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PROCEEDINGS BEFORE

**THE SUPREME COURT
OF THE
UNITED STATES**

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WASHINGTON, D.C. 20543

CAPTION: SHELDON B. BUFFERD, Petitioner v.

COMMISSIONER OF INTERNAL REVENUE

CASE NO: 91-7804

PLACE: Washington, D.C.

DATE: Monday, November 30, 1992

PAGES: 1- 39

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 SHELDON B. BUFFERD, :

4 Petitioner :

5 v. : No. 91-7804

6 COMMISSIONER OF INTERNAL :

7 REVENUE :

8 - - - - - X

9 Washington, D.C.

10 Monday, November 30, 1992

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States at
13 11:46 a.m.

14 APPEARANCES:

15 STUART JAY FILLER, ESQ., Bridgeport, Connecticut; on
16 behalf of the Petitioner.

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

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

2 (11:46 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument
4 next in number 91-7804, Sheldon Bufferd v. the
5 Commissioner of Internal Revenue.

6 Mr. Filler, you may proceed whenever you're
7 ready.

8 ORAL ARGUMENT OF STUART JAY FILLER

9 ON BEHALF OF THE PETITIONER

10 MR. FILLER: Mr. Chief Justice, and may it
11 please the Court:

12 This is a statute of limitations case.
13 Petitioner recognizes that this Court in the Badaracco
14 case decided that a statute of limitations should be
15 strictly construed in favor of the Government. In this
16 case, however, this Court must add phrases to an otherwise
17 clear and unambiguous set of statutory provisions in order
18 to affirm the opinion of the Second Circuit below.
19 Petitioner believes that this Court did not intend in
20 their prescription in Badaracco to mean that every time
21 there is a statute of limitation issue, the Government
22 wins.

23 The question presented is whether the three
24 sections of the Internal Revenue Code provide a statute of
25 limitations which bars adjustments to a shareholder's

1 income tax return with respect to items appearing on an S
2 corporation's income tax return. The three provisions are
3 section 6501(a), section 6037, and section 6012 of the
4 Internal Revenue Code of 1954, as amended and in effect
5 for 1979, the taxable year at issue in this case. All
6 three provisions are on page 1 and 2 of petitioner's brief
7 on the merits, if the Court wishes to refer to them.

8 It is important to note that Congress in 1958
9 created an entirely new entity for Federal tax purposes.
10 This entity was separate and distinct from its
11 shareholders. The IRS, not Congress, created a form 1120S
12 which is separate and distinct from the form 1040 filed by
13 the shareholders. Congress -- the IRS, not Congress, also
14 created a form K-1 and required the corporation to provide
15 the shareholders annually with a form K-1 which reported
16 the bottom line results of the S corporation for the
17 taxable year, and the shareholder was required to attach
18 this form K-1 to the shareholder's form 1040 and report on
19 the shareholder's return the bottom line results of the S
20 corporation for the taxable year.

21 While examining the shareholder's return, an IRS
22 employee must retrieve the form 1120S, must examine the
23 form 1120S, and must adjust the form 1120S. Pursuant to
24 section 6501(a) of the code, these adjustments must be
25 made within the 3-year period of limitations.

1 Only then can the IRS adjust the return of the
2 shareholder with respect to the items appearing on the S
3 corporation return. If additional time is required for an
4 adjustment to be made, the IRS employee may obtain an
5 extension of the period of limitations for either the S
6 corporation return, the shareholder's return, or both
7 returns. In fact, that is exactly what the Internal
8 Revenue Service did in the case at bar in 1980, the
9 taxable year following the year in dispute in this case,
10 and the 1980 taxable year is not before this Court.

11 QUESTION: Mr. Filler, can I ask you a question?
12 What if this were a subchapter C corporation? What is the
13 normal treatment of -- I report something on my personal
14 income tax return which turns out to be wrong because the
15 subchapter C corporation gave me information, which it
16 also reported on its return, that turns out to be wrong?

17 MR. FILLER: Okay.

18 QUESTION: Now, what if it's more than 3 years
19 ago that the subchapter C corporation did that?

20 MR. FILLER: I think the Government would not
21 dispute, frankly, Your Honor, that if this were a C
22 corporation and an adjustment of the C corporation were
23 necessary in order to adjust a shareholder's return -- and
24 I provided such an example in my brief with respect to a
25 dividend, okay? If it was necessary to adjust a C

1 corporation's return, that they would not and could not
2 adjust a C corporation's shareholder's return with respect
3 to the item after the C corporation's period of
4 limitations has expired.

5 QUESTION: Well, you cited --

6 QUESTION: Why is that?

7 MR. FILLER: Why is that? Because section
8 6012(a)(2) of the code provides that a C corporation, or a
9 corporation subject to taxation -- and by the way,
10 provided that much prior to 1958, when the S corporation
11 was created and carved out --

12 QUESTION: Okay, now, but you're trying to
13 answer my question, I take it.

14 MR. FILLER: Yes, I am.

15 QUESTION: Why don't you continue --

16 MR. FILLER: And section 6501(a) of the code
17 provides that a 3-year period of limitations from that
18 return -- from the filing of that return is applicable to
19 the C corporation's return.

20 QUESTION: Well, but why should the running of
21 the statute of limitations on the C corporation's return
22 prevent an adjustment in the taxpayer's return when the
23 taxpayer -- when an extension was obtained with respect to
24 him? Why is the Government bound with respect to the
25 individual taxpayer about some item on the C corporation's

1 return?

2 MR. FILLER: Congress created two separate and
3 distinct entities. In the case of a C corporation, when
4 originally created, it was what we call a separate and
5 distinct taxable entity. It reports its items of income
6 and deductions and pays a tax at the C corporation level.

7 Distributions to the shareholders are only taxed
8 to the shareholders if they can be treated as a dividend
9 within the meaning of the Internal Revenue Code.

10 Adjustments at the C corporation level must be
11 made within the C corporation's separate entity return
12 within the period of limitations or section 6012(a) has no
13 meaning.

14 QUESTION: You've made that statement, but I
15 simply don't -- I must say I don't follow your reasoning.
16 I don't understand from what you've said what statutory
17 provision or what case it is that you rely on to say that
18 the Government is bound in adjusting an individual
19 taxpayer's return, which it has extended the time for, by
20 the figures in a C return, which it has not extended the
21 time for.

22 MR. FILLER: I'm sorry I haven't made it clear,
23 Your Honor, but let me try one more time, Mr. Chief
24 Justice.

25 QUESTION: Well, maybe you've made it as clear

1 as it can be.

2 MR. FILLER: Section 6012(a)(2) of the code
3 requires a corporation subject to taxation to file a
4 return.

5 QUESTION: I know that.

6 MR. FILLER: Okay. And section 6501(a) says,
7 okay, that the period of limitations with respect to that
8 return is 3 years from the date of filing that return,
9 that adjustments to assess a tax within that period,
10 whether the tax is on the C corporation or the C
11 corporation's shareholders, must be made within the 3-year
12 period applicable to the C corporation return. And
13 frankly, Your Honor --

14 QUESTION: 6501(a)(2) says -- 610 --

15 MR. FILLER: 6501(a).

16 QUESTION: 6501 says all of what you have just
17 said?

18 MR. FILLER: I believe it does, sir, and I
19 believe it says it clearly.

20 QUESTION: I had the same problem as the Chief
21 Justice did. In your brief at page 12, you give this
22 example, but you cite --

23 MR. FILLER: The petitioner's brief on page 12?

24 QUESTION: Yes.

25 MR. FILLER: With the C corporation.

1 QUESTION: Yes, but you cite absolutely no
2 authority, no text, no statute, no regulations, no case.
3 It's just an assertion.

4 Now, the Government doesn't frontally deny what
5 you say. It may do so at oral argument, but it just seems
6 to me that's the whole issue in the case.

7 Suppose that a corporation makes a distribution.
8 It treats it as not out of earnings and profits. The
9 corporation's tax year closes, and it's then found that
10 there was -- it is very clear that this was a distribution
11 made out of earnings and profits. It is not clear to me
12 why the shareholder can't be charged with a dividend.

13 MR. FILLER: I think I know the answer, Your
14 Honor. In fact, in order to have a case for me to cite,
15 the Government would have had to attempted at least to
16 assess such a tax against the shareholder after the C
17 corporation's return was filed. In all my research, Your
18 Honor, I was unable to determine -- or find such a case,
19 and I provided that example --

20 QUESTION: But that indicates that that's the
21 very question before us to be decided. You state as a
22 premise what is really the question in this case.

23 MR. FILLER: Well, I think, Your Honor, that
24 there is authority in the terms of corporate tax textbooks
25 and other materials which are in use as acceptor of other

1 authorities that have always I think interpreted the C
2 corporation's period of limitations under 6501(a) to be
3 the filing of the return, the date of the filing of the
4 return under 6501(a), and that in order to adjust the C
5 corporation's return with respect to tax imposed either on
6 the C corporation -- it's a separate taxable entity -- or
7 the shareholder, it must be done within the period of
8 limitations of the C corporation --

9 QUESTION: Mr. Filler --

10 MR. FILLER: -- which is 3 years from date of
11 filing. Sorry.

12 QUESTION: 6501(a) to me does not say what you
13 said it said. It does not say that the Government is
14 bound not to examine into the taxpayer's return on matters
15 that are covered in the C return just because the C return
16 period is expired.

17 MR. FILLER: Well, it says except as otherwise
18 provided in this section. I'll go to reading it just for
19 a moment. The amount of any tax imposed by this title
20 shall be assessed within 3 years --

21 QUESTION: Okay, now, stop there.

22 MR. FILLER: Okay.

23 QUESTION: Is that the critical language? Is
24 that the critical --

25 MR. FILLER: The critical language is 3 years

1 after the return was filed. What the Government wishes --

2 QUESTION: Is that the critical language right
3 there?

4 MR. FILLER: Yes.

5 QUESTION: They are assessing this under an
6 extension of the 3-year period on the individual.

7 MR. FILLER: Yes, Your Honor, but they are two
8 separate and distinct entities, and I don't think you can
9 fail to recognize that. They are two separate and
10 distinct taxable entities in the case of a C corporation.

11 QUESTION: I know, but you are simply stating,
12 so far as I know, without pointing to any statutory
13 authority that the Government cannot reexamine anything
14 that comes out of a C return on an individual's return if
15 the time for examining the C return hasn't been extended.

16 Now, I simply don't see in your reference to
17 6501(a) anything that deals with that. Maybe you derived
18 some implication from it, but it certainly isn't express.

19 MR. FILLER: Well, I can only say, Your Honor,
20 that in thorough research, that there is nothing from
21 anyone or any source or any material written to believe
22 that Congress was not clear. I mean, of course, 6501(a)
23 and C corporations were created back at the -- almost at
24 the beginning of the history of the income tax, back in
25 the late teens -- 1914, 1915 was the whole concept

1 developed -- that this C corporation was a separate
2 taxable entity.

3 The S corporation that we are confronted with
4 today is an entity created only in 1958 where, in effect,
5 you might say part of the heart of the C corporation was
6 pulled out and part of the provisions of the -- for the S
7 corporation were enacted, okay, to change the implications
8 in some ways for a C corporation. But many of the
9 similarities of C corporate tax treatment are the same for
10 S corporations as they are for C corporations.

11 QUESTION: We'll resume there at 1:00.

12 (Whereupon, at 12:00 p.m., oral argument in the
13 above-entitled matter was recessed, to reconvene at 1:00
14 p.m. this same day.)
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1 AFTERNOON SESSION

2 (1:01 p.m.)

3 CHIEF JUSTICE REHNQUIST: Mr. Filler, you may
4 continue.

5 MR. FILLER: Mr. Chief Justice, and may it
6 please the Court:

7 Prior to the lunch break, we were discussing the
8 critical language of section 6501(a) which provides that
9 the period of limitation for assessment is 3 years from
10 the date the return -- the return -- was filed. The real
11 issue then before the Court is identifying what Congress
12 meant by the term, the return, in section 6501(a).

13 Petitioner's position is that the return can
14 only be identified in the case of an S corporation with
15 reference to the second sentence of section 6037 of the
16 code which provides that any return filed pursuant to this
17 section, which must mean every return filed pursuant to
18 this section, shall, for purposes of chapter 66 relating
19 to limitations, be treated as a return filed by the
20 corporation under section 6012.

21 There is nothing in the language of section
22 6501(a) that refers to the shareholder's income tax return
23 as the relevant return for purposes of beginning the
24 running of the period of limitations. Only by adding the
25 phrase -- only by adding the phrase -- against whom the

1 tax is imposed to the language of section 6501(a) may this
2 Court reach the conclusion of the Second Circuit and
3 affirm the opinion of the Second Circuit that it's the
4 shareholder's return that's referred to in section
5 6501(a).

6 They would have to add the phrase so that
7 section 6501(a) read as follows: the amount of any tax
8 imposed by this title shall be assessed within 3 years
9 after the return against whom the tax is imposed was
10 filed. That language is not present in section 6501(a).

11 QUESTION: It seems to me it's quite natural to
12 read it in by implication, though.

13 MR. FILLER: I think, Your Honor, that that
14 ignores the fact that there are two separate and distinct
15 taxable entities. Under section 65 -- 6012, rather,
16 (a)(1) of the code, the shareholder is a separate taxable
17 entity and must file a return that has the period of
18 limitations under 6501(a). Section 6012(a)(2) creates a
19 separate return for a separate taxable entity, the
20 corporation, the C corporation, which must also file a
21 return, or by reference to the second sentence of section
22 6012, the S corporation return is treated as a corporate
23 return under section 6012 for purposes of the period of
24 limitation.

25 QUESTION: Can you help me out on one thing?

1 Why is the taxpayer's return treated as a return filed,
2 quote, pursuant to this section under 6037?

3 MR. FILLER: I'm sorry now. No. It's the
4 corporate return, the S corporation return, that's treated
5 as a return.

6 QUESTION: That's what I thought.

7 MR. FILLER: That's what I said.

8 QUESTION: So, it's only the S corporation's
9 return that is referred to in the second sentence, isn't
10 it?

11 MR. FILLER: That's correct. It is the S
12 corporation's return that is treated as a corporate return
13 filed pursuant to section 6012 that is the return in the
14 language of 6501(a) that begins the running of the period
15 of limitations from the date that return, that S
16 corporation return, was filed.

17 Yes, Justice.

18 QUESTION: Mr. Filler, you say that you don't
19 want to add in that phrase in 6501(a), but it seems to me
20 it's necessary to read in some phrase, because it says
21 within 3 years after the return was filed. The return.
22 What -- I mean, the question comes immediately to mind,
23 what return? It doesn't -- it does not say within 3 years
24 after all relevant returns were filed, but after the
25 return was filed. Right?

1 MR. FILLER: Nor does it say, as the Second
2 Circuit held, Your Honor, that the relevant return is the
3 return against whom the tax is imposed. But reading the
4 language in the way the Court has implied and the Second
5 Circuit held would require the Commissioner to make an
6 annual examination of all the financial transactions on a
7 return that's filed, and if the Commissioner could adjust
8 the returns such that a tax could be imposed against that
9 return, then the Second Circuit and respondent argue that
10 that return has a period of limitations. If there is no
11 tax that could be imposed against the S corporation
12 return, the Second Circuit held and the respondent would
13 argue that there is no period of limitations.

14 There's nothing in the language of section 6037,
15 6012, or 6501(a) that indicates that Congress intended,
16 okay, that this one return have two separate and distinct
17 period of limitations: one when a tax was assessed --

18 QUESTION: Well, but I --

19 MR. FILLER: -- and one when the tax was not
20 assessed --

21 QUESTION: Can I interrupt you? May I interrupt
22 you, Mr. Filler?

23 I don't really follow your argument. There's
24 nothing that says about two different periods of
25 limitations, but it's one or the other each time. In the

1 S corporation, there's no tax assessed against it, at
2 least during the time involved here. So, you don't need a
3 period of limitations.

4 MR. FILLER: Well, then if -- reading it that
5 way, Your Honor, you've ignored the -- or read out of the
6 code, in effect, repealed effectively, I think the second
7 sentence of section 6037 which says, any return filed
8 pursuant to this section, which means every S corporation
9 return, whether it's subject to tax or whether it's not
10 subject --

11 QUESTION: That's any return filed pursuant to
12 6037. Right?

13 MR. FILLER: Which, if you read the first
14 sentence of -- is the return required to be filed annually
15 by every S corporation.

16 QUESTION: All right.

17 MR. FILLER: Okay. So, the first sentence says
18 they must file a return, and then Congress added a second
19 sentence that says any return filed pursuant to this
20 section, okay, has a period of limitations for purposes of
21 section 6501(a) as a corporation.

22 QUESTION: Where do you get --

23 MR. FILLER: The return is treated as a
24 corporate return.

25 QUESTION: Where do you get the cross reference

1 to 6501(a)?

2 MR. FILLER: Because section 6501(a) provides
3 the period of limitations for all returns required to be
4 filed whether -- and all returns that --

5 QUESTION: Just let me go one step at a --

6 MR. FILLER: -- are required to be filed are
7 under section --

8 QUESTION: May I go one step at a time with you?

9 MR. FILLER: I apologize, Your Honor.

10 QUESTION: Where do you get the reference to
11 6501(a) out of 6037?

12 MR. FILLER: Because section 6037 says it shall
13 be a corporate return -- it shall be treated as a
14 corporate return under section 6012, and when you go to
15 section 6012, and you have a corporate return filed, the
16 period of limitations for the filing of that return and
17 all returns filed under 6012 is section 6501(a). So,
18 section 6037 puts us in 6012, which puts us in 6501
19 because there's no other way to create a period of
20 limitations for that --

21 QUESTION: You mean it's implicit, it's not
22 explicit.

23 MR. FILLER: It has to be implicit, Your Honor,
24 because there's no way to ever create a limitation period
25 for that return even if it was capable of a tax being

1 assessed. If you don't get to 6012, okay, from --

2 QUESTION: What purpose does the limitations
3 period serve with respect to a return for which no tax is
4 -- pursuant to which no tax is paid?

5 MR. FILLER: The purpose of the period of
6 limitations, as is true of all periods of limitations, is
7 to create a deadline, a deadline upon which the two
8 parties to, in this case, a tax transaction, but any
9 period of limitations -- in which each party must act in
10 order to bring finality to the process, in this case the
11 tax return or the taxable year in question in a case.

12 And the subchapter S corporation is a separate
13 entity, distinct from its shareholders, okay, and has a
14 period of -- Congress provided a period of limitations.
15 The Second Circuit errs by attempting to analogize the
16 return of an S corporation to that of a partnership rather
17 than a C corporation. Section 6031 of the code provides
18 that a partnership must file an annual return similar to
19 that filed under the first sentence of section 6037 for an
20 S corporation.

21 However, Congress did not add a second sentence
22 to section 6031 that it did to section 6037, and Congress
23 specifically provided in that second sentence that every
24 return filed by a subchapter S corporation has a period of
25 limitations. We cannot ignore the clear and unambiguous

1 language of that section.

2 QUESTION: But that language, Mr. Filler, no one
3 is trying to impose a tax on the subchapter corporation
4 here.

5 MR. FILLER: I understand that no one is trying
6 to impose a tax, but they must make -- let me see if I can
7 state it this way. In order to impose the tax on the
8 shareholder, they must first make adjustments to the S
9 corporation return. Only by determining --

10 QUESTION: Why --

11 MR. FILLER: -- that an error was made on the S
12 corporation return and adjusting that and therefore
13 reaching a different bottom line result for the operations
14 of the S corporation as reported on its form may they then
15 adjust the shareholder's return.

16 QUESTION: Now, just stop a minute, Mr. Filler,
17 and let me ask. It seems to me you're making another
18 assumption here that I don't know of any authority
19 for -- maybe you know of some -- that in order to assess
20 the taxpayer, they have to make adjustments on the
21 subchapter S return even though they're not trying to
22 impose any tax on the subchapter S corporation. Why do
23 they have to do anything with the subchapter S return?

24 MR. FILLER: Well, when Congress created, Your
25 Honor, the second sentence of section 6037 in 1958, there

1 was no income tax imposed on an S corporation, no tax at
2 all. And yet, they added the second sentence of section
3 6037, which says that a return filed pursuant to that
4 section, which can only -- cannot include, rather, a
5 return upon which a tax was assessed. In 1958 when
6 they -- and your interpretation or your attempted
7 interpretation of that sentence effectively repeals the
8 sentence from 1958 until 1966 when for the first time
9 Congress added a tax directly on an S corporation.

10 If there are no further questions, I wish to
11 reserve --

12 QUESTION: I have just one question.

13 MR. FILLER: Yes, sir, Justice Kennedy.

14 QUESTION: Assume that X owes Y on a promissory
15 note.

16 MR. FILLER: Okay.

17 QUESTION: And X pays \$1,000. Let's say it's a
18 \$100,000 promissory note. And Y, the recipient, says this
19 is principal, I'm not going to report any interest, and
20 Y's tax year has closed. X leaves his year open. Can the
21 Government go back and say that this is not interest, that
22 it's just principal?

23 MR. FILLER: I'm sorry, Your Honor. In
24 following that -- was X a corporation?

25 QUESTION: No.

1 MR. FILLER: I'm sorry.

2 QUESTION: Just two individuals.

3 MR. FILLER: Oh, two individuals.

4 QUESTION: Yes.

5 MR. FILLER: One -- X loans Y money and Y pays
6 -- and X pays Y interest?

7 QUESTION: There's nothing that says they have
8 to be treated consistently, is there?

9 MR. FILLER: Is there anything that says that
10 the debtor and the creditor in a case must be treated
11 consistently?

12 QUESTION: Right, assuming one year -- one
13 person's year is closed so the IRS can't do anything about
14 it.

15 MR. FILLER: The -- yes, I believe that that is
16 correct, that should the payee, shall we say, of the
17 interest not have reported it, but the payor deducted it,
18 okay, and the period of limitations lapsed on the payee,
19 the IRS could not come in and add that to the payee's
20 income. If that's your question.

21 QUESTION: Yes.

22 MR. FILLER: I'm sorry. I hope I answered it.

23 QUESTION: In other words, if there are two
24 parties to a transaction, the tax year for one can close
25 and the other remain open, and the IRS is not foreclosed

1 from adjusting one -- the open taxpayer's return, is it?

2 MR. FILLER: I know, but there's no
3 interrelationship in the very real sense of a shareholder
4 and owner of a corporation between two individuals who
5 simply loan and borrow money, I don't think, Your Honor.
6 I'm not sure the analogy flows.

7 The Congress specifically created under section
8 6037 a requirement that this whole new entity it created
9 in 1958, the S corporation, have a period of limitations
10 separate and distinct from that of its shareholders, and
11 that the entities were separate and distinct for purposes
12 of income taxation.

13 So, I'm not sure -- at least having the question
14 first thrown at me at this moment, I'm not sure that
15 there's -- the analogy follows. I think that's the best
16 way I can respond.

17 QUESTION: Professor Filler, if you should
18 prevail here, I suppose all the Government will do in the
19 future is to get an 872 out of the corporations.

20 MR. FILLER: Yes, sir, and in fact, they've done
21 it. They've done it on many occasions. In our case, in
22 the very case at bar, in 1980, the tax year following the
23 year at issue, the Service did obtain an extension for the
24 S corporation's return, were able then to make adjustments
25 to the return, were able to adjust the taxpayer's return.

1 In order to make the adjustments for an S -- I
2 mean, for a tax shareholder, they've got to have the S
3 corporation return right in front of them. They can't
4 make it just by guessing. They examine the books and
5 records. At that time, if they're running out of time,
6 they can obtain such an extension.

7 QUESTION: Well, so all you're winning here is a
8 procedural thing except for the present case, of course.
9 But the Government can make up for it just by changing its
10 procedures.

11 MR. FILLER: And I think it's clear, Your Honor,
12 that that's what Congress intended the Government to do in
13 1958 when it created the second sentence of section 6037,
14 and any other holding ignores that second sentence to the
15 extent that I really and truly believe it repeals that
16 second sentence of section 6037.

17 If I may reserve --

18 QUESTION: Very well, Mr. Filler.

19 MR. FILLER: I appreciate the opportunity.
20 Thank you.

21 QUESTION: Mr. Jones.

22 ORAL ARGUMENT OF KENT L. JONES

23 ON BEHALF OF THE RESPONDENT

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

1 Under section 6501, the Service has 3 years from
2 the filing of any return to make an assessment of the
3 taxes imposed on that return. To understand the meaning
4 of this statute, you need to know what an assessment is.
5 An assessment is merely an administrative record filed in
6 the office of the Secretary of the Treasury. Based upon
7 the Service's review or audit of the taxpayer's taxable
8 income, the assessment records, as this statute states,
9 the amount of taxes imposed on that income.

10 Nothing in section 6501 suggests that by
11 limiting the time for recording an assessment, the statute
12 in any manner limits the amount of taxes imposed on the
13 taxable income of the taxpayer by the other provisions of
14 the code. I'd like to give you an example.

15 Assume that a corporation files a return
16 claiming a deduction of \$10,000 for compensation that it
17 paid to a certain employee. If the corporate return is in
18 error and the employee actually received \$50,000 of
19 compensation, nothing in section 6501 would prohibit the
20 Service from making an adjustment to the taxpayer's return
21 to include that \$50,000 as his taxable income. This
22 compensation is taxable income under the code and a tax is
23 imposed on that income under the code even if the
24 corporate return failed accurately to report it.

25 As the courts held in the Green, Fehlhaber,

1 Bufford, Durovic, and Leonhart cases, the fact that the
2 return of some other entity or person contains an error in
3 reporting the same transaction does not excuse the
4 taxpayer of his duty to properly state his own income on
5 his own return.

6 QUESTION: In your hypothetical, if the
7 corporation had been audited and its -- excuse me -- its
8 return closed and its year closed and then the employee
9 was assessed the extra \$40,000, could the corporation on
10 its -- now, wait. Could the corporation reopen its year
11 and claim a deduction?

12 MR. JONES: Well, I understood your question to
13 premise that the corporate return had -- the period had
14 closed for that year.

15 QUESTION: Yes.

16 MR. JONES: And the answer to your question is
17 that if that corporation's return period has closed, it
18 cannot be reopened. We mention in our brief certain
19 mitigation provisions that could apply when -- in other
20 circumstances, but those wouldn't apply here.

21 This Court reached a similar conclusion in the
22 Bull v. United States case which held that the
23 Commissioner properly could assess an income tax on an
24 item that had been previously, but erroneously reported as
25 an estate tax item on a different return that was no

1 longer open for correction. The point -- the general
2 point is that under 6501 each return starts a period of
3 limitations and the Service is responsible for determining
4 the taxable income and the amount of tax to be imposed on
5 that return regardless of whether the same information is
6 reported incorrectly somewhere else.

7 QUESTION: Mr. Jones, would you clarify for me
8 what the rule would be with respect to a so-called
9 subchapter C, or an ordinary corporation?

10 MR. JONES: The rule that we are describing is
11 identical for subchapter C, subchapter S partnerships.
12 Whatever other return has been filed, the information on
13 that return does not prevent the commissioner on a timely
14 basis with respect to the individual who received that
15 income from adjusting -- making adjustments on the
16 individual's return.

17 QUESTION: So, you disagree with the
18 petitioner's reading of the statute and his description of
19 what the rule would be for a different type of
20 corporation.

21 MR. JONES: Yes. We disagree with his reading
22 of 6501. We also disagree with his reading of 6037 which
23 deals only with subchapter S's.

24 QUESTION: And do you have any authority for the
25 answer that you've given to Justice O'Connor?

1 MR. JONES: Well, the -- this Court's opinion in
2 the Munter case is the closest direct authority on that
3 question, although we think that the proposition is
4 answered by all of the cases that I've already cited,
5 which hold that an error on some other return doesn't
6 prevent an adjustment on the taxpayer's return.

7 The Munter case held that the Service could
8 recharacterize income as dividend income even though it
9 had been claimed to be a return of capital by the
10 taxpayer. The Service was allowed to adjust the
11 shareholder's return many years after the events had
12 occurred that were the basis of this characterization
13 issue. The events that were the basis of the
14 characterization issue was how the corporation had
15 reported its earnings and profits over the prior decade.

16 So, the fact that the corporation in the Munter
17 case had taken a certain position with respect to its
18 earnings and profits and -- did not prevent the
19 Commissioner from restating -- from adjusting the
20 shareholder's return properly to state the shareholder's
21 income.

22 QUESTION: The Commissioner gets an extension of
23 time from the corporation and makes an adjustment in the
24 -- and finds that there was -- should have been more --
25 that the return was in error in terms of how much

1 dividends were paid out?

2 MR. JONES: Yes, sir.

3 QUESTION: You can't adjust the shareholder's
4 return unless you've got an extension from him too.

5 MR. JONES: Those are utterly independent
6 issues.

7 QUESTION: Yes.

8 MR. JONES: You need an extension if you want
9 -- from the corporation if you want to adjust its return.
10 You need an extension from the individual if you want to
11 adjust his return.

12 QUESTION: No matter what you do to the
13 corporation's return.

14 MR. JONES: That's correct. That's correct.

15 Petitioner's argument really misses the point in
16 asserting that section 6501 prevents adjustments to the
17 return of a subchapter S corporation after the time for
18 assessing taxes against the subchapter S corporation has
19 expired. When the Service adjusts a taxpayer's return and
20 assesses tax against the shareholder's income, it is not
21 adjusting the subchapter S corporation return. The
22 adjustments and the assessment are made on the
23 individual's return, not on the corporation's. The income
24 involved is the individual's income, not the
25 corporation's, and the tax is imposed on the individual,

1 not on the corporation.

2 The Second Circuit summarized this issue in the
3 Siben case when they said the return that starts the
4 running of the limitations period is that of the taxpayer
5 whose liability is being assessed and not that of a third
6 person who also reports the transaction.

7 The subchapter S return is obviously not the
8 return upon which tax can be assessed upon the individual
9 shareholder. The corporate return doesn't contain any of
10 the individualized information or any of the information
11 about other sources of income that are required to assess
12 a tax against the individual.

13 In the Automobile Club case in this Court, the
14 Court held that an information return that lacks the data
15 necessary for the calculation and assessment of
16 deficiencies is not a tax return within the contemplation
17 of section 6501. In this respect, the subchapter S return
18 is not functionally different from a W-2 return filed by
19 an employer reporting wages under section 6041 of the code
20 or by -- or from a form 1099 filed by a bank reporting
21 interest income under section 6049 of the code.

22 In all of these situations, the information that
23 has been provided to the Service is relevant to the
24 calculation of the individual's taxes, but none is
25 sufficient to determine the taxpayer's taxable income.

1 They, therefore, cannot constitute the return that
2 commences the period for assessment of taxes against the
3 individual.

4 Turning to section 6037, which deals
5 specifically with S corporations, under that statute the
6 return of the S corporation serves two separate functions.
7 It serves as an information return providing data relevant
8 to the calculation of the shareholder's taxes. Indeed,
9 section 6037 is contained within chapter 61, part 3 of the
10 Internal Revenue Code, which is entitled, Information
11 Returns.

12 The return of the subchapter S corporation also
13 serves as the tax return of the S corporation in the
14 narrow circumstances when that corporation is subject to
15 tax. As Congress explained in enacting section 6037 in
16 1958, when the S corporation is itself subject to tax, the
17 return of the S corporation commences the period of
18 limitations for assessment of tax against the
19 shareholders.

20 Petitioner's suggestion that our interpretation
21 of section 6037, which is simply Congress' interpretation
22 of that statute, somehow renders the statute meaningless
23 simply ignores the legislative history. The legislative
24 history says when the statute works and what it does.

25 QUESTION: Mr. Jones, what about the private

1 taxpayer, the individual taxpayer, who is relying on the
2 information return? Do I understand the situation to be
3 thus, that if there is a mistake in the information return
4 that is against the Government's interest, the Government
5 can ignore that mistake and make believe it never happened
6 and go against the individual as though the S corporation
7 had filed properly? Right?

8 MR. JONES: I believe that's correct.

9 QUESTION: Now, what if the mistake is in the
10 other direction? What if there is a mistake that's
11 against the Government's interest?

12 MR. JONES: In that situation, the shareholder,
13 if he overreported his income, would be entitled to seek,
14 if appropriate, a refund.

15 QUESTION: Can he do that? I mean, he does not
16 have to get a new information return somehow filed by the
17 corporation? He can challenge the accuracy of the
18 corporation's return even after it has been closed?

19 MR. JONES: Certainly. The information return
20 is just that. It's information. It's not binding. It's
21 not a finding. It's not a determination.

22 QUESTION: Okay.

23 MR. JONES: It's information.

24 QUESTION: I assume from your position that if
25 the shareholder knows or should have known of an error in

1 the sub S return that you could assess a negligence
2 penalty against him for filing it?

3 MR. JONES: Yes. In fact, one of the cases that
4 we have cited to you involves that situation. I think it
5 was Leonhart, but it might have been Durovic. But in
6 those -- yes, if the subchapter S return contains an
7 erroneous information and if the shareholder has a -- if
8 there is a basis for ascribing knowledge to the
9 shareholder of that error, that would be a basis for a
10 penalty assessment against the individual.

11 In enacting the unified accounting procedures
12 for large partnerships and large S corporations in 1982 in
13 the statute known as TEFRA, Congress agreed with the case
14 law in stating that under present law the filing of -- by
15 the corporation of its return does not --

16 QUESTION: Mr. Jones, it would help me if you
17 could lift your voice a little bit and --

18 MR. JONES: I'm sorry.

19 QUESTION: -- don't speak quite so softly.

20 MR. JONES: How far back should I go? I'll
21 start the whole sentence.

22 In enacting the unified accounting procedures
23 for large S corporations and large partnerships in 1982 in
24 the statute known as TEFRA, Congress agreed with the case
25 law in stating that under present law the filing by the

1 corporation of its return does not affect the statute of
2 limitations for the individual shareholders.

3 In a limited category of cases for years after
4 1982, Congress changed that result. In the ordinary case,
5 however, involving 95 percent of subchapter S corporations
6 that have five or fewer shareholders, Congress retained
7 the preexisting provisions of section 6037.

8 Thus, the prior law that Congress described in
9 enacting TEFRA is still the current law for most S
10 corporations. And as petitioner recognizes, Congress'
11 description of section 37 is thus authoritative for years
12 after 1982. Petitioner conceded that in footnote 47 of
13 their brief.

14 Giving section 6037 the same meaning before
15 1982, as it has after 1982, is appropriate, as this Court
16 said in the West Virginia University Hospital case, to
17 make sense rather than nonsense out of the corpus juris.
18 Moreover, the interpretation that Congress provided of
19 section 6037, both in 1958 and in 1982, is a reasonable
20 and logical one. It was made by Congress in performance
21 of its legislative function in enacting intertwining
22 amendments to a complex statutory scheme, and under this
23 Court's decisions in Seatrain Shipbuilding and Red Lion
24 Broadcasting, Congress' views should be given great
25 weight.

1 I should point out that petitioner's contrary
2 interpretation of section 6037 would mean that Congress
3 enacted a nullity when it enacted TEFRA and applied it to
4 the unified statute of limitations provisions for large S
5 corporations after 1982 because, under petitioner's view,
6 the same unified statute of limitations would be reached
7 for all large and small S corporations both before and
8 1982 if section 6037 had the meaning for which they
9 contend.

10 Petitioner didn't have time to mention it, but
11 the case that's on his side in this area is the Kelley
12 case decided by the Ninth Circuit. And what the Kelley
13 decision held was that it was more fair if the statute of
14 limitations for the shareholder and for the S corporation
15 were coterminus. The court reasoned that the shareholder
16 may have difficulty obtaining necessary books and records
17 after the period of limitations has expired for assessing
18 taxes against the corporation.

19 The courts of appeals in the Green, Fehlhaber,
20 and in this case all explain why that concern has no
21 weight. Taxpayers often need information from third
22 parties. There's nothing exceptional about that, and
23 indeed, in the context of S corporations, they have even a
24 greater ability to obtain the information that they desire
25 because by definition there are few shareholders, each of

1 whom is likely to have a greater input in the operations
2 of the corporation.

3 In fact, in this case, Mr. Bufferd is the
4 secretary and treasurer of Compo. He quite obviously had
5 the ability to obtain and retain any records that he
6 wanted. And just to gild the lily, the records in this
7 case have no meaning because petitioner conceded from the
8 outset that the deficiencies that the Service found in
9 their return were correct on the merits. He hasn't
10 contended that the books and records would somehow change
11 that.

12 In any event, whatever force the concerns
13 expressed in the Kelley case might be, they provide no
14 basis for ignoring the plainly limited language of section
15 6501 or the clear history of 6037 and its clear
16 provisions. By limiting the time for assessing taxes,
17 section 6501 does not limit the amount of taxes to be
18 assessed on a proper accounting of the taxpayer's income.

19 I would only like to make one other point in
20 response to a question by Justice Blackmun. Justice
21 Blackmun brought up the fact that it is possible, it is
22 conceivable for the Service to obtain extensions from S
23 corporations and thereby avoid this issue.

24 While it may be possible and conceivable, the
25 Commissioner has no leverage over S corporations to

1 require them to cooperate and provide an extension for the
2 simple reason that the S corporation has no liability for
3 taxes. In the normal case, it is possible to obtain -- it
4 is possible that a taxpayer might have an interest in
5 granting an extension because if he doesn't, the
6 Commissioner will then have to assess the highest
7 supportable level of taxes, but there is no such reason or
8 ability to coerce or obtain an agreement from an S
9 corporation because it has no exposure to taxes and the
10 Commissioner has no basis to require it to give an
11 extension.

12 I -- since time permits, I'll just take one
13 other second to talk about the suggestion that the
14 legislative history of section 6037 only contains one
15 example and that our position relies upon only that
16 example. What the history of section 6037 says is that
17 the return of the corporation will constitute the return
18 of the -- rather, the return of the corporation will
19 commence the statute running against the corporation when
20 it is not entitled to subchapter S treatment.

21 There's more than one reason why a corporation
22 would not be entitled to subchapter S treatment, but in
23 addition, a subchapter S that is entitled not to pay a tax
24 can have that -- even in 1958, can have that entitlement
25 terminated if he receives -- if that corporation receives

1 too much income from what are called passive sources or
2 from foreign sources. And those provisions are also set
3 out in footnote 17 of petitioner's brief.

4 Thank you very much.

5 QUESTION: Thank you, Mr. Jones.

6 Mr. Filler, you have 1 minute remaining.

7 REBUTTAL ARGUMENT OF STUART JAY FILLER

8 ON BEHALF OF THE PETITIONER

9 MR. FILLER: I can only go back to the
10 beginning, and that is that the second sentence of section
11 6037 provides any return filed by an S corporation shall
12 be treated as a return of a corporation pursuant to
13 section 6012.

14 The Second Circuit makes a major -- and the
15 respondent -- major chronological error by attempting to
16 interpret section 6037 in 1958 as a provision that only
17 applies to a corporation when it is subject to tax. In
18 1958, the subchapter S corporation was not subject to tax.
19 It was not until 1966, 8 years afterwards, that a tax was
20 first imposed on an S corporation.

21 QUESTION: No, but Mr. Filler, he makes the
22 point that it might not have thought it was subject to
23 tax, but it didn't qualify as S corporation status, and
24 therefore you need to limit the period in which a tax
25 might be assessed against it when it made that mistake.

1 MR. FILLER: The committee reports in the 1958
2 legislation specifically provide that the Congress knew
3 that a subchapter S corporation was not subject to tax.

4 QUESTION: No, but the taxpayer might have made
5 a mistake in thinking it was qualified. The person who
6 prepared the S corporation return might have erroneously
7 thought it was qualified as an S corporation when, in
8 fact, it was not, and the period of making that
9 determination is then set by the statute of limitations.

10 MR. FILLER: Yes, but in that case, the Congress
11 could not have drafted the second sentence saying any
12 return filed pursuant to this section or every return
13 filed pursuant to this section because every return would
14 have to include returns in which the corporation had
15 properly elected to be an S corporation.

16 QUESTION: Thank you, Mr. Filler.

17 MR. FILLER: Thank you, Your Honor.

18 CHIEF JUSTICE REHNQUIST: The case is submitted.

19 (Whereupon, at 1:37 p.m., the case in the above-
20 entitled matter was submitted.)
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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:

Sheldon B. Bufferd, Petitioner v. Commissioner of Internal

Revenue Case No: 91-7804

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BY *Loana May*
(REPORTER)