OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: HOLYWELL CORPORATION, ET AL., Petitioners., V. FRED STANTON SMITH, ETC., ET AL.;

and

UNITED STATES, Petitioner V. FRED STANTON SMITH, ET AL.

CASE NO: 90-1361 & 90-1484

PLACE: Washington, D.C.

DATE: December 4, 1991

PAGES: 1 - 52

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IN THE SUPREME COURT OF THE UNITED STATES

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HOLYWELL CORPORATION, et al., :

Petitioners :

v. : No. 90-1361

FRED STANTON SMITH, ETC., et al.,:

and :

UNITED STATES, :

Petitioner :

v. : No. 90-1484

FRED STANTON SMITH, et al. :

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Washington, D.C.

Wednesday, December 4, 1991

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:01 a.m.

APPEARANCES:

KENT L. JONES, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the Petitioners.

HERBERT STETTIN, ESQ., Miami, Florida; on behalf of the Respondents.

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P R O C E E D I N G S

(11:01 a.m.)

CHIEF JUSTICE REHNQUIST: The spectators are admonished not to talk. The Court remains in session. Do not talk until you get outside the courtroom.

We'll hear argument next in No. 90-1361, Holywell Corporation v. Fred Stanton Smith, and No. 90-1484, United States against Fred Stanton Smith.

Mr. Jones.

ORAL ARGUMENT OF KENT L. JONES

ON BEHALF OF THE PETITIONERS

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

In 1789, Benjamin Franklin said that there is nothing certain in life except death and taxes. For 200 years, Congress has endeavored to ensure that the tax part of this saying holds true. Since the 1790's, Congress enacted a comprehensive set of interlocking provisions designed to ensure that even insolvent taxpayers and their fiduciaries pay taxes owed to the United States.

This case involves application of these ancient statutes to a liquidating trustee appointed by a bankruptcy court who in the course of liquidating and investing the debtors' assets realized more than $80 million of taxable gains and interest income. Since

the debtors had been stripped of their assets by the bankruptcy court, they obviously could not pay the taxes due on this income.

Congress anticipated this simple fact pattern as long ago as 1916 by requiring in what is now section 6012(b) of the Internal Revenue Code that receivers, assignees, and trustees in bankruptcy with fiduciary control of the debtor's assets are to report and pay the taxes. The court of appeals concluded in this case, however, that the liquidating trustee is a mere contract trustee and therefore escapes the duty to report and pay taxes.

Inverting the statutory scheme, the court said that the Government should look to the penniless debtors, rather than to the trustee for taxes on the income --

QUESTION: Mr. Jones, would you explain to me whether the Government thinks two income tax returns should be filed for this period, one by the trustee and one by the debtor?

MR. JONES: The trustee should file returns for the individual debtor's estate and for the corporate estate.

QUESTION: And should the individual debtor also file an income tax return for the same period?

MR. JONES: I assume so, but that would be

completely outside the scope of this case. The individual debtor, if he has income during the period that he is in bankruptcy separate from his estate, that income would be taxable to him personally but the estate --

QUESTION: And would he have to show any of this transaction on his personal income tax?

MR. JONES: No. With respect to an individual, when he goes into bankruptcy his assets form a separate taxable entity, his estate in the bankruptcy court. That separate taxable entity for the individual files a return. The trustee does that.

If the individual is working or somehow has income independently of his estate, then he would have to file a return for his independent --

QUESTION: Yes, but of course the bankruptcy estate part had ended. This is a liquidation trustee. It's no longer in a bankruptcy estate, is it?

MR. JONES: No, it's -- that is in fact one of the critical issues. It is quite clearly still part of the bankruptcy estate.

QUESTION: Well, the normal bankruptcy estate is over. It's in liquidation, and it's a liquidation trustee, is that right?

MR. JONES: We have a trustee appointed by reorganization plan to liquidate the debtors' assets, but

the estate continues because the assets have not been returned to the debtor under 1141(b) of the Bankruptcy Code.

QUESTION: And you take the position that the trustee and only the trustee in liquidation is obliged to file the income tax return for the period in question.

MR. JONES: Yes, both for the corporation and separately for the individual estate.

QUESTION: I just want to make sure I understood the answers. What are the tax -- the only taxable entities we have before us here, the corporation and the individual?

MR. JONES: We have a corporation named Holywell which has several consolidated subsidiaries --

QUESTION: Yes.

MR. JONES: All of which should file one return, and the trustee under 6012(b) is to file that return.

In addition, we have an individual named Gould, and his individual estate, the return for that should be filed by the trustee, also.

QUESTION: Are there other areas in the tax law where there -- well, let me preface the question. Does the individual and the corporation, do they also have the obligation to file a return?

MR. JONES: Under section 1399 of the Internal

Revenue Code, a corporation is treated differently from an individual when it goes into bankruptcy. The corporation continues to be a taxable entity even when it's in bankruptcy, so the trustee under 6012(b) has to file a return for the corporation. In that return, he reports all of the income that he received from liquidating and managing the debtor's properties.

It's different for the individual. When the individual goes into bankruptcy, whatever he brought to the bankruptcy is a separate taxable entity that is -- and the return on that is made by the trustee.

QUESTION: Mr. Jones, the Government is relying only on section 6012, but the other petitioners rely on two other sections as well. What's your position on those two other sections?

MR. JONES: Well, as I will attempt to explain in more detail later on, 3713 of title 31 is called the absolute priority statute, and we agree with the debtors that it is a safety net, if you will, that if the trustee is not subject to reporting and paying taxes under 6012(b), he would be required to pay taxes under the absolute priority statute.

With respect to 28 USC 960, which is the other statute that the debtors refer to, there are two points of view about that statute. Historically, it was enacted

simply to make clear that a trustee or receiver was not exempt from State taxation, and the statute only referred to State taxation. When Congress recodified title 28 in 1948, for some reason that the legislative history does not explain, they added the word Federal to the statute, and so now it says that the officer of the court shall be responsible for State, local, and Federal taxes.

Since there is no legislative history, we are in the dark on what Congress meant to accomplish. The I.J. Knight decision of the court of appeals, I believe the Ninth Circuit, concluded that all that the word Federal did was to make it clear that there was no negative implication that somehow a trustee should be protected from Federal taxation. That's one view. The other view is the debtors', which is that by putting the word Federal in, Congress made many of these other statutes unnecessary.

We don't -- we haven't taken a position on that statute in this case. We certainly don't think that the Court need reach it because this case is quite comfortably resolved by section 6012(b) of the Internal Revenue Code, which is where we would anticipate Congress would place tax requirements. The Court --

QUESTION: You say comfortably, except you really are requiring that the language trustee in a case

under title 11 be applied to a situation in which the case under title 11 is completed.

MR. JONES: Well, we don't agree, and nor is there any authority that this case is completed. In fact, the trustee has acknowledged that the case hasn't been closed. A case can't be closed in bankruptcy when the assets of the estate still remain within the estate, as the bankruptcy court held in the In re T.S.P. case.

The case could have been closed. It could have been done differently. It could have been done in what they call the ordinary fashion. The assets could have been liquidated before a plan was provided to distribute them. We agree that that may be the more ordinary route, but we don't think Congress meant this statute to be a shell game that allows an inventive creditor to come up with a plan where the assets are liquidated within the estate but after a plan is confirmed and thereby get out from under the statute.

I want to emphasize that this is in fact a quite ancient statute. It's been around since 1916. During the lengthy history of this statute the agency and the courts have all uniformly applied it to any court-appointed fiduciary who comes into control of a debtor's assets.

The Treasury regulations, which were adopted back in the twenties, interpreted the phrase, trustee in

bankruptcy, which everyone agrees was simply modernized in 1980 to say trustee in a case under title 11, that the term trustee in bankruptcy explicitly included a liquidating trustee or, and I quote, "any other person designated as in control of the assets of a debtor in any bankruptcy proceeding."

QUESTION: Well, Mr. Jones, I guess you don't have to rely on whether this is a trustee in a case under title 11 if he's an assignee.

MR. JONES: Well, that's correct. We also think that he comfortably falls within that definition also. Again, there is a 60-year-old Treasury regulation that defines an assignee as simply anyone who acquires possession and control of a debtor's estate for the purpose of paying the debts. Under either of those definitions, either of those regulations, the trustee quite clearly is caught, and Congress quite clearly intended this income to be caught for taxation.

In the National Mufflers case this Court held that an agency -- that the Treasury's regulations should be upheld if they reasonably implement the statute. Well, no one disputes that these trustees, the income they receive is intended to be taxed by Congress and that these regulations reasonably implement the statute.

If -- if the regulation doesn't -- if the

statute doesn't reach the trustee, the debtors have no assets, the income would simply escape taxation. That's not a result that anyone in this case has suggested Congress intended.

The trustee's argument that this is -- that in 1980 when Congress amended the statute to insert the modern language, trustee in a case under title 11, that they converted this into a technical term, a term of art. That technical argument has no basis in the regulations or in the legislative history of the act, which refers simply to the fact that the statute is intended to require any fiduciary who has the debtor's assets to pay taxes.

QUESTION: Mr. Jones, can I ask you a question? It's kind of a broad question about the case. We have before us the bank, and we have the debtor, and we have the Government. Are there any general creditors out there who are going to be affected by the disposition in this case?

MR. JONES: Well, I think that all creditors will be affected by the disposition, because --

QUESTION: If this money has to go to you, it has to come out of the pockets of the general creditors, doesn't it?

MR. JONES: Well, the trustee -- it's our understanding the trustee has a large amount of money

still in his possession.

QUESTION: Has anyone representing the interests of the general creditors filed a brief in this case?

MR. JONES: Not that I'm aware of. I don't recall that they appeared in the bankruptcy court.

QUESTION: Well, was there any money for general creditors, or just secured creditors?

MR. JONES: According to the record, all the creditors were paid 100 percent on the dollar, except the United States, which received nothing.

QUESTION: Mr. Jones, may --

QUESTION: One question, please. But would they keep that 100 cents on the dollar if you win?

MR. JONES: I'm really not certain, Your Honor, what the financial ramifications of that would be.

QUESTION: I see.

MR. JONES: My assumption would be that somebody would have to return some money. The trustee has not retained sufficient funds to pay the taxes, so he would have to get it back.

Now, as we know, he sought and obtained an indemnification from one of the major creditors at the time he became a trustee. He looked at the plan, and apparently it was visible to him, although not to anyone else, that there would be a substantial gain and therefore

substantial income to be taxed.

Instead of going to court as he should have, according to this Court's decision in King v. United States, and told the bankruptcy court that there's a big tax obligation here, he went to the creditor who'd proposed the plan and he asked them for and received from them an indemnification if he should ever be held liable for taxes, and the Bank of New York --

QUESTION: Well, he eventually brought this suit though, didn't he?

MR. JONES: He eventually brought this suit.

QUESTION: He should have done it earlier.

MR. JONES: He waited 2 years, he distributed a lot of money, and when he brought this suit he said either I'm not liable for taxes, or if I am liable the Bank of New York should pay me because they defrauded me and the estate by proposing a plan that didn't provide for these taxes.

Well, it's pretty evident the trustee wasn't defrauded, but it is also clear that the estate was not properly implemented. We don't have to reach here any of these questions, though, about the scope of the trustee's fiduciary liability or his liability as an individual. We anticipate that collection can occur through the moneys the trustee has and through the indemnification that the

Bank of New York provided.

I would like to address the suggestion that there is a difficulty with calling this trustee a trustee in a case under title 11. Given the broad history of the statute and this Court's opinion in Bramwell v. U.S. Fidelity, that's a very difficult argument for the trustee to make. In Bramwell, the Court specifically concluded that terms such as executor, receiver, and assignee are to be given a functional rather than a technical meaning in statutes requiring fiduciaries and insolvents to pay taxes.

The Court reached the same conclusion in the Spring Valley Water case and in United States v. Key, in which the Court specifically said that such provisions are, quote, "to be liberally construed to achieve their broad purpose of ensuring a certain payment of taxes."

With respect to this trustee, he acknowledges he is a trustee. He acknowledges that this is a case under title 11. He concedes he was appointed as and functions as a trustee in this case under title 11. He posted a bond as a trustee, as required by section 322 of title 11, and the fact that he was not appointed until the plan was confirmed has no bearing on this because section 1123 of the bankruptcy code specifically contemplates that a trustee can be authorized or appointed to liquidate an

estate pursuant to a plan of what in this case is called a plan of reorganization.

When this occurs, the estate continues, the trustees admitted that the estate -- the case hasn't closed, the bankruptcy court retains jurisdiction to supervise the trustee, to approve claims, and the trustee in every sense continues to act as a trustee in the case.

As we've already discussed, if the statute had a gap it would be filled by the words, assignee, which applies, according to the regulations, to anyone who comes into custody or control of the assets for the purpose of paying the debtor's debts.

The collateral consequence that occurs if the trustee is deemed to be an assignee is somewhat significant, and I touched on it briefly. The United States would have an absolute priority for the payment of taxes under the absolute priority statute, instead of a bankruptcy priority under 501(b)(1) of the code and under the plan, and the trustee would also be personally liable for taxes under 3713(b).

We differ with the debtors on this only in that we think it's clear under cases like In re San Juan Hotel from the First Circuit in 1981 that a trustee has a fiduciary duty under title 11 to pay taxes and can be personally liable if he fails to do so.

To this point, all I've talked about is the corporate estate. The trustee's duty to file a return for the individual is under (b)(4) rather than (b)(3), which requires any fiduciary of an individual estate to file a return.

The court of appeals said that this trustee is not a fiduciary because his duties are too ministerial. In King v. United States the court rejected a similar claim that a disbursing agent had only ministerial functions and was not liable as a fiduciary for ensuring payment of taxes on a bankrupt estate. In that case, the court emphasized that what is critical is the element of control that the fiduciary has over the assets and not the scope of his discretion.

As Judge Cox noted in his dissent in this case, the trustee's duties here were far from ministerial. He was appointed to receive and manage the assets, to identify and determine claims against the estate, to liquidate and invest the assets, and ultimately to make distributions. Those are precisely the type of duties that a fiduciary performs in a bankruptcy, and prior to this case every court of appeals that had considered the issue had uniformly concluded that a liquidating trustee in an individual bankruptcy is a fiduciary subject to section 12(b)(4).

There are three other issues that I'd like to touch upon briefly that respondents have asserted. They have asserted that perhaps this is a grantor trust and that as a grantor trust the fiduciary should not be liable for taxes.

A grantor trust arises when someone creates a trust but retains the power to determine the disposition of the assets. The DePinto decision from the Second Circuit and Collier on bankruptcy both say that a bankruptcy cannot be a grantor trust because the debtor doesn't retain any control over the disposition of the assets. Clearly, this debtor doesn't retain any control over the estate.

They've also argued that there is a bar date for the Government's tax claim. This argument doesn't sit well for the trustee because he apparently was aware of the tax issue from the beginning and made no effort to bring it to the attention of the court as he's required to.

But in any event, there is no bar date for tax claims that arise in connection with the administration of the reorganization plan. Those claims are an administrative expense under Articles 5 and 6 of the plan. The court has entered no bar date for administrative expenses. The only bar that has been entered was with

respect to attorney's fee applications as administrative expenses, which I assume has been lifted because counsel for the trustee has recently filed an attorney's fee application.

The third issue that the trustee asserts is that the United States should have been more diligent in protecting its rights. Well, Congress was diligent in protecting the rights of the United States, and has been since the absolute priority statute was enacted in the 1790's. These statutes require the trustee to assess himself and to report to the United States. Since he has not done that, even to this date filed a return as required by law, he cannot claim that the United States -- any time has begun to run against the claim of the United States.

I'd like to reserve the balance of my time.

QUESTION: Very well, Mr. Jones. Mr. Stettin, we'll hear from you.

ORAL ARGUMENT OF HERBERT STETTIN

ON BEHALF OF RESPONDENTS

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

On October 10, 1985, the plan of reorganization of Holywell and Mr. Gould and the other joined debtors was confirmed and made effective. It became effective on that

date, and on that day the liquidating trustee assumed his powers.

He had absolutely no contact with this case prior to that time. It was a Chapter 11 that had been confirmed without his involvement in any manner. He was not affiliated with the debtors. He was not affiliated with any of the creditors. He was simply named in the plan which had been proposed by the major creditor -- the Bank of New York -- and his job was severely delimited. He was told what to do under the terms of the plan, a plan he did nothing at all to obtain the confirmation of.

His job was very simple. He was to sell the Miami Center property, the hotel and the office building, and he was to sell it to the Bank of New York, and they were going to satisfy their mortgage and pay the excess in cash to him and he was going to administer that cash and some other cash that he got from sale of other properties, and he was going to pay the claims of all the other creditors under the plan called classes 1 through 6, and they did get paid.

In answer to the Chief Justice's question, I think there are no other unpaid, unsecured creditors. They've all been paid. That plan also provided the Government was --

QUESTION: But is it not possible that they will

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be unpaid?

MR. STETTIN: Oh, yes, there is a distinct possibility if this is undone, and the bankruptcy court, district court, and Eleventh Circuit made this point. The confirmed plan has been substantially consummated. If we are now obligated to go back and redetermine the priority of payments and the Government is held entitled to receive taxes and given a priority for the payment of those moneys, it may very be that other creditors will have to disgorge moneys that they received. We don't know that yet, but it is likely that that may happen. The Government was not left out of --

QUESTION: But that, I take it, does not bear on the proper decision of the point involved in this case.

MR. STETTIN: To an extent it does, in that --

QUESTION: What doctrine would prevail that would cause the general creditors to prevail there where they would not otherwise?

MR. STETTIN: There is no general doctrine that would cause the general creditors to prevail over the Government if the Government were in fact entitled to priority and right of payment of these taxes.

QUESTION: Well, so really, then, we're not talking about a situation where if the Government had moved before all the payoffs and the plan was completed it

might have prevailed but now it's too late for it to prevail. I mean, I take it many plans have been undone because perhaps there was a superior lien that was not acknowledged at the time the plan was executed.

MR. STETTIN: Clearly, there are methods by which a plan can be undone, to use your phrase. This plan has been substantially consummated, and in fact in an earlier proceeding this Court denied certiorari from an appeal of the Eleventh Circuit's decision that the --

QUESTION: But am I right in thinking that you agree, or tell me if I am not right, that the fact that the plan has been consummated, as opposed to if it were just incipient, does not bear on how this case should be disposed of?

MR. STETTIN: You are correct if section 6012(b) does apply to this liquidating trustee.

QUESTION: So the fact that the plan has been consummated doesn't change the applicable law.

MR. STETTIN: If 6012(b) applies, it does not change the applicable law. In order for us to prevail, we must be able to show you that 6012(b) does not apply to this liquidating trustee, and to the extent that it requires that I get a little more detailed in facts, I apologize.

The Government took the position that they

received nothing under this plan. That is not true. The Government was a creditor in this case. They had filed proofs of claim for taxes, prepetition taxes, and under the terms of the plan, when confirmation became effective, they got paid. What they didn't do was avail themselves of every one of the remedies which the bankruptcy code provides.

They received notice of every single thing that was going on in this case. Bankruptcy rule 2002(j) mandates that they get notice of what is happening. They were a creditor. They did get a copy of the plan and the disclosure statement. That plan and that disclosure statement did not contain a provision for the payment of taxes to the Government on any sale or gain --

QUESTION: No, but Mr. Stettin, assume they had acted with due diligence, as you claim, then what would have happened.

MR. STETTIN: Several things would have happened. First, if they had said, the disclosure statement is defective, it doesn't say what the tax effect of what we're going to do is. We're going to sell this property back to the bank and you're not going to get enough money to pay the taxes that'll become due.

It's very common that property is transferred in satisfaction of a mortgage and you don't have enough money

left to pay the taxes that accrue as a result of that.

QUESTION: You're saying that should have been obvious to the Government but not to the bank or to the debtor.

MR. STETTIN: It should have been obvious to everyone.

My client, the liquidating trustee, did not even exist at that time. What he found when he became the trustee of this plan was a plan which had a disclosure statement that did not tax-effect this plan, and the cases are absolutely clear. You cannot confirm a plan if you don't provide this type of information.

The Government could have voted against this plan. The Government could have appealed from the order of confirmation. They did none of these things. They took the money --

QUESTION: No, but I'm still asking you, supposing they had acted with due diligence, what would have happened?

MR. STETTIN: The plan would not have been confirmable because one of the requirements under section 1129 is that the plan be shown to be capable of successfully being carried out.

QUESTION: And you're suggesting the Government should be solely responsible for the failure to discern an

obvious defect in the plan, even though neither the bank nor the debtor recognized the same defect.

MR. STETTIN: Whether it was --

QUESTION: Why didn't the trustee recognize the defect? He was entitled to employ a counsel. I think he spent a lot of money on counsel, if I remember the record.

MR. STETTIN: Yes. I was not counsel to him then. I became counsel to him later.

QUESTION: I understand, but he did have expensive counsel.

MR. STETTIN: Without question, the expenses in this case were significant for all parties, including counsel for the --

QUESTION: And why is it that the Government is fully responsible for an error that a lot of other high-priced lawyers should obviously have detected?

MR. STETTIN: The Government had the opportunity and did not take advantage of it. Other parties also had the opportunity and did not take advantage. As a result of the failure of the Government to take any efforts at all to determine what rights they had, what taxes they were owed, the moneys were paid out exactly as the plan required.

The trustee found himself when he took effect on October 10, 1985, with an absolute requirement.

Section 1142(a) of the bankruptcy code says that the person charged with carrying out the terms of the plan, the only other instance in the bankruptcy code where they talk about a liquidating trustee in a Chapter 11, shall carry out the terms of the plan and must obey the orders of the court.

The orders of the court were very basic: sell the property to the bank, sign a deed to do that, take the money that you get and pay the allowed claims and administrative expenses and pay them as the court ordered, and none of those expenses -- none of those costs included the Government. The trustee was supposed to, if I understand the Government correctly, the moment he took effect on October 10, to say I will not obey the order of the court appointing me and carry out this plan, or, I will convey the property to the bank, but I won't pay the cash that I get to any other creditors because they may be, in fact, inferior to the Government.

QUESTION: Well, did the trustee violate any term of the plan when he initiated this litigation?

MR. STETTIN: No.

QUESTION: Would he have lawfully initiated this litigation the day after he was appointed?

MR. STETTIN: He could legally have done that, except that it would not have allowed him to carry out the

terms of the plan within the time required under the terms of the plan.

QUESTION: Well, he's not going to be able to do that anyway.

MR. STETTIN: Well, he did carry out the terms of the plan to the extent of taking the money from the bank and paying it to the creditors whom the plan obligated him to pay.

If I can, I would like to address the inapplicability of section 6012(b), because I believe that is the heart of this case. 6012(b), in the first portion of it, deals with returns for corporations, and (4) deals with returns for estates. I'm going to take them in reverse order, if I may.

Mr. Gould is an individual. He was an individual Chapter 11 debtor. When he filed his Chapter 11 -- I think it's title 26, section 1398 required that a new taxpayer was created and a new tax return would be filed, so that during the Chapter 11 proceeding Mr. Gould, if he had individual income of his own, would file his own tax return, and the debtor in possession, Mr. Gould himself, incidentally, would file his return as a debtor in possession. There would be two returns filed during the Chapter 11 proceeding.

When the plan was confirmed the estate

terminated. The bankruptcy code says that. At that point, Mr. Gould resumed entire control over his fate and this plan specifically said that he was discharged of his debts and that he was free to go on about his business, and he incurred the obligation at that point to file his own tax returns again, and he did. In this case, Mr. Gould -- and the briefs say this -- did file his own tax returns following confirmation for the first year, before it was decided he did not want to follow that path.

Now, the three requirements under sub (4) of 6012 say that a fiduciary of an estate has to file a return for that. Well, this is not an estate. This is not a probate proceeding.

It also says that the fiduciary of a trust has to file it. There was a concession made at the trial of this case before the bankruptcy court and conceded at every level, including this Court, except by the debtor -- the Government still concedes this -- that the liquidating trust is not a separately taxable entity. In and of itself it is not taxable. Its taxable obligations, its tax obligations, arise entirely because of the wording of sections 6012(b)(4). In fact, it is not a taxable trust, the Government concedes.

The debtor does not say that. The debtor says that we are a taxable trust and therefore have to file a

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return for that. In fact, we are a grantor trust, which the Internal Revenue Code specifically recognizes as not being taxable to the trust. It is taxable to the settlor, to the person who in fact has his property used to pay his debts, and that's exactly what happened in this case.

QUESTION: Do grantor trusts have a reporting or disclosure obligation as opposed to a filing obligation?

MR. STETTIN: If it had any obligation at all, Justice Kennedy, it had a disclosure -- like a partnership return being filed just for informational purposes, but it had no obligation to pay tax, and clearly no return filing obligation under 6012 as contended by the Government.

A grantor trust is nothing more than taking property from some entity, a person in this case, and using it specifically, by contract, to pay his debts, and returning the excess back to the grantor. Clearly, the Service says that the grantor is liable for the taxes, and there's no reason why he shouldn't be, because in fact it was his property in this case.

Mr. Gould got all the benefits -- all the tax benefits -- for years prior to the confirmation of this plan for any depreciation or other expenses in the operation of the Miami Center.

QUESTION: Well, Mr. Stettin, who did the -- in the view of the participants in this plan, who was going

to pay the tax liability that obviously was owed by somebody for the preconfirmation activities?

MR. STETTIN: The plan is entirely silent on that issue. I believe that the record reflects that it was intended by everyone, because the plan provided this, that as soon as all of the claims of other creditors were paid the excess would be returned to the debtors, they were discharged of all of their prepetition obligations, the trustee was enjoined not to change their business so that he could not make it more difficult for them to continue on, and the debtors with the property revested in them after the payment of their debts would pay whatever taxes were due.

QUESTION: Why did that not occur, because there was no -- nothing went back to the debtors?

MR. STETTIN: This case is not closed 5 years and a couple of months after confirmation because of the incredible volume of appeals. We are in our 90th, or 95th separate appellate proceeding; 10 petitions have been filed before this Court. This is the first in which certiorari was granted. The trustee has simply defended himself on a regular basis from appellate proceedings initiated by Mr. Gould and Holywell Corporation, and the records of the Federal report are replete with it.

The last item in 6012(b)(4), which requires

filing by fiduciary, is of the estate of an individual under Chapter 7 or 11 of title 11, and I believe it was Justice O'Connor who pointed out well, didn't this estate end when confirmation occurred? It did, and in fact Mr. Gould himself recognizes this in his brief. The Government says otherwise. That's one of the clear distinctions, the issues between us.

The Government says the estate doesn't end, that the filing requirements during the Chapter 11 are simply shifted from the debtor in possession to the liquidating trustee. There is no statutory authority given for that. There is no case citation given for that. In fact, in the brief of --

QUESTION: Do you have any cases, just to follow Mr. Jones' last point, in which a grantor trust was created by a debtor in possession?

MR. STETTIN: The one case which both briefs discuss is In re Sonner. It is a bankruptcy decision in which similar facts occur. In a Chapter 11 proceeding a liquidating trust was set up, and it was determined to be nontaxable to the liquidating trustee, in part because it was a grantor -- it determined to be a grantor.

QUESTION: Is this the decision of the bankruptcy court?

MR. STETTIN: It is.

QUESTION: That's the only authority you've got.

MR. STETTIN: That's the only one that directly addresses the issue, as I understand it, from both briefs.

I would suggest to you, in the very last two pages of our brief we pointed out that the Service has the means to even correct that problem if they wish. There was statutory authority given in 1986 to the Service to establish regulations taxing grantor trusts. The Service has not issued any regulations taxing grantor trusts to this day.

It wouldn't apply in any event, because it predates -- our trust predates the effective date of that statute by approximately a year, but the argument that the Government raises that there is a loophole of troubling proportions was very troubling to me as well. This is a loophole, clearly, on grantor trusts they have the means and ability to correct, and they have chosen not to to this point.

If I could, I'd like to pass to 6012(b)(3). This is the one that requires where you've got a bankruptcy proceeding, it says in a case where a receiver -- clearly we are not a receiver, the bankruptcy court forbids the appointment of a receiver -- or a trustee in a case under title 11, or an assignee by a court of competent jurisdiction or otherwise --

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QUESTION: Now, I suppose he could be an assignee.

MR. STETTIN: We think not, and the reason we think not is because the 6012 statute and every one of the predecessors, going as far back as Mr. Jones has mentioned, has never applied 6012(b) to someone who did not have control over a debtor or a debtor's property.

We're not talking about operation of its business. That was in the statute originally.

QUESTION: Does it fit within the regulations definition of assignee?

MR. STETTIN: I believe that the regulations the Government mentions are under another tax statute, and they are not the regulations under this statute. All of the cases --

QUESTION: Well, do you think the ordinary meaning of the term could scoop up this trustee?

MR. STETTIN: The Government has argued that. They say -- and they use a Webster's Dictionary definition of assignee to say someone who, I believe, is a transferee of property. If that were true, then why would you need to say, receive a trustee in a case or assignee by order of a court and so on. All you'd have to say --

QUESTION: Well, I suppose just to be absolutely sure the Government gets its taxes one way or another.

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MR. STETTIN: Clearly, if Congress intended that the Government get its taxes when you've got an insolvent debtor who has got property in the hands of a third person, all you'd say -- all you'd need to say is that any person who holds possession or title or control -- any person, without describing what they are. But in fact they didn't do that. An assignee --

QUESTION: Well, could you give us an example of a case where the assignee clause of (b)(3) would come into play in a Chapter 11 type proceeding?

MR. STETTIN: Oh, surely. If it were in a Chapter 11 -- that is, before confirmation, Justice Kennedy -- there's no question that the trustee in the Chapter 11 or the debtor in possession in the Chapter 11 would have to file tax returns, but this is postconfirmation.

QUESTION: But -- no, I want a definition of an assignee. You wouldn't call a debtor in possession an assignee.

MR. STETTIN: He is an assignee technically, because by operation of law all of the property of the prepetition debtor is transferred to him.

QUESTION: I see. So that's the operative phrase.

MR. STETTIN: That's certainly one instance of

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an assignee, but I would agree with you, why would you have to use separate words for it if you intended it that way?

QUESTION: Mr. Stettin, why didn't the bank's plan provide something about the payment of taxes?

MR. STETTIN: I believe it was because it was intended that the plan would be consummated substantially within a very short period of time. The excess property not needed to pay the debts of the debtors would be returned to the debtors who would remain in control of their own fate and pay their own taxes.

QUESTION: The other plan submitted did cover taxes.

MR. STETTIN: No. The debtor's plan -- there were two competing plans here. The bank's plan was the one that was confirmed. It was voted on by an overwhelming majority of the creditors in favor.

The debtor's plan mentioned that on a liquidation analysis attached to the disclosure statement that there were some tax consequences. The debtor's plan also indicated, by the way, that there would be a sale of the Miami Center to a different buyer for a different price.

QUESTION: But normally these plans do make some reference to the payment of taxes, do they not?

MR. STETTIN: They should. In fact, there are a line of cases cited in our brief that say that if an objection is made on the ground that no tax effect is discussed in the disclosure statement, the court should not permit the disclosure statement to go out and certainly should not confirm a plan, because you don't know if you can actually consummate it. You don't know if you'll have enough money -- the key to the consummation of any plan.

I was thinking --

QUESTION: Before you go on, have you finished your discussion of assignee? You criticized the Government for using a dictionary definition.

MR. STETTIN: No, I have not. I have not.

QUESTION: I'm partial to dictionaries myself.. Why isn't the dictionary definition appropriate here?

MR. STETTIN: Because it would cover people clearly not intended to be covered as assignees. If, for example, a corporation were to have bought property of a debtor outside a bankruptcy setting and paid fair market value, full cash consideration, the purchaser is an assignee by definition because they are transferred the property of the debtor, but clearly they're not liable to file a tax return for the debtor they just paid and pay the tax of the debtor they just paid. There isn't any

reason to do that.

The only time it ever arises is when you've got an insolvent debtor and you've got these unique circumstances where there is some doubt that the Government will be able to get its tax money. That's when the priorities take effect.

I do agree with the Government that there is an attempt to create a pattern of preference to the Government. Outside of bankruptcy, before bankruptcy ever occurs, 3713 flat out says that if you've got the following conditions, if a debtor owes the Government money and the debtor is insolvent and he makes a voluntary assignment of his property -- the Government's argument, by the way, is that this was involuntary -- but if he makes a voluntary assignment of his property, then the Government gets paid first, and if they don't, the person who makes that transfer is personally liable.

The statute has to have the last part of it read. It says, in sub (2), this subsection does not apply to a case under title 11, and the logic is obvious. As long as you're not in bankruptcy you can establish a priority of payment rights to the Government for their taxes. Once you go into bankruptcy you've got to try and read the bankruptcy code together with the Internal Revenue Code. You've got to try and make sense out of

both of them, it seems to me, rather than say that one trumps the other, to use the phrase.

QUESTION: Well, if 3713 does not apply, what does apply?

MR. STETTIN: The bankruptcy code itself provides the preference to the Government in the payment of taxes due, and it clearly says that, and Mr. Jones cited you the statute -- 503, I believe it is. In addition --

QUESTION: Isn't that 507?

MR. STETTIN: I believe it's 507. I think you're right, sir.

QUESTION: Wasn't a similar argument to that rejected in the Key case, a similar argument to the one you're making now?

MR. STETTIN: I'm sorry, I don't understand. The argument --

QUESTION: Well, that the bankruptcy code supplied the tax consequences rather than what was then section 3466 at the time of the Key case.

MR. STETTIN: I must confess to you that I'm not familiar enough with the facts in Key to be able to respond accurately.

I would suggest to you that 3713 is simply entirely inapplicable to this case. By its own terms, it

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says it doesn't apply in a Chapter 11 case, in a case under title 11 at all. If it is a bankruptcy situation, the Government is given the priorities accorded it. It is also given the opportunity to protect itself.

The Government in this case simply chose not to. It chose to wait, and its argument today is, when everyone else has relied on what had happened, it is entitled at this late stage to come in and say 37 -- pardon me -- 6012(b)(3) simply says, regardless of whatever else happened, if we can make it applicable to you we're going to ask you to unravel this substantially consummated plan.

Now, I am very sensitive to the argument that if they're entitled to the money under any circumstances they ought to be entitled to get it regardless of when they ask for it, because there is no statute of limitations --

QUESTION: Excuse me. You say the Government had notice of the plan here and could have objected, blah, blah, blah. That happened to be because the Government was a creditor.

MR. STETTIN: And because rule 2002(j) requires that notice be given to the Internal Revenue Service.

QUESTION: Okay. So even if they hadn't been a creditor, the same thing --

MR. STETTIN: But they were in this case, as you point out.

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QUESTION: Yes, all right, and they would have gotten the same notice of the proposed plan.

MR. STETTIN: Yes, absolutely, without any qualification. The Government, in fact, in a footnote in their brief do concede that they simply filed nothing at all -- no objections to disclosure, or the plan, or appeals, or anything to protect their interest in this case.

Much was made of the fact that we have tried to distinguish under 6012 that we are in fact not within the definition of a trustee in a case under title 11 of the United States Code, that middle section that the Government says makes us responsible. In fact, what it is is exactly as Mr. Jones said. It was a technical amendment.

Prior to the enactment of the bankruptcy code in 1979, section 6012 used the phrase, trustee in bankruptcy, which had a very defined meaning under the Bankruptcy Act and still does under the bankruptcy code. It is a trustee appointed prior to confirmation to administer the estate. In fact, when 6012 was amended it was in fact to bring the language into line with the language used in the bankruptcy code, and it means today exactly what it meant then -- a trustee in bankruptcy.

QUESTION: What is your definition of assignee?

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MR. STETTIN: An assignee is someone who is in control of the debtor, who has hands-on ability to determine what its obligations and rights are and to control it. It is, in fact, something other than, as the courts below used in this case, a disbursing agent or a distributing agent. Please remember, the only thing that the liquidating trustee did in this case was to sell the property, take the money, and pay the creditors that were ordered to be paid by the court. He has always followed out the terms of the plan which say you will pay these people.

QUESTION: But may I ask, you say he must be -- have, in effect, management control of the property, but the statute doesn't say that. It says he must have possession or hold title to all or substantially all of the property or business of the corporation, and he does meet that standard, doesn't he?

MR. STETTIN: Justice Stevens, you are correct. In fact --

QUESTION: And where do we find the legal basis for your suggestion that a different standard should apply to assignees?

MR. STETTIN: In the line of cases that have in fact applied 6012(b). There are at least 30 or 40 cases which have in fact interpreted it.

QUESTION: And held that assignees were liable. How many of those held the assignee was not an assignee within the meaning of this provision?

MR. STETTIN: On a scale basis I can't tell you how many did and did not. I can tell you that of the ones that did, every one of those were an instance where the assignee was in control of the debtor more than simply having possession for the limited purpose of conveying it to a third person.

QUESTION: Well, that may be well be, but that doesn't necessarily mean that something beyond the statutory standard is required in order to qualify as an assignee, because it also doesn't say order of court. It's or otherwise. It's very broad language in the statute.

MR. STETTIN: It is, and if they had in fact intended that it cover every single instance -- and there are cases that say it does not. Sonner, as an example, says that it does not cover a grantor trust.

QUESTION: Oh, I understand your grantor trust, but this is a case where the bankruptcy proceeding is still alive. I guess you filed this complaint in the bankruptcy court, didn't you?

MR. STETTIN: The case is still open. It has not been closed.

QUESTION: Yes. I mean, and that's where this proceeding initiated.

MR. STETTIN: Yes, sir. If your question is, do I know of any instance where the limitations that you indicate in the language have been applied, the cases that I'm aware of are cited in the brief, by the way, all talk in terms of, if you are the equivalent of a disbursing agent. In re Alan Wood comes to mind, and it's cited in the brief. That was a Bankruptcy Act case. They said that it doesn't apply to a mere disbursing agent. That's the reason for the language in the appeals below, which said that we are the equivalent of because we have no discretion. That's really the difference.

QUESTION: Well, yes, but you needed lawyers and tax advisors and accountants, and you were going to spend a lot of money for your professional assistance, your trustee was. This is not a mere disbursing agent in the normal use of that term.

MR. STETTIN: No. A disbursing agent defined under the Bankruptcy Act in fact was someone who was supposed to receive a fund of money only, not sell property, and then pay it out in accordance with, at that time, a confirmed plan. I agree, but in fact the courts below --

QUESTION: What kind of compensation did this

trustee get?

MR. STETTIN: He has received a total in compensation of, I believe -- I could be off by a little bit -- of about $140,000 for services since October of 1985.

QUESTION: Not exactly a bargain assignment, I guess.

MR. STETTIN: He probably regrets having been lured into this, but that's another question for another day.

I've lost my train of thought, I'm sorry.

I was trying to think of another instance in which a liquidating trustee with duties similar to our trustee would not have the responsibilities of a typical assignee, and I can think of one other, and that's a Commissioner of Deeds. That's someone who was appointed to carry out the order of a court to convey property where there's some doubt or unwillingness on the part of the record titleholder to carry out those responsibilities.

This trustee, even though the plan clearly gave him the authority to operate this business, never operated it. He sold it the day the plan became effective. That fact, it seemed to me, is proof positive for the decisions made by the bankruptcy court, the district court, and the Eleventh Circuit, all of whom found on facts that his

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discretion was minimal, that he was charged only with these limited duties, and that he in fact was --

QUESTION: Why don't we look to the terms of the plan to see what his duties are?

MR. STETTIN: You can, except --

QUESTION: Why don't we look to just see what duties he performed as opposed to the capacity in which he was appointed?

MR. STETTIN: The answer I give you is because otherwise every single case would be fact-driven. In fact, in this case --

QUESTION: I think just the opposite. You're the one that's saying we should look at what he did, rather than what the document says, and it seems to me that when we look at the nature of a trustee, we look to the instrument which creates his fiduciary responsibilities.

MR. STETTIN: I agree with you that the plan circumscribes what his responsibilities are. Clearly, I cannot avoid that. What I can say is, if he was charged with the responsibility of filing tax returns, as the Government argues, if he is charged with the responsibility of filing the tax return for consolidated debtors, as they say in this case he was -- may I finish my response to your question?

QUESTION: Yes, but please wind it up.

MR. STETTIN: I will do it quickly.

Then he would have had to obtain information from a number of nonfiled debtors in order to file that consolidated return, and obtain information from a debtor which our brief has indicated stoutly resisted every effort he ever made to get fully information. He would not know what to put in the return.

QUESTION: Thank you, Mr. Stettin.

MR. STETTIN: Thank you, sir.

QUESTION: Mr. Jones, you have 9 minutes remaining.

REBUTTAL ARGUMENT OF KENT L. JONES

ON BEHALF OF THE PETITIONERS

MR. JONES: In the trustee's argument, what was omitted was the objective of Congress in enacting these statutes, which was to ensure that insolvents' income doesn't escape taxation. The regulations that have been in existence for decades quite clearly encompass this trustee. Congress did not reject those regulations in 1980 when it inserted the words, trustee in a case under title 11, into the statute. The legislative history --

QUESTION: Well, but Congress can never make you collect taxes you don't show up to collect. I think the trustee did say that on his view of this scheme if the

Government had behaved as it ought to have when it got notice of the plan, the taxes would have been collected. I mean, to say that no matter what happens the taxes have to be collected, I mean, that's just not true. No matter what kind of a scheme Congress sets up, you can destroy it by not doing what you're supposed to.

MR. JONES: Well, there's been no suggestion by any court that the Government is estopped or barred by any bankruptcy code provision. All of the arguments that you've heard from the trustee on that point are just sort of equitable arguments about gee, if the Government had been diligent, maybe they could have protected themselves.

QUESTION: No, I'm not making an estoppel argument, but I'm saying the system makes sense. It does not leave a big hole in which the Government will not collect its taxes. It makes sense on the assumption that the Government had done what it was supposed to do.

MR. JONES: There was nothing that the Government should have done that it needed to do that wasn't performed in this case. The plan has a direct basis for the payment of taxes. If the trustee had been diligent, he would have paid them.

The plan provides in articles 5 and 6 that the obligations of the trustee are an administrative expense of the estate. One of the obligations of the trustee

under 6012(b) is to report and pay taxes. If he had performed that obligation it would have been a charge, an administrative expense, first priority under this bankruptcy plan, and the United States would have been paid first if he had done that.

Instead, he went and got an indemnification from the other creditors who said, give me the money now. If the Government wins this tax issue later on, I'll indemnify you.

Now, the other --

QUESTION: The obligation to pay the taxes you're describing is a statutory obligation, not one created by the plan.

MR. JONES: It is a statutory obligation. It is nonetheless an obligation of the trustee, which is what the plan talks about.

QUESTION: What paragraph of the trust gives this obligation -- places obligation on the trustee?

MR. JONES: I believe it's on page 44 of the joint appendix. Paragraph 6, all costs, expenses, and obligations incurred by the trustee in administering the trust shall be a charge against the trust property. One of the --

QUESTION: You say this particular tax obligation is something that was incurred by the trustee

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in administering the trust.

MR. JONES: Absolutely. It was incurred because their gain was recognized during the administration of the trust postconfirmation. It is an administrative expense under the code, 503(b)(1)(b) of the bankruptcy code. It is an administrative expense under this plan because it is an obligation of the trustee, and if you will note, on page, I believe 46 of the Joint Appendix, Class 1 claims, which is the kind of claim this administrative expense is, incurred subsequent to -- it says consummation but it should say confirmation date, shall be paid as soon as practicable.

What he should have done with respect to this claim, once --

QUESTION: But Class 1 claims are defined as those which have been approved by the bankruptcy court.

MR. JONES: No, sir. A Class 1 claim is an administrative claim that is an obligation of the trustee. Now, he has --

QUESTION: Administrative claims as the same are allowed and ordered by the court, is what it says on page 38, and this one was not allowed or ordered by the court.

MR. JONES: It hasn't been allowed or ordered because he hasn't submitted it.

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QUESTION: Well, I know, but it still doesn't fit within the plain language of the plan, is what I'm suggesting.

MR. JONES: Well, all I was suggesting was if he had implemented the plan as he should have, he would have submitted this for the court for approval, it would have been approved, it would have been a Class 1 claim under the plan, and it would have been paid.

QUESTION: Mr. Jones, now the liquidating trust is not a separate taxable entity, I gather.

MR. JONES: For the individual estate, it certainly is. It is a separate taxable entity from the day that the individual goes into bankruptcy. The only concession that we ever made about separate taxable entities is what the statute says. 1399 of the Internal Revenue Code says that when a corporation goes in its estate is not a separate entity, separate from the corporation.

All of this discussion about -- that somehow we've conceded that we can't tax the trust is utterly off the point. The trust is taxable as a separate entity for the individual, and it is taxable because it holds the corporation's assets for the corporation.

I want to just refer once again to this idea that somehow the Government's estopped on a diligence

theory. Nothing in the disclosure statement indicated there would be a penny's worth of gain from this real estate transaction.

Unless the United States has to assume that every piece of real estate that is sold is going to create a large taxable gain and that the trustee is not going to properly implement the plan that requires him to pay his obligations and to hold them as Class 1, why would the United States have done anything? There would have been no reason to.

It was the trustee that should have done something if he felt there was a taxable gain, and the only thing he did when he decided there was a taxable gain was to get an indemnity instead of paying the taxes.

QUESTION: Mr. Jones, would you tell me what you respond to the argument made by your colleague to the effect that you can't take the dictionary definition of assignee in 6012(b)(3) because if you do any purchaser of the assets will be an assignee?

MR. JONES: Well, we would rely on the regulatory definition, which we do think focuses on what the statute is intended to guard against, and that is that an assignee who obtains possession of the assets of the debtor for the purpose of paying the debtor's debts, we think that's the kind of assignee that the statute

reaches. That's what the regulations say.

QUESTION: So you also don't argue for the dictionary definition.

MR. JONES: Well, I think that -- only for the part of it that involves an assignment, and there was an assignment here to the trustee. Under the plan, the assets of the estate were assigned directly to the trustee and he was empowered to manage them in any manner that any owner would be empowered to.

The trustee did have a broad discretion. The only case that he cites for his grantor trust argument is this In re Sonner case. Sonner is an unusual case, because it involved a fiduciary of an individual's estate, and the bankruptcy court simply missed 6012(b)(4). The court said that there was no -- that 6012(b)(3) didn't reach the trustee because that involves corporations, and the court never even considered the fact that (b)(4) applies to fiduciaries such as trustees in a bankruptcy.

Also, In re Sonner, we submit, is simply wrong because every bankruptcy estate would then be a grantor trust. The trustee would never have to file tax returns under 60(b)(12) -- I'm sorry, 6012(b) as a trustee in bankruptcy if a bankruptcy is a grantor trust. Congress didn't think so, and neither did the Second Circuit in the DePinto case.

Thank you, Your Honor.

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

(Whereupon, at 12:01 p.m., the case in the above-entitled matter was submitted.)

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NO. 90-1361 - HOLYWELL CORPORATION, et al., Petitoners V. FRED STANTON SMITH, ETC., et al., and

NO. 90-1484 - UNITED STATES, Petitioner V. FRED STANTON SMITH, et al.

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