

The Burger Court Opinion Writing Database

Fulman v. United States

434 U.S. 528 (1978)

Paul J. Wahlbeck, George Washington University
James F. Spriggs, II, Washington University in St. Louis
Forrest Maltzman, George Washington University



Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

December 10, 1977

Re: 76-1137 - Fulman v. United States

MEMORANDUM TO THE CONFERENCE:

My vote is to affirm. This was my
tentative position before I left the Conference.

Regards,

WRB 13

Wm. Brennan 8-77

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

February 16, 1978

Re: 76-1137 - Fulman v. United States

Dear Bill:

I join.

Regards,

WRB

Mr. Justice Brennan

Copies to the Conference

To: The Chief Justice
 Mr. Justice Stewart
 Mr. Justice White
 Mr. Justice Marshall
 Mr. Justice Black
 Mr. Justice Brennan
 Mr. Justice Harlan
 Mr. Justice Burger

From: Mr. Justice Brennan

Circulated: _____

Revised: _____

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 76-1137

Arthur Fulman et al., Trustees,	} On Writ of Certiorari to the
Petitioners,	
United States.	
v.	United States Court of
	Appeals for the First
	Circuit.

[February —, 1978]

MR. JUSTICE BRENNAN delivered the opinion of the Court.

The question presented in this case is the validity of the provision of Treas. Reg. § 1.562-1 (a), 26 CFR § 1.562-1 (a), that a personal holding company's distribution of appreciated property to its shareholders results, under §§ 561 and 562 of the Internal Revenue Code of 1954, 26 U. S. C. §§ 561-562, in a dividends paid deduction limited to an amount that is "the adjusted basis of the property in the hands of the distributing corporation at the time of the distribution."¹ The Court of

¹ "§ 561. Definition of deduction for dividends paid.

"(a) General Rule.

"The deduction for dividends paid shall be the sum of—

"(1) the dividends paid during the taxable year

"(b) Special rules applicable.

"(1) In determining the deduction for dividends paid, the rules provided in section 562 . . . shall be applicable." 26 U. S. C. § 561.

"§ 562. Rules applicable in determining dividends eligible for dividends paid deduction.

"(a) General rule.

"For purposes of this part, the term 'dividend' shall, except as otherwise provided in this section, include only dividends described in section 316" *Id.*, § 562.

"§ 1.562-1 Dividends for which the dividends paid deduction is allowable

"(a) General rule. . . . If a dividend is paid in property (other than money), the amount of the dividends paid deduction with respect to such

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

January 24, 1978

Re: No. 76-1137, Fulman v. United States

Dear John,

I would rather not adopt your suggested rewrite of pages 6-7 of my draft opinion in this case. My conference notes reflect that a majority felt petitioners' argument would have been persuasive were there no Treasury Regulation in the field. Moreover, I am really not persuaded that your objection to petitioners' argument is sound.

Under § 311(a) of the 1954 Code, a corporation distributing appreciated property as a dividend does not have to recognize income at the corporate level for purposes of the ordinary corporate income tax. It is not clear to me what purpose of the personal holding company tax would be served by forcing such recognition for purposes of the 70% penalty tax.

Moreover, although I admit that petitioners' § 301 argument seems to confer a tax benefit without exacting a tax cost, ultimately I think this is not the case. Assume by way of example a corporation with \$75,000 of undistributed personal holding company income (§ 545) held as cash and property worth \$75,000 with a basis of \$10,000. Assume further that the corporation seeks to distribute sufficient dividends to avoid the penalty tax and then liquidates.

Case A. If \$75,000 cash is distributed, the corporation recognizes no gain or loss on the transaction and shareholders recognize \$75,000 taxable income under § 301. No personal holding company tax is exacted. The property is then distributed in liquidation. Again, the corporation recognizes no gain or loss (§§ 336, 337) and the shareholders recognize gain (which might be subject to capital gains treatment) to the extent the fair market value of the property (\$75,000) exceeds their taxable basis in the stock of the corporation (§§ 331(a)(1), 1001(a), 1001(b)).

-2-

Case B. If \$75,000 property is distributed, the corporation recognizes no gain or loss on the transaction (§ 311(a)) and shareholders recognize \$75,000 taxable income under § 301. No personal holding company tax is exacted under petitioners' theory. The cash is then distributed in liquidation. Again, the corporation recognizes no gain or loss, and the shareholders recognize gain (which might be subject to capital gains treatment) to the extent the \$75,000 exceeds the basis of their stock (§§ 331(a)(1), 1001(a)).

Because the tax outcomes of case A and B are the same, and because no other case occurs to me which would allow tax avoidance by retaining cash and distributing appreciated property, isn't there considerable merit to petitioners' argument as a logical proposition? If you have some other problem in mind -- or if you think my analysis is wrong -- I certainly would be willing to consider modifying my opinion.

Sincerely,

Bill
7

Mr. Justice Stevens

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

January 27, 1978

Memorandum to the Conference

Re: No. 76-1137, Fulman v. United States

Enclosed is a second draft of my opinion in Fulman, which incorporates some stylistic changes. In light of John's latest memorandum (of January 24), you will note that there is no change in the section (pp. 6-8) about which we corresponded.

Bill

The Chief Justice
 Mr. Justice Stewart
 Mr. Justice White
 Mr. Justice Marshall
 Mr. Justice Blackmun
 Mr. Justice Powell
 Mr. Justice Brennan
 Mr. Justice Stevens

From Mr. Justice Brennan.

Revised 2/1/78

Revised 2/1/78

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 76-1137

Arthur Fulman et al., Trustees, } On Writ of Certiorari to the
 Petitioners, } United States Court of
 v. } Appeals for the First
 United States. } Circuit.

[February —, 1978]

MR. JUSTICE BRENNAN delivered the opinion of the Court.

The question presented in this case is the validity of the provision of Treas. Reg. § 1.562-1 (a), 26 CFR § 1.562-1 (a), that a personal holding company's distribution of appreciated property to its shareholders results, under §§ 561 and 562 of the Internal Revenue Code of 1954, 26 U. S. C. §§ 561-562, in a dividends paid deduction limited to an amount that is "the adjusted basis of the property in the hands of the distributing corporation at the time of the distribution."¹ The Court of

¹ § 561. Definition of deduction for dividends paid.

"(a) General Rule.

"The deduction for dividends paid shall be the sum of—

"(1) the dividends paid during the taxable year . . .

"(b) Special rules applicable.

"(1) In determining the deduction for dividends paid, the rules provided in section 562 . . . shall be applicable." 26 U. S. C. § 561.

§ 562. Rules applicable in determining dividends eligible for dividends paid deduction.

"(a) General rule.

"For purposes of this part, the term 'dividend' shall, except as otherwise provided in this section, include only dividends described in section 316 . . ." *Id.*, § 562.

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Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

January 24, 1978

Re: No. 76-1137, Fulman v. United States

Dear Bill,

I think the change John Stevens suggests in his letter to you of today is a good one.

Sincerely yours,

Mr. Justice Brennan

Copies to the Conference

P.S.
✓

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

January 24, 1978

Re: No. 76-1137, Fulman v. United States

Dear Bill,

My note earlier today was sent before I had read your reply to John. I now withdraw from the field, expecting happily to agree with whatever you two work out.

Sincerely yours,

Mr. Justice Brennan

Copies to the Conference

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Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

January 24, 1978

Re: No. 76-1137, Fulman v. United States

Dear Bill,

I am glad to join your opinion for the
Court in this case.

Sincerely yours,

P.S.

Mr. Justice Brennan

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

January 23, 1978

Re: 76-1137 Arthur Fulman v. U. S.

Dear Bill,

Please join me.

Sincerely,



Mr. Justice Brennan

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

January 24, 1978

Re: No. 76-1137, Fulman v. United States

Dear Bill:

Please join me.

Sincerely,



T.M.

Mr. Justice Brennan

cc: The Conference

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✓
Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

January 20, 1978

Re: No. 76-1137 - Fulman v. United States

Dear Bill:

Will you please indicate at the end of your opinion that I took no part in the consideration or decision of this case.

Sincerely,

Harry

Mr. Justice Brennan

cc: The Conference

To: The Chief Justice
 Mr. Justice Brennan
 Mr. Justice Stewart
 Mr. Justice White
 Mr. Justice Marshall
 Mr. Justice Blackmun
 Mr. Justice Rehnquist
 Mr. Justice Stevens

From: Mr. Justice Powell

Circulated: 24 JAN 1978

1st DRAFT

Recirculated: _____

SUPREME COURT OF THE UNITED STATES

No. 76-1137

Arthur Fulman et al., Trustees, Petitioners, v. United States.	}	On Writ of Certiorari to the United States Court of Appeals for the First Circuit.
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[February —, 1978]

MR. JUSTICE POWELL, dissenting.

The Court's opinion, with commendable candor, recognizes that logic supports petitioners' position:

"[We do] not deny the logical force of petitioners' argument that, since the purpose of the personal holding company tax is to force individuals to include personal holding company income in their individual returns, the corporate distributor should get a deduction at the corporate level equal to the income generated by the distribution at the shareholder level as defined by § 301, that is the fair market value of the appreciated property in this case. See 28 U. S. C. § 301 (b)(1)(A)." *Ante*, at 6.

The Court also recognizes the "circularity," *ante*, at 6, and the "ambiguity" of the relevant provisions of the Internal Revenue Code, *ante*, at 8, as well as the absence of any clarification thereof in the legislative history. In the end, the Court resolves the statutory jumble in favor of the Treasury regulation.

It is virtually conceded that this result cannot be squared with the acknowledged purpose of the personal holding company tax. Where statutory ambiguity exists without clarification in the legislative history, a court should read the statute to accord with its manifest purpose. A regulation that

To: The Chief Justice
 Mr. Justice Brennan
 Mr. Justice Stewart
 Mr. Justice White
 Mr. Justice Marshall
 Mr. Justice Blackmun
 Mr. Justice Rehnquist
 Mr. Justice Stevens

From: Mr. Justice Powell

Circulated: _____

Recirculated: 4 FEB 1978

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 76-1137

Arthur Fulman et al., Trustees,	}	On Writ of Certiorari to the
Petitioners,		United States Court of
v.		Appeals for the First
United States.		Circuit.

[February —, 1978]

MR. JUSTICE POWELL, dissenting.

The Court's opinion, with commendable candor, recognizes that logic supports petitioners' position:

"[We do] not deny the logical force of petitioners' argument that, since the purpose of the personal holding company tax is to force individuals to include personal holding company income in their individual returns, the corporate distributor should get a deduction at the corporate level equal to the income generated by the distribution at the shareholder level as defined by § 301, that is the fair market value of the appreciated property in this case. See 28 U. S. C. § 301 (b)(1)(A)." *Ante*, at 6.

The Court also recognizes the "circularity," *ante*, at 6, and the "ambiguity" of the relevant provisions of the Internal Revenue Code, *ante*, at 8, as well as the absence of any clarification thereof in the legislative history. The Court simply resolves the statutory jumble in favor of the Treasury regulation.

It is virtually conceded that this result cannot be squared with the acknowledged purpose of the personal holding company tax. Where statutory ambiguity exists without clarification in the legislative history, a court should read the statute to accord with its manifest purpose. A regulation that

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

January 27, 1978

Re: No. 76-1137 - Fulman v. United States

Dear Bill:

Please join me.

Sincerely,

WHR

Mr. Justice Brennan

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

January 24, 1978

Re: 76-1137 - Fulman v. United States

Dear Bill:

In my judgment the petitioners' argument which you summarize at the bottom of page 6 and the top of page 7 is a non sequitur. I do not agree that it has "logical force" (p. 6); nor am I persuaded that it "might well prevail" (p. 8) if the regulation were less clear. I wonder, therefore, if you would be willing to consider a revision of the paragraph beginning at the bottom of page 6 to read something like this:

"Petitioners suggest that the way out of this circularity is to adopt the valuation rules for distributions of property found in § 301 of the Code, 26 U.S.C. § 301. We cannot agree, for § 301 deals not with the problem of valuing the distribution with respect to the distributing corporation, but establishes rules governing the valuation with respect to distributees. This distinction also provides the answer to petitioners' argument that, since the purpose of the personal holding company tax is to force individuals to include personal holding company income in their individual returns, the corporate distributor should get a deduction at the corporate level equal to the income generated by the distribution at the shareholder level as defined by § 301, that is the fair market value of the appreciated property in this case. Even though such a rule would correctly measure the distributees' taxable income, it would allow the distributing corporation to retain earnings equal to the amount of appreciation in the value of the distributed asset without having reflected that appreciation in its own income. In any event, even if the view urged by petitioners might prevail in the absence of the

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Commissioner's Regulation, the issue before us is not how we might resolve the statutory ambiguity in the first instance, but whether there is any reasonable basis for the resolution embodied in the Commissioner's Regulation. We conclude that there is."

Respectfully,



Mr. Justice Brennan

P.S. Apart from this minor problem, I think the opinion is fine.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

January 24, 1978

Re: 76-1137 - Fulman v. United States

Dear Lewis:

Before receiving your dissent this afternoon, I had sent the attached letter to Bill Brennan. If he does agree to change his opinion, I thought you should know that the change was not entirely precipitated by your reliance on the quoted paragraph.

Respectfully,



Mr. Justice Powell

Copies to the Conference

Attachment

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

January 24, 1978

Re: 76-1137 - Fulman v. United States

Dear Bill:

Your examples do indicate that petitioners' view would be acceptable if a dividend distribution is promptly followed by a liquidation, but I am still troubled by the more likely situation in which the corporation is not liquidated.

Assume that the corporation has an original net worth of \$10,000 represented by property with no cash and no liabilities. Assume further that over a period of years the asset generates \$75,000 of cash income and also appreciates to a market value of \$75,000. To avoid the penalty tax, the corporation must distribute a \$75,000 dividend. Prior to the dividend distribution the corporation has a book value of \$85,000.

If petitioners' view prevails, the corporation could distribute the asset and it would thereafter have a book value of \$75,000. In other words, the book value of the corporation will have been increased from \$10,000 to \$75,000 without realizing any taxable income.

Perhaps the Government objects to this method of adjusting a corporate balance sheet for the same reasons that it does not allow tax free adjustments in book values to reflect changes in the market value of corporate assets.

In any event I am still not persuaded that it is completely logical to measure a corporate deduction by the amount of the distributees' income and would like to give the problem further study.

Respectfully,



Mr. Justice Brennan

Copies to the Conference

To: The Chief Justice
 Mr. Justice Brennan
 Mr. Justice Stewart
 Mr. Justice White
 Mr. Justice Marshall
 Mr. Justice Blackmun
 Mr. Justice Powell
 Mr. Justice Rehnquist

1st DRAFT

From: Mr. Justice Stevens

SUPREME COURT OF THE UNITED STATES

Circulated: JAN 30 78

No. 76-1137

Recirculated: _____

Arthur Fulman et al., Trustees,	}	On Writ of Certiorari to the
Petitioners,		United States Court of
v.		Appeals for the First
United States.		Circuit.

[February —, 1978]

MR. JUSTICE STEVENS, concurring in the judgment.

The only portion of the Court's opinion which I am unable to join is that quoted by MR. JUSTICE POWELL in dissent. I do not see the ineluctable logical need to equate the amount of income received by the shareholder distributee with the amount of the deduction allowed the corporate distributor. In my judgment market value is the appropriate measure of the recipient's income, and adjusted basis is the appropriate debit on the corporation's books.