw corn. So what had happened to it a couple times in the late 1930s was that it had gotten squeezed by rapid rises in the price of corn. It was already committed to sell its corn oil at a given price and it had to buy corn at a much higher price than it had anticipated, which led to losses on the sale of its product.

So to protect itself against those sort of price rises, what it did was, it bought corn futures, so that it was assured a supply of corn at a price that it could depend on later.

Now, the only difference from the true hedge is that it did not protect itself against a decline in the price of corn. That is not what it was concerned about. It was worried about the losses that it would suffer on the sales of its product.

If the price of corn had declined, then, it would have suffered some losses on the futures, because the value of its futures would have declined. So there was an element of possibility of loss there on the value of its futures, but that wasn't what it was worried about, and it didn't really affect the fact that the corn futures were really part of their inventory control system, and essentially were a substitute for stored corn. And that is what the Court held in Corn Products. It didn't hold anything more, and I think as we through in great detail in our Brief, the Opinion, while it is not, certainly, the clearest opinion that was ever written, certainly cannot be said to he rejected the idea that this is an interpretation of the statute, and not the creation of a new exception.

QUESTION: One does get a little bit the feeling, though, of: "Heads I win, tails you lose," when you see the Government's position in Corn Products and the Government's position in this case.

MR. HOROWITZ: Well, I think I just have to reiterate that this case is so far removed from anything that went on in Corn Products. It is true that we were on the other side in Corn Products.

QUESTION: And all the courts who have been following Corn Products, other than in hedging operations, have really misread the case.

MR. HOROWITZ: That is absolutely right, starting with the Booth Newspapers case.

QUESTION: All of those Judges?

MR. HOROWITZ: All those courts have misread the case. I agree. I think the fact that there are all those Court of Appeals opinions out there should give the Court some pause. I think what the Court should do with that pause is to read the opinions, and I think you will see that they don't rest on anything other than a misinterpretation of Corn Products.

QUESTION: Congress has certainly had plenty of opportunity to disagree with all these courts and it has never disturbed --

MR. HOROWITZ: Congress has not done anything one way or the other.

QUESTION: Well, certainly some of those Courts of Appeals opinions rest on just as much as Corn Products did.

MR. HOROWITZ: Well, I think I have to disagree with that, Mr. Chief Justice. Corn Products rested on a free, firm foundation. There was well-recognized administrative construction that these sorts of hedging transactions were basically inventory transactions.

QUESTION: Mr. Horowitz, haven't some of those Court of Appeals opinions gone in favor of the Government to deny a taxpayer capital gains treatment and have benefitted the Government in the past?

MR. HOROWITZ: Well, I actually never really finished answering the question before, Justice O'Connor. Let me try to get back to it. I don't think it has really been a "heads I win, tails you lose" proposition for the Government, because it is effectively impossible, practically impossible, and I am not aware of any case where the Government can successfully challenge a taxpayer's assertion that he bought a stock as an investment.

The taxpayer, it is not even going to be discovered in audit if the taxpayer has a gain on the sale of stock. He is going to report it as investment capital gain and there isn't going to be anything the Government can do about it. So it might be that the Government would like to be arguing in these gain cases, to be invoking the Corn Products Doctrine in its favor, but the fact is that it is just practically impossible for it to do it, and I don't know that it has ever successfully done it.

The Petitioner in his Reply Brief points out that sometimes the Government wins these cases when there are disputes about whether it is a capital loss or not. But I don't know about capital gain cases. So I don't think it has ever been a "heads I win, tails you lose" process, and I don't think the 1986 Act changed that. It has nothing to do with the Government's position in this case.

And I should also add that the fact that the capital

gain, the difference in rates on capital gains still does not completely remove the incentive or the opportunity for the taxpayers to play a "heads I win, tails you lose" game, because it is still in the taxpayer's interest in many cases to have an investment gain or to have a gain on sale of stock treated as a capital gain.

To give you an example, suppose a company had $100,000 in regular income from its manufacturing operations and it also had a$100,000 capital loss on the sale of investment stock, that was clearly an investment. And suppose there is a third category of money out there. They have some what we might call Corn Products stock, stock that they would be able to gin up a kind of argument that there was a business purpose for getting it.

Well, if they sell that stock at a gain, let's say also a $100,000 gain there, it is in their interest to have that $100,000 be denoted capital gain, because it will then give them an opportunity to offset their $100,000 capital loss that they have on the sale of investment stock. So the upshot would be that they only have $100,000 in total income whereas if that so-called Corn Products stock is treated as ordinary gain, then a capital loss will not be available to them and they'll have to report $200,000 in income.

So the problem that we identify in our brief of where the taxpayers can kind of wait and see whether they have a gain

or loss and then decide how to treat it still remains, although to something of a lesser extent, under the 1986 Act.

QUESTION: Mr. Horowitz, you explain the Revenue Rulings that seem to have accepted the what we'll call bad Corn Products, as opposed to good Corn Products, your narrower reading of it. You explain them as simply bowing to the inevitable in order to give guidance to the taxpayers.

Can you give any examples of the Revenue Service asserting in the past the position that you are now giving us? You explain away its apparent acceptance of Corn Products. Can you give us any examples of its rejection of a broad reading of Corn Products?

MR. HOROWITZ: Well, in the litigation in this case from the start we asserted that the Windle case that is mentioned in the briefs, which is the Tax Court's version of the Corn Products doctrine is also a case where we argued the Corn Products Doctrine didn't exist. We argued to the First Circuit on appeal there, and that appeal had to be dismissed because of a jurisdictional problem.

QUESTION: When was that? How long ago?

MR. HOROWITZ: 1978? Late 1970s.

QUESTION: Was that the first time you have really taken aim at Corn Products?

MR. HOROWITZ: I don't believe so. All these cases, Booth Newspapers and Schlumberger, and all these cases, are all

cases we lost, and we were always litigating as a taxpayer and always losing. But I haven't looked at the briefs in all those cases to see exactly what the Government's position was. But I think the Government has never taken a broad reading of Corn Products.

QUESTION: Your position didn't prevail in all those cases?

MR. HOROWITZ: No. No. No question about that. We had a succession of losses in the Courts of Appeals.

QUESTION: Do you have any comments about Rev. Rule 58-40?

MR. HOROWITZ: I was about to say actually that Rev. Rule 58-40 might be something of an exception to what I've just said. Rev. Rule 58-40 is not discussed directly, but it is discussed sort of indirectly in our Brief at Footnote 17, Page 45. There was a Decision of the Tax Court in 1952 called Western Wine & Liquor Company. That was a pretty narrow fact situation, but it did involve stock. It was a case where the stock of a liquor company was purchased for a very short time and the Court found it was purchased for the sole purpose of assuring a supply of liquor, basically for an inventory purpose. Rev. Rule 58-40 -- the Service lost that case. We had challenged it and litigated against it. But the Service then did not -- acquiesced in the decision, and Rev. Rule 58-40 accepted that decision as correct.

So to that narrow extent, in 1958, the Service did accept that stock could be an ordinary asset. We don't think Western Wine was a crazy result. We don't think Rev. Rule 58-40 is completely off the wall. But we have concluded, as we explained in our footnote, that given the difficulty that the courts have had in captioning this kind of exception in any sort of narrow form, it is really better, and more administratable, to have a rule that does not allow stock at all to be a non-capital asset.

QUESTION: I take it we have had cases in the past where a regulation has approved a certain course of action and the Treasurer changes its mind and changes the regulation. And certainly you are not doing any more than that here.

MR. HOROWITZ: I think we are doing quite a bit less than that.

QUESTION: Exactly.

MR. HOROWITZ: We have been trying for a long time to get to the Supreme Court on this issue, and we are finally here. You know, we file this Petition in 1971.

QUESTION: What would you say if you were asked do you think that adopting your position would upset some very subtle expectations of taxpayers, that they stand to lose a lot of money?

MR. HOROWITZ: Well, the Service, if the Government prevails in this case, the Service is going to have to figure

out how to deal with that. It may do it on a case by case basis.

QUESTION: In this case I would suppose that they were going to buy this stock no matter what.

MR. HOROWITZ: Well, yes, I was going to go on to say that this is not the sort of area where there is, I think a big expectations problem. A, you're talking only about stock that supposedly was purchased for a business purpose, that they would have done anyway; B, you are only talking about cases where they suffer losses on the sale or exchange of the stock. And presumably they didn't go into these transactions with the expectation of suffering losses.

So there may be some case where there is. I can't say there is no case where there are no expectations. But it's not a big issue.

QUESTION: But if we do what you say, we're just not going to affect just stock. You are asking us to kill the bad Corn Products, and that has application in a lot of other areas, doesn't it?

MR. HOROWITZ: It does have application in some other areas, although stock has been in the main focus of the litigation.

QUESTION: What other areas? You say stock has been the main focus?

MR. HOROWITZ: Well, I know there is a ruling out

there about transactions in foreign currency I think that the Treasury had treated it as the Corn Products Doctrine applying to that, although I think that has actually been, there is a special treatment for foreign currency now in the 1986 Act anyway. I'm not sure, Justice Scalia.

QUESTION: Mr. Horowitz, it seems to me that almost by definition, these transactions are ones in which if they are not made for an investment purpose but as in Booth or the other case, to secure an inventory or get some business objective accomplished, that it is probably not a wise investment and there is a probability of a loss. You are willing to do it even if you face the consequence of a loss. That's sort of almost the test, isn't it? If the business purpose dominates the transaction, and you are willing to do it for the business reason even if you lose, it just isn't a normal investment.

MR. HOROWITZ: If the business purpose is so predominant, then it seems to me you probably aren't worried about the tax, whether it's going to be a capital loss or not, either.

QUESTION: That's true.

MR. HOROWITZ: I think one of the problems with the Corn Products Doctrine is that you can't separate out the business and investment purpose so well. The record in this case indicates that Arkansas Best told their stockholders that they had all this information about what a great investment

this National Bank of Commerce stock was going to be.

QUESTION: Yes, but that was before 1971.

MR. HOROWITZ: The two motives tend to coalesce.

QUESTION: That was before 1971, wasn't it?

MR. HOROWITZ: Yes, that was before 1971.

QUESTION: They were only talking about those purchases made to protect their reputation.

MR. HOROWITZ: Well, again, we discussed in our Brief that I don't really accept the characterization that the Tax Court made this finding that that was the only purpose of purchasing the stock. The Tax Court also said that it was to preserve their equity in the company. As Justice O'Connor said before, basically they had an investment in the company and they were trying to protect that investment and enhance that investment.

So I am not sure that I agree that the later purchases were necessarily covered by it. But I kind of don't want to get into that because we don't think that the doctrine is sound at all, and I would like to talk about the statute a little bit.

QUESTION: The Government contends then that Corn Products, the holding of Corn Products means that buying futures by a company in the business that Corn Products was in, it applies to that situation but not to any others. It doesn't apply to stock at all?

MR. HOROWITZ: that is correct.

QUESTION: In other words, the only way stock can be treated as ordinary income, a gain or loss, is if you are a dealer?

MR. HOROWITZ: If you are a dealer, that's right. And that would follow from Corn Products. That is the same principle if it is being held as inventory than it is an ordinary asset, and that is what the statute says in 1221(1). But only dealers hold stock --

QUESTION: And to whatever extent the Treasury has departed from that basic proposition in the past, it has now changed its mind?

MR. HOROWITZ: Well --

QUESTION: Yes. Yes.

MR. HOROWITZ: Okay. But I just don't think we have departed very far from that. I've been here before talking about --

QUESTION: To the extent you have, you shouldn't be stuck with it. But I think you have changed your mind.

MR. HOROWITZ: Yes, we've changed our mind. After we've seen what has happened with the Corn Products Doctrine, we decided that any possible extension of Corn Products is a very bad idea.

QUESTION: And the Devil made you do it.

MR. HOROWITZ: The Courts of Appeals made us do it.

QUESTION: Mr. Horowitz, straighten me out on my technical question. Was the Tax Court Opinion reviewed by the Full Court?

MR. HOROWITZ: No, it was not.

QUESTION: I didn't think it was. Thank you.

MR. HOROWITZ: Despite Petitioner's avoidance of it in this Brief, there is a statute that addresses this issue, at Section 1221 of the Internal Revenue Code, and I would like to focus on it a little bit, because we do think it controls this case. It is set forth at Pages 1 to 3 of our Brief.

The statute says the term "capital asset" means property held by the taxpayer, whether or not connected with his trade or business, but does not include -- and then it goes on to enumerate five specific exceptions, none of which are implicated in this case.

QUESTION: Is there any disagreement about that at all?

MR. HOROWITZ: I didn't think there was, although Mr. Hughes, I thought, suggested that maybe they were holding this National Bank of Commerce stock for sale to customers, because they eventually ended up having to sell it. Then he seemed to concede that that wasn't what the statute was about. So I don't think there is any dispute about that. He did say something in argument that suggested that. I guess I should say that is the only time I have heard the Petitioner ever

suggest how the statute could possible be construed to support their position. Basically, their position is that the statute should be ignored and that the lower courts' exposition of this Corn Products Doctrine should be substituted for the statute.

The first thing to notice about the statute is I guess what I've just said. It clearly doesn't help the Petitioners in this case. Their stock is property within the beginning first clause of the statute, which means it is a capital asset unless it is covered by one of the exceptions, and it's not covered by any oaf the exceptions. And by the same token, nothing in the statute supports the general rule that Petitioners argue for, that is, that there is a general business versus investment distinction in the statute.

QUESTION: What exception in the statute was it that Corn Products came under?

MR. HOROWITZ: Section 1. Stock and trade with taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

QUESTION: And the futures were other property of a kind?

MR. HOROWITZ: Yes, that's correct. The Court found that. Now, it is true that in Corn Products the Court said it did not regard this as a quote "literal" interpretation of the statute. The Petitioners have kind of set up a straw man here

by saying that the Government is arguing for a literal interpretation of the statute. By that they seem to mean a kind of wooden reading of the statute that you can't look beyond the four corners of the dictionary.

QUESTION: Those were quieter days, 1955. What was considered departing from the literal language of the statute was apparently relatively little.

MR. HOROWITZ: I guess that is right, Justice Scalia, because I'm not sure even they needed to say they were departing from the literal language of the statute. But whether the statute is read broadly or narrowly is not what the issue is here. The issue is whether the statute is to be read at all.

QUESTION: Can I go back to Corn Products for a second? Is it your view that it was the Exclusion Number 1? The Court didn't say that, did it? The Court just said that literally none of the exceptions covered it, because they say in so many words "1" doesn't apply. Maybe that is the best place to put it. But all I'm suggesting is I think maybe you are putting it there and that the Court in Corn Products didn't.

MR. HOROWITZ: As I said, it is not a very clear Opinion. The Second Circuit's Opinion is quite clear.

QUESTION: Yes.

MR. HOROWITZ: The Second Circuit placed it under

Number 1. Now, the Court relied heavily on the 1936 General Counsel Memorandum which had stated that these hedging transactions were no to be treated as transactions in capital assets, that they were inventory transactions.

QUESTION: But Justice Clarke said it was really a form of insurance.

MR. HOROWITZ: That is what the General Counsel memorandum said also. But it was insurance for their inventory supplies. It would be nicer if the Court had cited the 1221(1), but I think it is hard to read the Opinion any other way, Justice Stevens.

I would like to say that the statute not only does not cover and not only does not support Petitioner's position but it is really quite hostile to the exception that they try to invoke here. The Corn Products Doctrine that Petitioner seeks to draw here can't just be explained as some sort of an omission by Congress in drafting the statute or some extra kind of exception and addition. It is completely antithetical to what Congress has said and done in the statute.

The first thing to focus on is the language right at the top of Page 2, the parenthetical provision here, whether or not connected with his trade or business. In other words, capital asset includes all property, whether or not connected with his trade or business. The only purpose of that seems to be to dispel the exact intention the Petitioner is making here.

And that his that a business versus investment distinction is what is significant. It is completely insignificant under the statute and the statute clearly contemplates that there would be capital assets that were connected with business.

Second, and even more significantly I think, is to look at the various exceptions. Now, this Section 1221 was not enacted as a whole all at one time. It has been added to bit by bit over the years. The original section only included what we have called the inventory exception, Section 1. Now, Section 2, this was added in 1938, excepts property used in his trade or business, of a character which is subject to depreciation. And then the second clause of Section 2 adds real property used in his trade or business that was added in 1942.

QUESTION: Unfortunately for your case, it is subsequent to 1955. None of them is subsequent to Corn Products, is it?

MR. HOROWITZ: I don't understand Petitioner's argument to be that Corn Products changed the law. And certainly, it wouldn't have.

QUESTION: No, but if Congress had adopted one of these exceptions after Corn Products, you could argue that evidently Congress didn't think that Corn Products said what your opponent claims it says because then the new exception would have been unnecessary. All of these exceptions are

pre-1955.

MR. HOROWITZ: I don't dispute that fact, that they are pre-1955, but I don't think it really undermines our argument. All of these exceptions show that Congress never thought that the statute drew a business purpose versus investment purpose distinction. I don't understand Petitioners to argue that that distinction arose in 1955.

QUESTION: It doesn't undermine that part of your argument, but it does not enable you to use any oaf the exceptions for the proposition that Congress has no acquiesced in effect, in Corn Products, seen it and said it was good.

MR. HOROWITZ: Congress has not said anything about Corn Products, one way or the other. I don't think that is so remarkable, really, because clearly, just as you can see from the briefs in this case, it is a controversial issue. The Service feels strongly about it and taxpayers feel strongly about it, and Congress has basically decided not to get into it. The little legislative history in 1976, if anything, suggests that somebody in Congress thought it might be a good idea to make some compromise, and probably nobody liked the compromise so I just decided to let it drop.

So I guess I just don't think you can say either way. But you can say, I think, that Petitioner's argument that since 1921, which is what they say in the Reply Brief, and say here today, that there has been this business versus investment

exception, is quite wrong, because otherwise, all of these exceptions are completely unnecessary. The fact is, that in 1938, when Congress added Section 2, everybody understood that a factory was a capital asset and that this change in the statute was necessary to except it from capital asset determination.

Maybe I should just talk briefly about their argument on the 1921 Act, seems to turn on the particular language of the 1921 Act, which included the phrase "for profit and investment." This is set forth at Page 20, Footnote 10 of our Brief. They read that language as just saying "for investment" and suggesting that capital assets have to be investment property. But the actual language of the statute is "for profit or investment" and the term "for profit" I think clearly contemplates business, so-called business assets.

One straw man that Petitioners have set forth today in their argument is this notion that you can't look into motive or the purpose for acquiring an asset under the Government's position. That's not right. We never suggested that. It is clear enough again that the statute contemplates in certain circumstances an inquiry into motive. In the second exception, it looks into whether the property is used in a trade or business. So you have to look at that. Under the inventory exception, some assets may or may not fall under the inventory exception, depending on the use they are put to.

That was true in Corn Products. That was true in an example that Petitioners give in their Brief.

QUESTION: Mr. Horowitz, I take it you are arguing here that the statute is so clear that the Treasury would never be permitted to again issue some of the Revenue Rulings that it has; that any departure, anything outside a narrow reading of Corn Products is just forbidden by the statute. You are not just suggesting that this is a permissible construction of the statute that the Treasury Department may follow?

MR. HOROWITZ: I agree. It is not up to the Service. Congress has not seen fit to except stock in any circumstance.

QUESTION: But of course you could win if we just said this is a permissible construction of the statute that Treasury can follow.

MR. HOROWITZ: Well, I suppose so, although that is not what we are arguing. We are arguing the statute sets forth a definition.

QUESTION: Yes.

MR. HOROWITZ: I really view this whole case as kind of ironic, because I know the Court, this Court and other courts are often grappling, trying to define terms in the Internal Revenue Code and trying to define policies behind them and wondering why the Code doesn't, why Congress doesn't just define the term for it, and here that is exactly what they have done.

QUESTION: Mr. Horowitz, you know, if you are right, that the statute as written governs, it is awfully hard to fit even Corn Products' so-called inventory exception with that, because those futures weren't inventory. The Court said they were something that helped the taxpayer maintain an inventory. But you can't say they really are stock in trade or inventory.

MR. HOROWITZ: I guess there you are just talking about sort of a narrow versus a broad interpretation of the statute. I think the Court found that the purposes of the inventory exception were served by having these futures in, and they pointed out the problems there would be if they were not treated as inventory. For example, at the end of the Opinion, the Court noted that the taxpayers could decide for themselves whether to make them ordinary or capital.

One other point I would like to make before my red light goes on is that the policy, the Congressional intent that Petitioners rely on is not supported by the slightest bit of evidence. There is nothing in the reports, nothing in any other inquiry into Congressional intent that suggests that there was ever a general business versus investment dichotomy. The categories of assets that Congress decided should be separated between capital and ordinary were set forth in Section 1221. Congress has added to those periodically and there is no other real policy to be relied upon here.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Horowitz. Mr. Hughes, you have five minutes remaining.

ORAL ARGUMENT OF VESTER T. HUGHES, JR., ESQUIRE

ON BEHALF OF PETITIONER - REBUTTAL

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

To Corn Products itself, Justice Clarke's language was: "Admittedly, Petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business." That is Justice Clarke's language.

QUESTION: Mr. Hughes, do you think your taxpayer fits within the language of the statute somehow?

MR. HUGHES: Justice O'Connor, there are two ways that this could be approached, and I think that either way gets us to the correct answer for the purpose of tax administration, as it should be interpreted and applied.

The first of these is that you don't get to 1221 if there are certain factors present. A good argument can be made that that is what Burnet v. Harmel was all about, because there is no doubt about it that Mr. Harmel sold property. He sold oil and gas leases, he sold seven-eighths interest, of 1932. There is no doubt that in 1955, in the Corn Futures case, that futures fitted within what then was the 58-40 ruling, that if you were a speculator, that that was a capital asset. You have

to look at the motive.

There is no doubt that in P.G. Lake, when Mr. Lake and the O'Connor estate sold oil payments, they sold property. But what the Court said was that you didn't get there, that it wasn't 1221 and the language that you would have to go back to is the 1921 Act.

Now, you could go a different action to divine the purpose of Congress, and that may be a more palatable way, because this Court has done that, if you will recall, and the reason I went back to 1932, the other way is that you look to see what Congress was trying to tax in one manner and what it was trying to tax in another. Justice White, as for example, Justice Sutherland's Opinion in Gregory, where there is nothing in the statute, there is nothing in the reorganization sections about a business purpose for reorganization. And yet that has been a requirement since Ms. Gregory's case in 1935. There is nothing in the statute about continuity of interest required for a reorganization. That was reaffirmed recently by this Court. It started out in Letulle v. Scofield and in Pinellas Ice. But it was reaffirmed within the last four years by this Court. There was nothing in the statute about Justice O'Connor's Opinion in Hillsboro, there was nothing about there being a tax benefit rule. But it was a way to implement how Congress intended a tax be generated on income. And the same thing is true also within the last four years in this Court's

opinion in Bob Jones University. There is no requirement of a common law of charity in the statute, in 170, it's not there.

But it is a reasonable approach to what the people over on the other side of this Hill meant as to what the purpose of the statute was. And the same thing is true here. And that's what you came up with in Corn Products.

QUESTION: Why do they make all those exceptions then, if all of those exceptions would automatically be --

MR. HUGHES: Justice Scalia, I don't think they would have automatically been taken out. But part of it was. Congress was starting with a new Revenue Act when it wrote this in 1921 and when it said whether or not it is the business of the taxpayer, they wanted to show that a taxpayer in business could have a capital asset. And it is clear that they could.

QUESTION: That's fine, but then why do they have to say, except, it does not include one, two, three four, and some of those exceptions are not '55, but the latest was what, '54.

MR. HUGHES: There is no doubt about it that it could have been done a different way. I just suggest to you, Your Honor --

QUESTION: It's not that it could have been done a different way. I cannot understand why you say something, if it is used in business, is automatically not included but then go on to say by the way, these things that are used in business are not included.

MR. HUGHES: There is no doubt about it, that Corn Products suffers from that difficulty of analysis. The fact remains that in many instances, you don't get to the level of the statute to talk about it. If the word "dominant" is terribly important here -- dominant purpose. Dominant purpose. Those may have dual purposes, as indeed Corn Futures might have. The classic case that came up to this Court was the one on rental cars which you had to make the decision, and then you did make the decision.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Hughes. The case is submitted.

(Whereupon, at 11:52 a.m., the case in the above-entitled matter was submitted.)

REPORTER'S CERTIFICATE

DOCKET NUMBER: 86-751 (Supreme Court)

CASE TITLE: Arkansas Best Corp. v. IRS

HEARING DATE: Dec. 9, 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 United States Supreme Court and that this is a true and accurate transcript of the case.

Date: Dec. 11, 1987

Margaret Daly

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