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OFFICIAL TRANSCRIPT  
PROCEEDINGS BEFORE

THE SUPREME COURT  
OF THE  
UNITED STATES

**CAPTION:** TRINOVA CORPORATION, Petitioner -v-  
MICHIGAN DEPARTMENT OF TREASURY

**CASE NO:** 89-1106

**PLACE:** WASHINGTON, D.C.

**DATE:** October 1, 1990

**PAGES:** 1 - 42

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IN THE SUPREME COURT OF THE UNITED STATES

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TRINOVA CORPORATION, :  
Petitioner :  
v. : No. 89-1106  
MICHIGAN DEPARTMENT OF :  
TREASURY :  
- - - - - X

Washington, D.C.  
Monday, October 1, 1990

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 12:59 p.m.

APPEARANCES:

PETER S. SHELDON, ESQ., Lansing, Michigan; on behalf of the  
Petitioner.

RICHARD R. ROESCH, ESQ., Assistant Attorney General of Michigan, Lansing, Michigan; on behalf of the  
Respondent.

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PROCEEDINGS

(12:59 p.m.)

1  
2  
3 CHIEF JUSTICE REHNQUIST: We'll hear argument  
4 now in No. 89-1106, Trinova Corporation v. Michigan  
5 Department of the Treasury.

6 Mr. Sheldon.

7 ORAL ARGUMENT OF PETER S. SHELDON

8 ON BEHALF OF THE PETITIONER

9 MR. SHELDON: Thank you, Mr. Chief Justice, and  
10 may it please the Court:

11 This case involves the constitutionality of a  
12 value-added tax, specifically the Michigan Single Business  
13 Tax, which is known more commonly as the SBT. The case  
14 comes to this Court on stipulated facts from a decision of  
15 the Michigan Supreme Court that upheld the tax against  
16 petitioner's constitutional challenge.

17 There are two questions presented. The first  
18 question is whether the three-factor property payroll and  
19 sale apportionment formula that is contained in the SBT  
20 taxes value added outside of Michigan and produces a  
21 grossly distorted result in violation of the Due Process  
22 and Commerce Clauses. The second question is whether that  
23 same three-factor apportionment formula discriminates in  
24 favor of in-State businesses and against petitioner and  
25 other similarly situated out-of-State businesses by

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1 systematically and irrationally reducing the tax bases of  
2 the former, while systematically and irrationally  
3 increasing the tax bases of the latter.

4           The primary points we make are these. First,  
5 the tax base of the SBT, like the tax base of all value-  
6 added taxes, consists primarily of site-specific  
7 components, and those site-specific components,  
8 principally compensation and depreciation, are readily  
9 susceptible to precise identification and allocation on a  
10 State-by-State basis. They are site specific because you  
11 know where the labor is performed, and therefore where  
12 value added by the labor takes place. You know where the  
13 depreciable plant is located, and therefore where value  
14 added by depreciable plant takes place.

15           For the average SBT taxpayer the record in this  
16 case shows that its tax base consists of compensation to  
17 the extent of 77 percent, capital to the extent of another  
18 17 percent, and profit to a much lesser extent, only about  
19 6 percent. So you can see the site-specific components  
20 dominate. And for Trinova, the petitioner in this case,  
21 those site-specific components are even more dominant,  
22 because here also the record clearly shows by stipulation  
23 that Trinova's tax base consisted of compensation to the  
24 extent of 102 percent, depreciation to the extent of  
25 another 11 percent, and profit, profit added not 1 cent of

1 positive contribution to the value-added tax base. And  
2 that is because Trinova, during the 1980 tax year that is  
3 at issue here, incurred a significant loss from its  
4 operations.

5 QUESTION: Suppose the facts were different and  
6 profit produced the greatest factor. Would the operation  
7 of the tax violate the Constitution as applied?

8 MR. SHELDON: Perhaps not, Your Honor, if -- if  
9 Trinova had had a tax base that was comprised of the  
10 profit component to a significant extent. But in this  
11 case the contribution of profit to the value-added tax  
12 base component was zero. In fact it was a negative  
13 contribution.

14 Now because these site-specific components are  
15 susceptible to allocation, there is no need to apportion  
16 that.

17 QUESTION: May I interrupt to -- to follow up on  
18 Justice Blackmun's question? Is there an agreement  
19 between the adversaries in this case that in the general -  
20 - throughout the general run of taxpayers that the site-  
21 specific components is around 90 percent?

22 MR. SHELDON: It's not a matter of stipulation,  
23 Justice Stevens, but in the merits brief, appendix 1a  
24 contains a publication from the Department of Treasury  
25 that clearly sets forth for the average taxpayer what

1 their components of tax base are. And there, very  
2 clearly, the compensation component is dominant and  
3 constitutes approximately 77 percent of the average  
4 taxpayer's tax base.

5 QUESTION: Mr. Sheldon, let me put this question  
6 in terms of one of the examples given in one of the briefs  
7 taken from a law review article, as I recall. The  
8 statement was made that a tax upon -- upon sleeping,  
9 measured by the number of shoes in your closet, is in fact  
10 a tax upon shoes. Do you agree with that?

11 MR. SHELDON: The point, Justice Scalia, is that  
12 a tax has to be analyzed, in testing its constitutionality  
13 under the Due Process and Commerce Clauses, in terms of  
14 its practical effect, in terms of its economic reality.

15 QUESTION: Right.

16 MR. SHELDON: And here, this tax, by whatever  
17 label it may be called, is in practical effect and more  
18 than anything else a tax on compensation.

19 QUESTION: Well, suppose you, you could have --  
20 we have approved gross receipts taxes, right?

21 MR. SHELDON: Yes, Your Honor.

22 QUESTION: Now why isn't, why aren't they just  
23 as discriminatory against out-of-State, some out-of-State  
24 companies, and just as contrary to the other principles  
25 that you are urging as this tax is?

1 MR. SHELDON: Well, a gross receipts tax is  
2 generally aimed at determining a tax base that relates to  
3 the gross receipts, the actual gross receipts that is  
4 derived from activity within the taxing State. What we  
5 have here is not a gross receipts tax. We have a value-  
6 added tax, and the measure of the tax base is something  
7 different from a gross receipts tax.

8 QUESTION: The measure is the receipts in  
9 Michigan, right? I mean, that's the measure that you  
10 complain about.

11 MR. SHELDON: The tax base of a value-added tax  
12 base that uses the additive method of calculation, such as  
13 the Michigan SBT, is comprised of --

14 QUESTION: What you claim distorts this is the  
15 fact that they are using Michigan sales, isn't that it?

16 MR. SHELDON: That is correct.

17 QUESTION: But they could tax you 100 percent on  
18 Michigan sales, and we would say it's okay. So if you  
19 view this as not really a tax on value added or on  
20 anything else, but just as a tax on gross receipts in  
21 Michigan, we would say fine. So if you believe it's a tax  
22 on shoes rather than on sleeping, this is okay.

23 MR. SHELDON: But it's not a tax on gross  
24 receipts, Your Honor, it's a tax on value added. And when  
25 you look at the value added components of tax base, the



1 principal component is compensation.

2 QUESTION: Well, this, this is a tax on value  
3 added, the same way the first tax I mentioned to you was a  
4 tax on sleeping. It doesn't matter whether they say its a  
5 tax on value added. If they are measuring it by Michigan  
6 sales, it is a tax on Michigan sales. So what? And we  
7 have said that is okay.

8 MR. SHELDON: But the measure of the tax, Your  
9 Honor, is not Michigan sales. The measure of the tax, the  
10 tax base is the compensation payments that the taxpayer  
11 makes --

12 QUESTION: You have no complaint about that,  
13 that is okay. That isn't what distorts it here, right.

14 MR. SHELDON: What distorts it, Your Honor, is  
15 the inclusion of an equally weighted sales factor --

16 QUESTION: Michigan sales.

17 MR. SHELDON: -- in the three-factor  
18 apportionment formula. And what that equally-weighted  
19 sales factor does is that it skews the attribution of the  
20 major site-specific component of a value-added tax base,  
21 which is compensation.

22 QUESTION: But Justice Scalia's point is that  
23 the State of Michigan could have disregarded the site-  
24 specific factors and taxed you solely on your gross  
25 receipts, and you would be right about at the same place.

1 In fact, you would probably be in worse shape.

2 MR. SHELDON: But -- that may be true, Your  
3 Honor, but the State of Michigan has not elected to tax  
4 gross receipts. It has elected to tax value added, and -  
5 -

6 QUESTION: It's a tax on sleeping, you say,  
7 right?

8 MR. SHELDON: I am saying that --

9 QUESTION: But you just acknowledged that that  
10 doesn't matter. It doesn't matter what you call it. What  
11 you measure it by is what the tax is imposed on.

12 MR. SHELDON: Your -- Your Honor, and the  
13 measure of the tax is value added.

14 QUESTION: This is a tax on sleeping, not on  
15 shoes.

16 MR. SHELDON: The practical effect of the tax,  
17 we submit, Your Honor, is a tax on value added, and the  
18 only way that Michigan could exact a positive contribution  
19 of tax from Trinova in this case is by taxing extra-  
20 territorial value, which the Due Process and Commerce  
21 Clauses --

22 QUESTION: Well, isn't there another answer to  
23 Justice Scalia? Two different taxpayers, one situated as  
24 you are and another one with precisely the same gross  
25 receipts in Michigan, pay vastly different taxes.

1 MR. SHELDON: That's correct. That's correct,  
2 Your Honor.

3 QUESTION: So it's not a tax on gross receipts.

4 MR. SHELDON: That is my point. If this tax, as  
5 we contend, is unconstitutional because it taxes extra-  
6 territorial value and produces a grossly distorted result,  
7 or because it is discriminatory, the fact that Michigan  
8 could have imposed a plainly valid gross receipts tax and  
9 generated as much revenue as a result of that can't be  
10 used as a legal justification for excusing or saving the  
11 unconstitutional infirmities of this tax.

12 QUESTION: Is it all that clear? You keep  
13 calling this a site-specific tax. Is it going to be  
14 conceded by the State that this allocation is so precise?  
15 Suppose -- these were sales people mostly in Michigan?

16 MR. SHELDON: That is correct, Your Honor.

17 QUESTION: Suppose that the sales people were  
18 very, very important in giving information to the  
19 manufacturing component in the other State about the  
20 design requirements for this glass. And suppose that they  
21 contributed a very, very significant amount to sales and  
22 to the overall success of the company just by their  
23 contribution to what was happening back in Iowa. It's not  
24 all that clear to me that this is site specific.

25 MR. SHELDON: Your Honor, we acknowledge that

1 sales activity, including, for instance, the intangible  
2 contributions of centralized management, functional  
3 integration, and economies of scale may indeed impact and  
4 influence taxpayer decisions that relate to the employment  
5 and deployment of labor, and to the acquisition and  
6 location of depreciable plant. And we acknowledge also  
7 that sales activity and these other intangible factors may  
8 also influence taxpayer decisions as to the amount that  
9 may be paid for those value-adding activities.

10 But the fact nevertheless remains that when  
11 those taxpayer decisions are implemented, you will still  
12 know precisely where that value-adding activity takes  
13 place, and you will know precisely the amount of value  
14 added by that activity. The influence or the efficiencies  
15 that may be generated by sales activity or by these  
16 intangible contributions of centralized management and the  
17 like will be reflected only in the measure of the profit  
18 component of a value-added tax base.

19 QUESTION: Well, why is that necessarily so? I  
20 mean it might be or it might not be. You are saying that  
21 labor is so site specific that it must be, without  
22 variation, apportioned precisely to the amount of activity  
23 that is economically measurable by a payroll. But that's  
24 just contrary to economic theory, isn't it, and to the  
25 concession that you just made that there are a lot of



1 intangible factors that go to make up the success of a  
2 unitary business?

3 MR. SHELDON: The intangible factors only impact  
4 on the measure of the profit component of a value-added  
5 tax base, which we acknowledge may be properly subjected  
6 to three-factor formulary apportionment. But under value-  
7 added taxing principles, and indeed as confirmed by  
8 language that is contained in the Single Business Tax Act  
9 itself, and indeed even as the Michigan Supreme Court has  
10 noted, the measure of value added by labor and capital,  
11 specifically the compensation and depreciation  
12 contributions to those components, is the taxpayer's cost.

13 QUESTION: I don't understand why that is.

14 MR. SHELDON: Well, translated, the cost with  
15 respect to the labor component is what the taxpayer pays  
16 its employees for the services they have performed. And  
17 with respect to depreciation, translated, the cost is the  
18 amount of capital consumed during the accounting period  
19 that is measured by tax depreciation. The Single Business  
20 Tax Act itself, Your Honor, in section 9 specifically  
21 defines the contribution of labor to a value-added tax  
22 base in terms of what the employer pays its employees.

23 There is no transferred value concept that  
24 applies here. There is no enhanced value concept that  
25 applies here. The measure of value added with respect to

1 the labor contribution is what the employer pays for. And  
2 the same is true, and section 9 of the SBT confirms this,  
3 with respect to the depreciation component of the SBT.

4 QUESTION: Is it your theory that the  
5 constitution requires that the State adopt the most  
6 precise mechanism available for apportionment, given the  
7 theory of the tax?

8 MR. SHELDON: We say, Your Honor, that with  
9 respect to the site-specific components of a value-added  
10 tax base, there is no need to apportion them. That is not  
11 to say that the State could not come up with an  
12 apportionment formula that might fairly reflect the  
13 contributions of labor and depreciation to Michigan, even  
14 though that formula might not derive an absolutely precise  
15 result. If it didn't result in gross distortion, I don't  
16 think we would have a constitutional problem here.

17 But in this case, in this case application of  
18 the three-factor formula against petitioner's tax base for  
19 the 1980 year has attributed to Michigan compensation that  
20 is 39 times more than value added by petitioner's  
21 Michigan-based employees, and then it has attributed to  
22 Michigan depreciation expense that is 970 times more than  
23 the value added by the capital consumption that is  
24 associated with petitioner's Michigan-based plant.

25 QUESTION: How large does a discrepancy like

1 that have to be before you say the Constitution prohibits  
2 it? Where -- where would you ever draw the line?

3 MR. SHELDON: Well, Justice O'Connor, in the  
4 Hans Rees case, of course, a distortion of 250 percent, or  
5 about 2.5 times, was found to be significant, enough to  
6 justify a holding in the taxpayer's favor. Here we have  
7 distortion that is many multiples of that. It is between  
8 39 and 970 times, depending upon which of these more --

9 QUESTION: Suppose that the taxpayer did have a  
10 sizable profit, unlike the taxpayer we have in this case.  
11 How should the State apportion that part of the --

12 MR. SHELDON: We have no quarrel with the  
13 application of the three-factor apportionment formula  
14 against the profit component of the value-added tax base,  
15 because, as this Court has observed on many prior  
16 occasions, and which we do not contest, income is  
17 difficult to source on a State-by-State basis. And that  
18 again is because net income results from the coalescence  
19 of a number of different factors, some of which are site  
20 specific, but some of which, like centralized management,  
21 economies of scale, and the like, are not.

22 But as to the compensation and depreciation  
23 contributions to the labor and capital components of a  
24 value-added tax base, those items, unlike net income, are  
25 site specific.

1           QUESTION: Mr. -- surely Michigan is entitled to  
2 take into consideration the fact that the sales activity  
3 of Trinova to purchasers in Michigan, presumably  
4 automobile companies, is going to bring in a great deal of  
5 revenue to Trinova, is it not?

6           MR. SHELDON: Sales activity will derive  
7 revenue, that's right, Your Honor. Whether it derives  
8 income is another point.

9           QUESTION: Well, why does Michigan have to  
10 settle for income? Why can't it talk about revenue?

11           MR. SHELDON: Well, it has not talked about  
12 revenue here. It could have if it wanted to. It could  
13 have established as its primary business tax a tax on  
14 gross receipts, but it has not elected to do here.

15           QUESTION: This is a tax on sleeping. We keep  
16 coming back to that, but you answered that question the  
17 other way. I thought you answered the question that even  
18 though you call it a tax on sleeping, if you measure it by  
19 the shoes it is a tax on shoes. Suppose Michigan had  
20 never mentioned value-added tax. Suppose it had never  
21 mentioned the fact that the tax base would be total  
22 compensation plus total capital cost plus -- plus profit.

23           Suppose it had simply said for every business,  
24 for every company doing business in Michigan we are going  
25 to impose a tax that consists, a tax of 2 percent on the



1 three- the three-factor formula, Michigan compensation  
2 over total compensation, plus Michigan capital costs over  
3 total costs, plus Michigan sales over total sales, divided  
4 by 3. Suppose that's how the tax were described. Would  
5 that tax be constitutional? It never mentioned value  
6 added, it never mentioned what it is taxing, except it  
7 recites the factor. And for anybody doing business in  
8 Michigan you pay that tax.

9 MR. SHELDON: I'm not sure I understand the full  
10 hypothetical. You described for me the factors, what I  
11 understood to be a property payroll and sales factor, and  
12 then said that there was going to be a 2 percent tax. But  
13 what is the tax base in your question, Your Honor?

14 QUESTION: The total value of the business  
15 divided by those -- those three factors.

16 MR. SHELDON: Well, if you define the total  
17 value of the business in terms of value added principles,  
18 like Michigan has done here, most of the tax base is going  
19 to be compensation, and that three-factor formula will  
20 inevitably cause gross distortion, because the sales  
21 factor -- the reason that is so is because the sales  
22 factor provides absolutely no clue whatsoever as to where  
23 the dominant site-specific productive activity that  
24 underlies payments of compensation and depreciation, which  
25 are the lion's share of the tax base, take place. There

1 is no rational relationship. And this Court has said on  
2 numerous occasions that an apportionment formula in order  
3 to be fair has to reflect a reasonable sense of how income  
4 or value is generated. Here we don't have --

5 QUESTION: Does that translate to the theory  
6 that a distortion is measured against the theory of the  
7 tax?

8 MR. SHELDON: No, the distortion is measured --

9 QUESTION: Because it seems to me that that has  
10 to be your argument.

11 MR. SHELDON: The components of tax base -- what  
12 we are taxing here is we are taxing productive activity  
13 that is undertaken by the taxpayer, and the tax itself  
14 defines productive activity in terms of labor costs, in  
15 terms of capital costs, and to a very much lesser extent  
16 in terms of profit. That is what is being taxed. And  
17 then it is saying now, what is Michigan's fair share of  
18 this total value-adding productive activity that the  
19 taxpayer is undertaking? And it has said we are going to  
20 measure that by using an apportionment formula that is  
21 widely used to apportion income under an income tax act.

22 And the problem there is again the use of an  
23 equally weighted sales factor, because the value added by  
24 the labor contribution to a value-added tax base is  
25 sufficiently measured by the payroll factor alone. And

1 the value added by the depreciation contribution to the  
2 capital component is fairly reflected in the property  
3 factor alone. Those are the dominant parts of the SBT tax  
4 base. Statistics tell us so. 77 percent of the average  
5 SBT taxpayer's tax base is not income, it is compensation.

6 Because of that, when you throw into the mix an  
7 equally-weighted sales factor, you are adding to the mix  
8 in terms of assigning those values to Michigan something  
9 that is irrelevant and something that is going to cause  
10 distortion. Because again, sales activity provides no  
11 rational clue whatsoever as to where the value-adding  
12 activity that underlies the payments of compensation and  
13 depreciation take place.

14 In addition and independent of the gross  
15 distortion that this tax generates, it also produces a  
16 discriminatory effect. And here again the culprit is the  
17 sales factor. For those labor-intensive businesses that  
18 have property and payroll factors which when averaged are  
19 greater than their sales factor, this formula will enable  
20 them to export out of Michigan some of their site-  
21 specific, value-adding activity, while for the labor  
22 intensive business that has property and payroll factors  
23 which when averaged are less than their sales factor, they  
24 will be forced to import into Michigan some part of their  
25 site-specific value-adding activity.

1           And what this means, what this means is that the  
2 out-of-State taxpayer that has the characteristics I have  
3 just described will pay more tax on its Michigan value-  
4 adding activity than will the in-State taxpayer that has  
5 the characteristics that I have just described. And while  
6 that difference in tax responsibility is admittedly not  
7 the result of the application of different tax rates or  
8 varying exemptions or varying credits, nonetheless, the  
9 practical effect of the tax is the same. And it serves to  
10 provide a direct commercial advantage, and an unfair one,  
11 to the in-staters, and it serves as well to exert  
12 impermissibly on out-of-State taxpayers the possibility  
13 and the inducement to make non tax-neutral decisions to  
14 locate their property and their work force in Michigan.

15           If I -- if the Court doesn't have any additional  
16 questions at this time I would like to reserve the balance  
17 of my time for rebuttal.

18           QUESTION: Very well, Mr. Sheldon.

19           Mr. Roesch, we'll hear now from you.

20           ORAL ARGUMENT OF RICHARD R. ROESCH

21           ON BEHALF OF THE RESPONDENT

22           MR. ROESCH: Michigan levies a single business  
23 tax, so-called because it replaced seven previous existing  
24 taxes. It is imposed upon business activities. These  
25 business activities are measured by a so-called value add.



1 It is quantified by Federal taxable income, plus several  
2 deductions from gross income to arrive at Federal taxable  
3 income, namely compensation cost, depreciation cost, net  
4 interest expense, and net royalty expense.

5 Now in the case of a unitary multistate  
6 business, this --

7 QUESTION: May I just interrupt you there?

8 MR. ROESCH: Yes.

9 QUESTION: You start by talking about the  
10 Federal income tax. That is -- is it not correct that for  
11 most businesses that is a small portion of the tax base?

12 MR. ROESCH: Yes, that's very true, Your Honor.

13 QUESTION: So there isn't really a big  
14 disagreement about whether 90 percent of the items that  
15 are taxed are site specific.

16 MR. ROESCH: No, there is no disagreement. In  
17 fact, the gross national product figures also say that 77  
18 percent is compensation payments. There's no  
19 disagreement.

20 To go on, in the case of unitary multistate  
21 business, this tax base which results is apportioned to  
22 Michigan by the standard three-factor formula of property,  
23 payroll, and sales. Now, the question here is not does  
24 Michigan tax any discrete components. The question here  
25 is very simply is Michigan taxing a unitary multistate

1 enterprise. Trinova is --

2 QUESTION: Can I ask you a question right there?  
3 Assume we have a unitary multistate enterprise subject to  
4 the tax, and assume Michigan wants to impose a payroll tax  
5 on unitary businesses, nothing but a payroll tax, and 90  
6 percent of the payroll is in Ohio and 10 percent is in  
7 Michigan. Could they use the unitary formula to allocate  
8 such a tax, in your judgment?

9 MR. ROESCH: Justice Stevens, if Michigan were  
10 to impose a payroll tax similar to a FICA tax upon  
11 payrolls, obviously Michigan wouldn't have a  
12 jurisdictional reach over Ohio components.

13 QUESTION: Why not? It's a unitary business.  
14 You are just using the formula to allocate, and a salesman  
15 in Michigan probably bringing in all these sales. What  
16 would be wrong with it?

17 MR. ROESCH: Wait, we are not -- the Michigan  
18 tax is upon business activities. It's an entirely  
19 different --

20 QUESTION: Well, I am  
21 hypothesizing a payroll tax on a unitary business  
22 apportioned by the formula.

23 MR. ROESCH: A payroll tax, if it were simply  
24 upon payroll specifically, could not be justified under  
25 the unitary business --

26 QUESTION: But if it's payroll which is 90

1 percent and you add 10 percent more for profit, then it's  
2 all right to apportion it?

3 MR. ROESCH: That's not what I am saying, Your  
4 Honor.

5 QUESTION: You're not.

6 MR. ROESCH: What I am saying is that the  
7 Michigan tax is not upon compensation. It is not upon  
8 depreciation. It is not upon any particular element. It  
9 is upon the business activities. It is business  
10 activities that are apportioned. Surely we measure these  
11 business activities not by net income; we measure it  
12 differently. And we come right back to the unitary  
13 business principle. If a -- if a State seeks to tax the  
14 proportional activities within the State of a unitary  
15 enterprise, it may certainly do so by unitary  
16 apportionment.

17 In Mobil Oil, for example, this Court said the  
18 unitary business principle is the linchpin of  
19 apportionability, and that this allowed separate  
20 accounting for foreign source dividends.

21 QUESTION: But the reason behind that was that  
22 it is impossible otherwise to find a fair way to apportion  
23 -- to identify the site-specific nature of the profit,  
24 where the profit comes from, except by a formula. But  
25 here you base this entirely on, 90 percent on factors that

1 can be identified.

2 MR. ROESCH: The factors can be identified, but  
3 you cannot identify where the value is added. For  
4 example, I believe it was your opinion in Moorman which  
5 pointed out that for all that appears the Iowa sales, the  
6 large sales may have produced much greater income, a much  
7 greater margin of income than the Illinois property and  
8 payroll. And so it is here we cannot -- there has been no  
9 separate accounting for value added. There has been only  
10 a reference to separate accounting for so-called  
11 components for the two costs, compensation, which surely  
12 is the biggest cost, and depreciation. But this Court  
13 already has said in Container Corporation and Amerada  
14 Hess, it said very specifically --QUESTION: What if the  
15 tax, instead of just value added, was a value added by  
16 labor tax, and then you apportion it. You figure your  
17 salesmen produce much more of -- then it would be all  
18 right, I guess.

19 MR. ROESCH: A value added by labor?

20 QUESTION: A value added by labor, and you use  
21 -- your component is payroll. And then you go ahead and  
22 apportion it by the formula. Would that be permissible?

23 MR. ROESCH: I believe that very well might be.  
24 But I pose even a better one. Could Michigan say we are  
25 going to look at the major expense of the business, namely



1 compensation, and we are going to go ahead and apply this  
2 major -- to this major expense, to all of your \$226  
3 million in this particular case, we are going to go ahead  
4 and we are going to say of this expense there is  
5 attributable to Michigan 9 percent, the average of your  
6 insignificant property payroll and your 27 percent sales.  
7 And I say most certainly Michigan could use that 9 percent  
8 as a measure of Michigan business activity. And this is  
9 really what we have here. We have here --

10 QUESTION: Mr. -- Mr. Roesch, is it accurate to  
11 say that this is a tax upon business activity? It's a tax  
12 that is said to be measured -- the tax base consists of,  
13 according to the Michigan law, total compensation plus  
14 total capital costs plus profit. I read that as a tax  
15 upon compensation, capital costs, and profits, not a tax  
16 upon business activities.

17 MR. ROESCH: Yes, Your Honor.

18 QUESTION: It's the shoes, not the sleeping.

19 MR. ROESCH: Yes, Your Honor, but for purposes  
20 of -- for purposes of measuring, for purposes of measuring  
21 how much Michigan may get of these items, they are not  
22 site specific. Like I tried to say in Amerada Hess, this  
23 Court specifically noted that -- that the cost of a  
24 unitary enterprise cannot be deemed confined to the  
25 locality in which they are incurred. And this is, this

1 Court has disallowed specific accounting for items either  
2 of income or cost. So what I am saying is none of these  
3 items as such is site specific when I tax activity.

4 QUESTION: That's fine, but does that mean that  
5 simply because you can't identify it precisely you don't  
6 even have to try to identify it approximately?

7 MR. ROESCH: If Michigan were to have separate  
8 taxes upon these components, and this is our major  
9 disagreement here. Trinova views the tax as being one tax  
10 upon compensation, one tax upon depreciation, another tax  
11 upon interest and royalty expense, and they say we can  
12 identify where these, where all of these site specific --  
13 or site-specific costs are incurred, and therefore the  
14 State of Michigan must take that into account. It can  
15 only tax a certain amount of compensation; it can only tax  
16 a certain amount of depreciation.

17 If this is what Michigan did, rather than  
18 imposing a tax upon the overall proportional business  
19 activities in Michigan, then most certainly Trinova would  
20 have an argument. Then it could separate out these  
21 components. This Court has never allowed in a unitary  
22 business case, has never allowed the sourcing of foreign  
23 source dividends in Mobil, or the functional separate  
24 accounting in Exxon v. Wisconsin, or the separate  
25 accounting for the stores in Butler Brothers v. McColgan.

1 In each case this Court has said that in a unitary  
2 enterprise we cannot identify where the tax base, at what  
3 link in the chain of multistate operations this tax base  
4 is generated. And I submit that there is no way to say  
5 that the Michigan activities do not contribute the amount  
6 of value to -- that is being taxed by the State of  
7 Michigan.

8 QUESTION: But why wouldn't the same result  
9 follow from Justice Stevens' first hypothetical that he  
10 gave you where there was a tax just on compensation, but  
11 that there was an apportionment measure used based on  
12 income? I don't know why you conceded at the outset that  
13 the State couldn't do that. It would seem to me that any  
14 fair measure --

15 MR. ROESCH: It seemed to me that --

16 QUESTION: Unless you are saying, unless you are  
17 conceding, which is what I thought Trinova should be  
18 arguing, which is that the theory of the tax and the  
19 measure of the tax must be in correlation. If they had  
20 conceded that I would have asked them what authority there  
21 is for that.

22 MR. ROESCH: The theory of the tax and its  
23 apportion mechanism completely really unrelate. If we're  
24 talking about value-added tax, the only theory is that we  
25 tax the difference between the amount of costs I have for

1 raw materials and services throughout the business and the  
2 amount of my gross receipts. The theory here is very  
3 simply you must pay for governmental services the social  
4 costs you generate. And on income tax, we are talking of  
5 ability to pay, really. So these are really when we are  
6 talking about the theories.

7 But as I understood Justice Stevens' question it  
8 was this, if the State of Michigan were to say we are  
9 imposing a straightforward payroll tax, then I would  
10 believe that Michigan, if on the straightforward payroll  
11 tax let's say of 1 percent upon, could only tax the  
12 Michigan payroll. It couldn't reach outside and tax  
13 Nebraska payroll or Iowa payroll.

14 QUESTION: Well, suppose it was done on a  
15 formula that would, when applied by other States if they  
16 enacted a similar tax, was equitable to all. What would  
17 be wrong with it?

18 MR. ROESCH: If -- if you have no internal  
19 consistency problem, and that is what your question really  
20 implies, if other States enacted a similar tax and we  
21 would have -- and it would be equitable, then I would have  
22 no hesitation to say yes, a State could enact that. I am  
23 going now to Container Corporation. Container Corporation  
24 requires apportionment formula to be both internally and  
25 externally consistent.



1           You know what that internal consistency means?  
2           That if all the States enacted a similar apportionment  
3           device there would be no great overlapping of tax base.  
4           There would be no multiple taxation. External consistency  
5           the Court has interpreted as being that the factors used  
6           in the apportionment formula must be related to the  
7           ultimate activities here.

8           And I believe, for the taxing subject, I believe  
9           that when Michigan says we are taxing you upon your  
10          business activities which you are conducting in Michigan,  
11          and a certain proportion thereof is attributable to  
12          Michigan, that it can use certainly the three-factor  
13          formula which this Court, once again in Container  
14          Corporation, called a benchmark. I believe that averaging  
15          the three factors of property, payroll, and sales truly  
16          does reflect the activities which a corporation or any  
17          business conducts within the State. And I believe that a  
18          State is justified in asking a return in such an event.  
19          The --

20                 QUESTION: You may successfully argue that  
21          Michigan isn't reaching beyond its borders to tax, but you  
22          still have to answer the question of whether it  
23          discriminates against -- against --

24                 MR. ROESCH: The discrimination argument can be  
25          answered very simply once again as it was answered in

1 Moorman. The discrimination argument hinges completely  
2 upon acceptance of the requirement of separate accounting  
3 for this type of a tax. If no separate accounting is  
4 required, then obviously the Michigan -- there is no  
5 discrimination, because the out-of-State industry cannot  
6 show that the out-of-State industry is burdened more than  
7 in-State.

8 The other coin -- the other coin that we have  
9 here is the alternative argument, which presupposes a two-  
10 factor formula. A two-factor formula ends up, as noted on  
11 page 44 of our brief, with a tax of \$5,199 for doing a  
12 business resulting in over \$104 million of revenue to the  
13 State -- to Trinova. Now, this \$5,199 on top of it would  
14 never change, because it is only property and payroll,  
15 whether Trinova sold \$100, \$1 million, or \$100 million in  
16 this year.

17 Now such a two-factor formula in my estimation  
18 would really -- it may pass constitutional muster, but  
19 would not really reflect any kind of business activity,  
20 because I believe that the social costs generated by sales  
21 of \$100 million, just the use of the courts, the highways,  
22 the schools, are much greater than the social costs  
23 generated by a sale of \$100. And yet the two-factor  
24 formula would lead to that particular result.

25 Now, I think that Moorman very clearly answers

1 the discrimination argument by noting that the only way  
2 you can show discrimination is if you say that the  
3 Michigan formula, that the Michigan formula -- that you  
4 must look to other formulas to see that the Michigan  
5 formula is discriminatory.

6 QUESTION: Of course, Moorman was an attack on  
7 the apportionment formula. It didn't have anything to do  
8 with the tax base, did it?

9 MR. ROESCH: No.

10 QUESTION: And here the basic attack is on the  
11 way that the tax base distorts the whole thing.

12 MR. ROESCH: Your Honor, Your Honor, you are  
13 correct. Moorman had not included the tax base. But  
14 let's talk about tax base for a minute.

15 Tax base in Michigan obviously could be  
16 apportioned gross receipts, and indeed apportioned gross  
17 receipts, (inaudible) tax as so, apportioned gross  
18 receipts were the measure of the tax upon the doing of  
19 business in the 1959 Second Railway Express case v.  
20 Virginia. In that case this Court upheld the Virginia tax  
21 which was measured by apportioned gross receipts, namely  
22 total gross receipts of Railway Express apportioned to  
23 Virginia by a mileage ratio.

24 So obviously, if -- if gross receipts may be  
25 apportioned, and obviously if net income may be

1       apportioned, then something in between --

2               QUESTION: But of course the purpose of the  
3       apportionment of the gross receipts there was to find out  
4       how many of those receipts took place within the taxing  
5       jurisdiction. Here we know how many of the -- how much of  
6       the compensation and how much of the depreciation took  
7       place in the taxing jurisdiction -- virtually none.

8               MR. ROESCH: That is correct, Your Honor. But  
9       we are not taxing, once again, the depreciation. We are  
10      not taxing -- we are only looking --

11              QUESTION: And here we are not taxing gross  
12      receipts. We are just using sales as one of the factors  
13      for apportioning that which we assume otherwise could not  
14      be apportioned.

15              MR. ROESCH: That is correct, Your Honor. We  
16      are not taxing the total gross receipts, but we are taxing  
17      a goodly portion of gross receipts. Indeed, the Michigan  
18      SBT has a nice distinguishing feature. It says at the  
19      option of the taxpayer he may pay upon 50 percent of his  
20      gross receipts. Now this option really is only taken by a  
21      taxpayer whose so-called value added would exceed 50  
22      percent. So really what we have is in effect a gross  
23      receipts tax limited to 50 percent of gross receipts.

24              Now, in this connection I cannot see very much  
25      difference here between the New Jersey case, Amerada Hess,



1 and between the -- the Michigan tax which is involved here  
2 with the SBT. In New Jersey what we had, we had a so-  
3 called New Jersey net-income measure. But in New Jersey  
4 net income was augmented by the special deductions for net  
5 operating loss and other special deductions, plus the  
6 Federal income tax and the Federal windfall profits tax.  
7 Now, in that case what you really had, you had an income  
8 tax which was augmented by costs of the business.

9 And this Court -- what was stressed in this  
10 Court was that windfall profits tax was site specific, it  
11 should be excluded from the preapportionment tax base.  
12 This Court disagreed. It said in a unitary enterprise the  
13 costs are no more site specific than the income elements  
14 may be deemed site specific. And it upheld the New Jersey  
15 tax.

16 Now in this case what we have is we also start  
17 with Federal taxable income. It is only that we have  
18 different additions to Federal taxable income. What we  
19 have is a compensation addition and a depreciation  
20 addition. And these expense additions, they form the tax  
21 base. And these, obviously, if the windfall profits tax  
22 could not be -- a cost could not be deemed site specific,  
23 it is hard to see why depreciation and compensation, which  
24 are also costs, should be deemed site specific.

25 QUESTION: Except the additions here are 90

1 percent of the total, and in the typical income case your  
2 addition is a very small percentage of the total.

3 MR. ROESCH: Yes, but it has never been the rule  
4 that your apportionment, that the factors in your  
5 apportionment factor be reflected in the tax subject, in  
6 the tax base. That has never been the rule. It would  
7 never even be with the special industries, because mileage  
8 formulas really do not reflect, for example, any  
9 particular property or payroll.

10 QUESTION: Well, wasn't it hoped in Michigan  
11 that adopting this particular tax might -- might attract  
12 some business to the State?

13 MR. ROESCH: The hope was --

14 QUESTION: As a matter of fact, hasn't it?

15 MR. ROESCH: That is very hard to say. It may  
16 have attracted some business to the State, but --

17 QUESTION: Wasn't it hoped that it would?

18 MR. ROESCH: It was hoped that it would.

19 QUESTION: And the reason was because it would  
20 be more favorable to be located in the State than to be  
21 located outside the State.

22 MR. ROESCH: That is incorrect, Your Honor.  
23 That's incorrect, Your Honor. Why do you think for a  
24 minute --

25 QUESTION: You don't need to ask me a question.

1 (Laughter.)

2 MR. ROESCH: Thank you, Justice White. No, I  
3 was just going to mention that the large plants with the  
4 small compact cars of General Motors were not built in  
5 Michigan, they were built in Tennessee. So obviously all  
6 this attraction didn't really work out. It was not meant  
7 to discriminate in favor of Michigan. If Michigan wanted  
8 to discriminate it would have --

9 QUESTION: Well, why did you adopt this new --  
10 this scheme replaced something else, like an income tax.

11 MR. ROESCH: Yes. Our income tax in Michigan  
12 was -- was unpredictably cyclical. There were years in  
13 which Michigan got practically no income from its  
14 corporate income tax, and then boom years it got a lot.  
15 It also replaced the net worth tax in Michigan. That was  
16 the only stable tax that we had in Michigan. It replaced  
17 a tax -- but that tax was disliked by the, by all the  
18 business community, in State and out State. It also  
19 displaced a tax upon intangibles, mainly accounts  
20 receivable for the business. And finally a tax upon their  
21 business inventories, which was a property tax, which is  
22 really an anachronism because most States have repealed  
23 their personal property taxes, particularly upon  
24 inventories.

25 Now this was also a tax simplification. Instead

1 of having to deal with all of these taxes, the taxpayer  
2 now had to deal only with one tax. This tax would be more  
3 --much more stable, because -- like a gross receipts tax  
4 would be extremely stable. And so anything that is a  
5 modified gross receipts tax, which you can view this SBT  
6 as a modified gross receipts tax, also is much more  
7 stable. It is not subject to fluctuations that base, like  
8 income, is subject to fluctuations. It was hoped that  
9 because of simpler tax simplification, also because the  
10 businessman could more closely forecast his tax liability,  
11 that this would in itself be greatly attractive to  
12 industry.

13 But there was no design to try -- in the Single  
14 Business Tax, to bring business into the State, to, in the  
15 words of Westinghouse v. Tully, to exert an inexorable  
16 hydraulic pressure to have business performed in the State  
17 rather than out of State. Quite to the contrary, if  
18 Michigan had done that it probably would have adopted a  
19 flat sales factor the way Iowa has, for example. That  
20 would really have -- that really would have been an  
21 encouragement to perform in the State and sell out of  
22 State. And yet this Court upheld in Moorman the single  
23 factor sales formula.

24 Now, ultimately what this case boils down to is  
25 that while Trinova admits that separate geographic



1 accounting is not permissible for an income tax, that it  
2 should be constitutionally required when we have other  
3 than an income tax, that if we have a tax like Michigan  
4 which can be viewed as either an income augmented by cost  
5 tax, modified gross receipts tax, or, as the Michigan  
6 court puts it, a tax upon the value added to products and  
7 services.

8 Now, Trinova's separate accounting argument  
9 really results in converting an admitted value added, an  
10 admitted tax base of \$221 million, into a Michigan loss of  
11 \$2 million. Trinova pays no Michigan tax for the  
12 privilege of doing \$104 million worth of business in the  
13 State of Michigan. That is the consequence of the  
14 separate accounting argument.

15 In Butler Brothers v. McColgan the Court was  
16 faced with the same idea. It was faced also once again  
17 with that idea in Exxon v. Wisconsin. And in each one of  
18 these cases the Court flatly disallowed converting a  
19 preapportionment tax base positive into a negative loss  
20 within the State.

21 Realizing that the separate accounting theory  
22 might not be accepted, Trinova evolved a secondary  
23 argument which is inconsistent with its separate  
24 accounting theories. It evolved the argument yes, maybe  
25 apportionment is proper for our value added. But they say

1 it should only be apportioned by a two-factor formula.  
2 But as I noted before, and as explained on page 44 of the  
3 State's brief, such a two-factor formula would produce  
4 exactly the same amount of tax whether or not there was  
5 any substantial sales activity in Michigan by Trinova,  
6 whether they sold \$1,000, \$1 million, or \$100 million  
7 worth of sales in Michigan.

8 In Complete Auto Transit, in Complete Auto  
9 Transit this Court tried to get away from looking to the  
10 labels of a tax and said we are going to look at a  
11 practical effect of this tax. And yet the whole argument  
12 here is on labels. It is admitted that if Michigan  
13 imposed a straightforward income tax it could use the  
14 three-factor formula. If it imposed a gross receipts tax,  
15 sure it could use a three-factor formula. A net worth  
16 tax, as it did impose previously, a three-factor formula  
17 may be applied.

18 QUESTION: May I ask you, you say a three-factor  
19 formula for gross receipts tax? Why would you need a  
20 three-factor formula?

21 MR. ROESCH: Your Honor --

22 QUESTION: There isn't a precedent for that, is  
23 there?

24 MR. ROESCH: No.

25 QUESTION: I thought all the formula unitary

1 business cases were all income tax cases, because you need  
2 some formula to allocate the income. You don't need a  
3 formula to allocate gross receipts.

4 MR. ROESCH: Your Honor, you are correct. The  
5 three-factor formula has only been applied in income tax  
6 cases. On gross receipts the only case that I know of and  
7 I mentioned was Railway Express v. Virginia, which did use  
8 a mileage apportionment --

9 QUESTION: It was mileage, which --

10 MR. ROESCH: -- against total gross receipts,  
11 meaning gross receipts may be apportionable as a measure  
12 of business activity.

13 QUESTION: Right, if you have some reasonable  
14 method of apportioning it.

15 MR. ROESCH: That is correct.

16 QUESTION: And there is some relationship to  
17 predicting how many of the gross receipts were from that  
18 particular State.

19 MR. ROESCH: Well, the State was taxing business  
20 activity, and it said we are going to tax this business  
21 activity not by taxing a portion of your income, but a  
22 portion of your gross receipts.

23 QUESTION: Right.

24 MR. ROESCH: And Michigan here says the same  
25 thing. We are going to tax that portion of your business

1 activity attributable to Michigan not by measuring it by  
2 income or even gross receipts, but by something in  
3 between.

4 Now the practical operation of the tax, Trinova  
5 pays 28.5 cents per \$100 of sales, less than 3/10 of 1  
6 percent. And I could tell you by statistics -- well, it  
7 is said and it is admitted that the Michigan business on  
8 the average will pay over 4/10 of 1 percent in terms of  
9 gross receipts.

10 QUESTION: Because they'll have a bigger  
11 proportion of their other two factors in Michigan.

12 MR. ROESCH: That is possible, Your Honor.

13 QUESTION: Well, that's the whole answer, isn't  
14 it?

15 MR. ROESCH: No, that is not the whole answer.  
16 Let us take in-State Michigan business, completely  
17 intrastate business. It also pays over 4/10 of 1 percent.

18 Now, I can contemplate, I am talking about the  
19 practical operation of the tax. I can contemplate a  
20 practical operation of this tax whenever I wash the  
21 windshield of my 1980 Oldsmobile. I knew that Trinova  
22 sold this window glass, this windshield, to the General  
23 Motors plant, the Oldsmobile plant in Lansing, Michigan,  
24 for about \$100. And I know that the value it has added to  
25 this windshield is about \$56. Now Michigan, instead of



1 using the \$100, uses the \$56 to apportion to itself a  
2 certain amount. When I look at this \$100 windshield, I  
3 say for this business in Michigan, the State of Michigan  
4 is extracting from you \$28.5 cents. I think that is a  
5 modest recompense for the privileges and protections  
6 afforded by the State.

7 If there are no more questions I will end my  
8 argument.

9 QUESTION: Thank you, Mr. Roesch.

10 MR. ROESCH: Thank you, Mr. Chief Justice.

11 QUESTION: Mr. Sheldon, do you have rebuttal?

12 REBUTTAL ARGUMENT OF PETER S. SHELDON

13 ON BEHALF OF THE PETITIONER

14 MR. SHELDON: Thank you, Your Honor, I do.

15 Just because a business is a unitary business  
16 does not mean that the tax bases of every tax to which it  
17 may be subject must be apportioned. I don't think anyone  
18 will argue that a real property tax, or a tax on immobile  
19 tangible personal property, or a severance tax that is  
20 imposed against a business has to be apportioned just  
21 because the business is a unitary business.

22 Here the practical effect of this tax is not a  
23 tax on business activity. That is merely the legal  
24 justification, the legal excuse, if you will, for Michigan  
25 to be able to impose a tax against those businesses that

1 are conducting business in the State. The practical  
2 effect of the tax is that for most taxpayers it is a tax  
3 on compensation, and a tax on compensation is like a tax  
4 on payroll. And a tax on payroll is, in practical effect,  
5 no different than a tax on real property, or on immobile  
6 tangible personal property, or a severance tax. And like  
7 those taxes, it too should not be subjected to  
8 apportionment. You need not apportion it.

9 Amerada Hess, the point is made that this Court  
10 said in Amerada Hess that the cost of unitary business and  
11 whether those costs are or are not site specific is  
12 irrelevant in determining their contribution to an income  
13 tax base. But Amerada Hess involved a New Jersey statute,  
14 a taxing statute that was clearly an income tax. It  
15 wasn't even close to what the Michigan SBT is. Even after  
16 you denied the deduction for the windfall profit tax  
17 deduction, what was left of the New Jersey tax was plainly  
18 an income tax measured by Federal taxable income with just  
19 the one deduct taken away for windfall profit tax.

20 Here we have a value-added tax where 90 percent  
21 of the tax base, over 90 percent consists of site-specific  
22 components, principally compensation. The point is  
23 Amerada Hess does not stand for the proposition that site-  
24 specific components of a value-added tax base have to be  
25 apportioned, or that their site specificity is irrelevant.

1 Counsel claims that, look, Trinova had \$104  
2 million of sales in Michigan this year, during the 1980  
3 year, and the SBT as applied to it exacted a tax that  
4 amounted to 3/10 of 1 percent of its sales. So what has  
5 Trinova to argue about? Well, what Trinova has to argue  
6 about is that this tax is not a gross receipts tax. It's  
7 a tax on value added.

8 Appendix 3a of our merits brief clearly  
9 discloses that the gross receipts alternative is only  
10 available to a small fraction of Michigan taxpayers, less  
11 than 10 percent use this gross receipts alternative. So  
12 in practical effect we're not talking about a gross  
13 receipts tax. We're talking about a value-added tax. And  
14 the only way, the only way Michigan can exact 1 cent of  
15 tax from Trinova is to tax its extraterritorial value, the  
16 value that it has added to the contributions of its labor  
17 and its capital outside of Michigan.

18 Thank you.

19 CHIEF JUSTICE REHNQUIST: Thank you, Mr.  
20 Sheldon.

21 The case is submitted.

22 (Whereupon, at 1:58 p.m., the case in the above-  
23 entitled matter was submitted.)

24  
25

## CERTIFICATION

*Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of: 89-1106*

*Trivona Corporation, Petitioner -v- Michigan Department of  
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Treasury  
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*and that these attached pages constitutes the original transcript of the proceedings for the records of the court.*

BY *Raymond H. Hartel*  
(REPORTER)



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