REPLY BRIEF

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In the Supreme Court of the United States

October Term, 1961

United States, petitioner
v.
Thomas Crawley Davis, et al.

On writ of certiorari to the United States Court of Claims

REPLY BRIEF FOR THE UNITED STATES

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I

THE MARITAL OBLIGATIONS DISCHARGED IN THE "MESTA" AND "HALLIWELL" CASES WERE OF THE SAME NATURE AS THOSE INVOLVED IN THE INSTANT CASE

Taxpayer argues (Br. 14–16) that *Commissioner* v. *Mesta,* 123 F. 2d 986 (C.A. 3d), certiorari denied, 316 U.S. 695, and *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C.A. 2d), certiorari denied, 319 U.S. 741, are not authorities in point on the ground that there the transfers were made in discharge of obligations to support and were not transfers by way of division of common property of the spouses, which taxpayer asserts is the case here. Both facets of this contention seem to us incorrect.

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In *Mesta* and *Halliwell* the transfers were not merely in consideration of discharge of support rights but of discharge of all marital rights against the respective husbands' property. Thus, in *Mesta,* 42 B.T.A. 933, 934–935:

> the delivery of the securities and property mentioned above by him was "in full settlement and satisfaction of all claims and demands on the part of Mrs. Mesta for her maintenance and support, and in lieu of all rights which she may now have, or hereafter acquire, against the property of Mr. Mesta, as wife, widow, or in any manner arising out of ~~or~~ resulting from the relationship of husband and wife * * *." She also released Mesta, his heirs, executors, administrators and assigns, from all claims for support and maintenance and from all rights, interests, claims, demands or preferences in or against him or his estate that she might have as wife, widow, or otherwise.

Again in *Halliwell* the parties agreed that if the husband died pending the divorce action, the securities and cash specified in the agreement were to be delivered to the wife "in lieu of any and all statutory and other rights in and to petitioner's estate." Additionally the wife "executed a release in which she released petitioners, his executors, administrators, and estate from all of her rights to share in his property at his death." (44 B.T.A. 740, 743.)

Moreover, in the present case all of the transfers were made in consideration for the release of all rights she had against him both by way of support and as against any of his property.[1] As the Court below found, all of the property involved in the property settlement agreement was owned by Mr. Davis (R. 115) and as discussed in our main brief (pp. 22–23) under Delaware law, with the possible exception of dower, the wife had no property interest in any of the property owned by the husband. She could not have prevented him, for example, from selling the duPont stock, and she had no specific right in any of his property. While the agreement purports to make "division" (R. 93) of certain items of property including the stock and impose certain other obligations on him for her maintenance and support, use of the word "division" in the agreement is a legal misnomer. The term does not describe what transpired under the Delaware law except in a loose, figurative and nonlegal sense. The wife had no property involved in the settlement agreement which she could divide with him; on the contrary, as the Court found,

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[1] Paragraph 13 of the settlement agreement (R. 97) reads as follows:

> 13. The parties hereto and each of them covenant that this agreement is and shall be a complete and final settlement of all claims of every nature and kind between them. Upon performance of husband's covenants and undertakings under this agreement, the wife hereby waives, releases and relinquishes unto the husband all rights that she might otherwise have to any of the property of the husband and to any claim for support or maintenance for herself and their minor child, and that she will not incur or contract any debt or obligation on the husband's credit and that she will keep the husband and his estate indemnified against and from all debts and liabilities to be contracted or incurred by her with all actions, proceedings, claims and demands, costs, damages and expenses whatsoever in respect to such liabilities or any of them.

all of the property involved was owned by him. Indeed, property settlements and continuing periodical payments are but alternative methods of settling the same obligations arising from the marital relationship. This is illustrated in the present agreement by the provision that "for her maintenance and support" (R. 95) he agrees to pay her a sum of money equivalent to the dividend paid to holders of duPont stock during the period before he shall have transferred the entire 1,000 shares to her. Similarly, the stock and its dividends, once he did transfer it to her, represented satisfaction *pro tanto* of the same obligation and indeed of all obligations arising from the marital relationship.

Finally, the court below clearly considered *Mesta* and *Halliwell* as authorities in point, although it refused to follow them.[2] (R. 108–109.)

II

THE GOVERNMENT IS NOT INTRODUCING A DIVERGENCE IN THE TAX LAWS BETWEEN COMMON-LAW AND COMMUNITY-PROPERTY JURISDICTIONS

Taxpayer argues that the Government is asking the Court "to introduce into the tax laws a serious divergence of treatment" (Br. 9) between common-law and community-property jurisdictions. Such divergencies have long existed, however, and are the product simply of the different "property" rights created by the laws of the several states. If it is thought to be undesirable to have tax consequences turn upon such differences, the remedy lies with Congress, and not with the courts. Congress has in fact acted to remove some of the divergencies in tax consequences between common-law and community-property states, but it has by no means removed all of them.[3] Among the areas in which Congress has been content to allow tax consequences to turn upon state law is that of property transfers incident to a divorce, for although the rule objected to by the taxpayer was adopted in the *Mesta* and *Halliwell* cases over twenty years ago, Congress has not seen fit to change it. That the results here, as in many other areas of the tax law, may turn upon differences of property law among the

[2] Thus, the opinion below states (R. 108–109):

> The result is that we are faced with two precedents pointing in opposite directions and an attempt to distinguish the two is impossible.
>
> Since there is no clear ground for distinguishment between the rule of the *Mesta-Halliwell* cases and the *Marshman* case, it behooves us to decide which rule is the correct one in the premises. * * *

[3] Although Congress removed one of the most basic discrepancies by permitting spouses in common-law states to file joint returns with "income-splitting" for tax computation purposes, there remain, even in the limited area of the treatment of current items of income and expenses, substantial additional benefits available to taxpayers in community-property states. Because of the wife's "ownership" of one-half of the community income, community-property spouses need not file joint returns to gain the benefits of income-splitting and are therefore free to file separate returns when it is advantageous to do so—*e.g.*, to avoid joint liability; to permit deduction of capital losses up to $2,000 rather than $1,000 (Section 1211); or to lower the amount (3% of adjusted gross income) which medical expenses must exceed to be deductible (Section 213). Other benefits that would not be available in a common-law state if the husband owned all the income include, for example, a maximum dividend exclusion of $100 rather than $50 (Section 116) and a maximum retirement income credit of $480 rather than $240 (Section 37).

several states is not, by itself, a sufficient reason for this Court to reject those long-standing decisions.

III

IF THERE WAS A TAXABLE EXCHANGE, THE CONSIDERATION RECEIVED SHOULD BE MEASURED BY THE VALUE OF THE STOCK ON THE DATE OF THE TRANSFER

Taxpayer in his brief here makes two contentions, not raised below, bearing upon the measure of the consideration which he received for the duPont stock transferred in March 1955.

First, he urges (Br. 21–22) that, if the market value of the duPont stock is to be accepted as the equivalent of the rights released by his wife, the relevant value is its market value on the date of the agreement (November 1954) and not, as the Government claims, the date when the stock was transferred to Mrs. Davis (March 21, 1955). He states that the market value in November 1954 was below his basis for the stock and concludes that he therefore suffered a loss, not a gain, from the transaction. That this is a wholly new argument in this Court is shown by the absence from the record of any proof of the market value of the stock in November 1954.

Superficially, it might be possible to follow the equivalence of value rationale the further step and say that, since the parties here could not know the future price of duPont stock, the value they assigned to the marital rights should be the value on the day they signed the agreement. In this instance as in others, however, we suggest that any rationale developed should provide, above all else, a workable and understandable rule consistent with the main body of tax law. Tax solutions, like the Law Merchant, should, when possible, contribute to ease of administration by taxpayers and the Government.

In all other cases under the Internal Revenue Code when a taxable exchange actually takes place on a given date, the property given up and the property received are valued on that date, even though the exchange may be pursuant to an earlier binding agreement. The date of exchange was used in the *Mesta* and *Halliwell* cases,[4] and was not contested by the parties. The Commissioner's selection of that date was similarly not contested below by the taxpayer in this case.

The administrative necessity for that rule can be seen by a more common example of an instance where the value of the property received is measured by the property given up. If, in a taxable exchange, a

[4] In *Mesta* (123 F. 2d 986, 42 B.T.A. 933) the property settlement agreement was signed by the husband on March 22, 1935, and by the wife on April 13, 1935. The husband agreed to deliver 5,200 shares of stock and certain personal property. The contract contained provisions whereby the parties would respectively release and discharge each other from all claims or demands. On April 17, 1935, the husband delivered the stock. The court took the fair market value of the stock on the date of the transfer ($156,975) less the cost ($7,574) as the measure of the husband's gain.

In *Halliwell* (131 F. 2d 642, 44 B.T.A. 740), the parties agreed to a property settlement on March 16, 1938, on which date the wife executed a release of the husband's marital obligations. The property (securities) was transferred on July 16, 1938. Although it appears from the Board of Tax Appeals' opinion that the value of the securities was the same on both dates (44 B.T.A. at 743–744), making the question unimportant, the court of appeals in terms referred to the value on the date of delivery as controlling (131 F. 2d at 643).

taxpayer corporation exchanges stock listed on a national exchange for stock in a closely held corporation for which there is no established market price, all would agree that the gain to the taxpayer may be measured by the value of the stock given up. Yet it has never been suggested heretofore that any value other than that on the closing date should be used. Nor would any other date be feasible in such intercorporate exchanges. If the date of "agreement" were to be used, there would usually remain questions in varying factual situations as to whether the date of "agreement" was the date of the initial agreement of the negotiators, the date it was approved by the directors, the date it was approved by the shareholders, the date on which a regulatory agency approved the proposed exchange, the date a favorable tax ruling upon which the exchange was contingent was received, *etc.* Much the same problem exists in the case of a marital settlement where the property understanding is quickly reached but dispute over custody of the children, formal divorce proceedings or some other important, but not necessarily financial, consideration makes it difficult to pin down the precise date of final agreement. Since the date of exchange is readily ascertainable without any confusion between formal and actual agreement and has been fixed by the parties themselves for the mutual transfer of equivalent obligations, it should be the determinative date for valuation of the properties exchanged. Such a solution, giving to the time of physical delivery and receipt prime significance in measuring rights and

liabilities, has the virtue of simplicity and precision which no alternative solution would afford.

The second contention raised by taxpayer for the first time on brief here (p. 22) is the "intriguing and serious question as to when this consideration was received." Suggestion is made that the consideration is received not in the year of transfer (1955) but rather in 1954 (the year of agreement), in 1956 (the year of the second transfer of 500 shares of duPont stock), or in 1964 (when the last of the periodic payments is to be made).

Again resort must be had to a workable rule. The gain could not have been taxed in 1954 since the shares which would be used to fulfill the obligation were not yet identified. The selection of 1956 would also result in a bunching of income in one year. The selection of 1964 would cause an unreasonable postponement since Mr. Davis will have had the full benefit of the release from marital obligations for many years prior thereto.

The ratable realization of gain accomplished by matching the income received with the property surrendered is a necessary corollary to the rule of equivalence of value. Moreover it comports with the reality of the situation. Petitioner could have sold these shares for some $7,500 more than they cost him. Instead he used the shares to satisfy his obligation to his wife. Since he received the benefit of conferring the full fair market value on her in 1955, he should be taxed in that year rather than in a later year when he has disposed of another lot of stock.

Respectfully submitted.

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SUPREME COURT OF THE UNITED STATES

Nos. 190 AND 268.—OCTOBER TERM, 1961.

United States, Petitioner, 190 v. Thomas Crawley Davis et al.	On Writs of Certiorari to the United States Court of Claims.
Thomas Crawley Davis et al., Petitioners, 268 v. United States.	

[June 4, 1962.]

MR. JUSTICE CLARK delivered the opinion of the Court.

These cases involve the tax consequences of a transfer of appreciated property by Thomas Crawley Davis[1] to his former wife pursuant to a property settlement agreement executed prior to divorce, as well as the deductibility of his payment of her legal expenses in connection therewith. The Court of Claims upset the Commissioner's determination that there was taxable gain on the transfer but upheld his ruling that the fees paid the wife's attorney were not deductible. 287 F. 2d 168. We granted certiorari on a conflict in the Courts of Appeals and the Court of Claims on the taxability of such transfers.[2] 368 U. S. 813. We have decided that the taxpayer did have a taxable gain on the transfer and that the wife's attorney's fees were not deductible.

In 1954 the taxpayer and his then wife made a voluntary property settlement and separation agreement calling

[1] Davis' present wife, Grace Ethel Davis, is also a party to these proceedings because a joint return was filed in the tax year in question.

[2] The holding in the instant case is in accord with *Commissioner* v. *Marshman*, 279 F. 2d 27 (C. A. 6th Cir. 1960), but is contra to the holdings in *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C. A. 2d Cir. 1942), and *Commissioner* v. *Mesta*, 123 F. 2d 986 (C. A. 3d Cir. 1941).