# SUPREME COURT
# OF THE UNITED STATES

IN THE SUPREME COURT OF THE UNITED STATES

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THOMAS A. CONNELLY, )
AS EXECUTOR OF THE ESTATE OF )
MICHAEL P. CONNELLY, SR., )
Petitioner, )
v. ) No. 23-146
UNITED STATES, )
Respondent. )

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Pages: 1 through 62

Place: Washington, D.C.

Date: March 27, 2024

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3 THOMAS A. CONNELLY, )

4 AS EXECUTOR OF THE ESTATE OF )

5 MICHAEL P. CONNELLY, SR., )

6 Petitioner, )

7 v. ) No. 23-146

8 UNITED STATES, )

9 Respondent. )

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12 Washington, D.C.

13 Wednesday, March 27, 2024

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15 The above-entitled matter came on for

16 oral argument before the Supreme Court of the

17 United States at 11:41 a.m.

18

19 APPEARANCES:

20 KANNON K. SHANMUGAM, ESQUIRE, Washington, D.C.; on

21 behalf of the Petitioner.

22 YAIRA DUBIN, Assistant to the Solicitor General,

23 Department of Justice, Washington, D.C.; on behalf

24 of the Respondent.

25

1 C O N T E N T S

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1 P R O C E E D I N G S
2 (11:41 a.m.)
3 CHIEF JUSTICE ROBERTS: We will hear
4 argument next in Case 23-146, Connelly versus
5 United States.
6 Mr. Shanmugam.
7 ORAL ARGUMENT OF KANNON K. SHANMUGAM
8 ON BEHALF OF THE PETITIONER
9 MR. SHANMUGAM: Thank you, Mr. Chief
10 Justice, and may it please the Court:
11 To ensure continuity in their
12 operations, closely held corporations will often
13 agree to redeem the stock of a shareholder upon
14 his death and then obtain a life insurance
15 policy on the shareholder in order to fund the
16 redemption obligation.
17 This case presents the question of how
18 the federal estate tax treats such arrangements.
19 Because the proceeds from a life insurance
20 policy to fulfill a contractual redemption
21 obligation do not increase the corporation's net
22 worth, they do not increase the estate tax owed
23 on the decedent's stock. The court of appeals'
24 contrary conclusion was erroneous.
25 The legal framework governing this

1 case is relatively straightforward. The
2 Internal Revenue Code and Treasury regulations
3 provide that where the parties agree on the
4 price to redeem a shareholder's stock, that
5 price will establish the value of the stock for
6 purposes of the estate tax in certain
7 circumstances.
8 But where, as here, those
9 circumstances have not been met, the value of
10 the stock is determined by the price at which
11 such stock would change hands between a
12 hypothetical willing buyer and willing seller.
13 Here, a hypothetical buyer would not
14 treat the life insurance proceeds as increasing
15 the value of the stock because that asset is
16 offset by the contractual obligation to redeem
17 shares, a preexisting corporate liability.
18 Now the government argues that a court
19 should attach no weight to the redemption
20 obligation when assessing the value of the
21 company. But the government fails to
22 distinguish between a contractual obligation to
23 redeem stock on the one hand and a voluntary
24 stock redemption on the other.
25 A hypothetical buyer would treat the

1 contractual redemption obligation like any other
2 debt that reduces the net worth and therefore
3 the value of the company. The government's
4 approach would lead to a grossly inflated
5 valuation of the decedent's shares, and it would
6 effectively lead to double taxation. It would
7 defy common sense to take one side of the
8 transaction into account but to ignore the other
9 for purposes of the estate tax. And it would
10 destroy a valuable succession planning tool that
11 the nation's small businesses have openly used
12 for decades. The judgment of the court of
13 appeals should be reversed.
14 I welcome the Court's questions.
15 JUSTICE THOMAS: Mr. Shanmugam, the --
16 if a very interested buyer showed up the day
17 after Michael died, would Thomas sell the
18 business to him for 3.86 million?
19 MR. SHANMUGAM: So, if Thomas were the
20 person we were thinking about and not Michael, I
21 think it is quite possible that a hypothetical
22 willing buyer would pay $3.68 million --
23 JUSTICE THOMAS: No, I'm -- I'm -- I'm
24 -- I'm more focused on the asking price. If a
25 buyer showed up the day after Michael died and

1 offered to buy it at any price, what would he
2 sell it for?
3 MR. SHANMUGAM: So I think it's
4 important here to distinguish between Michael
5 and Thomas.
6 JUSTICE THOMAS: Which one died?
7 MR. SHANMUGAM: Michael is the one who
8 died.
9 JUSTICE THOMAS: Okay.
10 MR. SHANMUGAM: And -- and Michael, of
11 course, is the one whose shares would be subject
12 to the $3 million --
13 JUSTICE THOMAS: But -- but Thomas --
14 MR. SHANMUGAM: Yes, Your Honor.
15 JUSTICE THOMAS: -- is the -- he is
16 actually in charge of the estate and the
17 company, so he's on both, so he can actually
18 sell the property, right?
19 MR. SHANMUGAM: Yes, except for the
20 fact that, under the buy-sell agreement, Thomas
21 is actually disabled from selling the company.
22 JUSTICE THOMAS: Well, he has the
23 first option.
24 MR. SHANMUGAM: He has the first
25 option. That is correct. But, under the terms

1 of the buy-sell agreement, the estate cannot
2 sell the stock.
3 JUSTICE THOMAS: Okay. Let's --
4 MR. SHANMUGAM: So the way --
5 JUSTICE THOMAS: Well, let me just
6 blink that for a minute, okay? What would he
7 ask for it, assuming he could sell it? Would he
8 ask 3.86 million or 6.86 million, assuming that
9 the insurance was in -- was included in the
10 assets or liabilities of the company?
11 MR. SHANMUGAM: Sure, Justice Thomas.
12 So the first question is what is the net worth
13 of the company, because we're in agreement with
14 the government that that is the first question.
15 Our view is that the net worth of the
16 company throughout all of this is $3.86 million.
17 The government's view is that the net worth of
18 the company is $6.86 million because, in the
19 government's view, you take into account the
20 life insurance proceeds but not the offsetting
21 redemption obligation.
22 JUSTICE THOMAS: So, if a willing
23 buyer shows up -- and who owns the life
24 insurance policy?
25 MR. SHANMUGAM: So the company is

1 entitled to the proceeds of the life insurance.
2 And that is hugely important when you're
3 applying this test because the fundamental
4 problem with the government's view -- our view
5 is that 77 percent of $3.86 million is $3
6 million. The government's view is that
7 77 percent of $6.86 million is $5.3 million.
8 A willing buyer would never, at that
9 moment, if buying Michael, the decedent's,
10 shares, pay $5.3 million. Why? Because a
11 willing buyer would not be able to capture those
12 life insurance proceeds by swooping in before
13 the redemption. Those life insurance proceeds
14 belong to the company.
15 JUSTICE THOMAS: Well, the value has
16 to go someplace. The 3 million goes someplace.
17 Does it go into the value of the remaining
18 stocks? And if it is there, why isn't the
19 appropriate valuation 6.86 million?
20 MR. SHANMUGAM: The $3 million of the
21 life insurance proceeds are used to redeem
22 Michael's shares under the terms of the parties'
23 agreement.
24 Now, as a practical matter, the
25 problem here and the fundamental issue that all

1 of us are wrestling with is that what we know is
2 that you can't use the $3 million as simply the
3 valuation. Why? Because, as I noted at the
4 outset, we didn't satisfy the requirements of
5 Section 2703.
6 And, therefore, you have to engage in
7 this counterfactual inquiry, and the problem
8 with the counterfactual inquiry that the
9 government wants this Court to engage in is,
10 again, that it requires you to disregard the
11 redemption obligation.
12 Now it is true that one consequence of
13 our interpretation is that, as to Thomas, the
14 surviving stockholder, Thomas in some very real
15 sense benefits from the increase in value by
16 virtue of this transaction. Why? Because
17 Thomas goes from having 22 percent of the
18 company to a hundred percent of the company.
19 But, under our approach, as under the
20 government's approach, that is taken care of by
21 the eventual application of the capital gains
22 tax.
23 What the government wants you to do is
24 to effectively take those life insurance
25 proceeds into account twice, once when

1 calculating the estate tax because the
2 government wants you to tax this higher amount,
3 $5.3 million -- and, again, no hypothetical
4 willing buyer would ever have paid that. Crown
5 would never have redeemed the shares for $5.3
6 million. And I'm happy to explain why.
7 But then the government also will
8 subject Thomas eventually to the capital gains
9 tax on the increase in the value of his shares.
10 And that, in our view, is the fundamental
11 problem with the government's approach here, and
12 that is why this is effectively double taxation.
13 And to just spell out for another
14 sentence or two why the $5.3 million valuation
15 --
16 JUSTICE KAGAN: But, if I can just
17 stop you there because it seems that the
18 fundamental problem with your approach is that
19 Thomas's -- you know, Thomas's asset has
20 quadrupled in value, and it's quadrupled in
21 value without him putting a single cent more
22 into the company.
23 And there might be some taxation
24 effect in the end of all that, but -- but not
25 sufficient to -- you know, to -- to make up for

1 the fact that your -- it's -- it's a -- it's a
2 tell that your way of -- of calculating the
3 thing is wrong that somebody can come away with
4 four times the value without putting a single
5 cent into the company.
6 MR. SHANMUGAM: So, with respect,
7 Justice Kagan, I completely disagree with that,
8 and let me explain why.
9 It is true that Thomas is in a very
10 real sense practically the beneficiary of the
11 life insurance proceeds. Why? Because those
12 proceeds extinguish the offsetting liability on
13 the books, the offsetting redemption obligation.
14 And so this is a context in which
15 Thomas does come away with the benefit of those
16 proceeds because he is the sole owner of a
17 company that is worth $3.86 million.
18 Now the government complains around
19 the edges about the fact that it's the capital
20 gains tax, the capital gains tax only operates
21 upon realization, there is a stepped-up basis
22 when someone dies and passes the stock along and
23 so forth.
24 But those are all features of the
25 capital gains tax system. That is not a bug

1 with our position. Again, our position is the
2 rational one precisely because the tax system
3 captures that increase.
4 And, of course, under our approach,
5 Michael's heir is still, of course, paying the
6 estate tax. Michael's heir is paying the estate
7 tax at -- on stock at around $3 million,
8 coincidentally roughly the amount that was
9 contained in the buy-sell agreement, which I
10 think confirms that that amount was a rational
11 amount here.
12 But the problem with the $5.3 million,
13 again, the government's view is -- let's take
14 Crown. The government's view is presumably that
15 if there had been a proper arm's-length
16 agreement here, Crown would have been willing to
17 pay $5.3 million to redeem this stock.
18 That would have required Crown to use
19 all of the life insurance proceeds here, the
20 entire $3.5 million, and also to dip into its
21 operating assets in order to redeem those
22 shares. That illustrates why the government's
23 position here is irrational.
24 Now, to be sure, I think there is a --
25 JUSTICE SOTOMAYOR: Why?

1 MR. SHANMUGAM: -- conceptual --

2 JUSTICE SOTOMAYOR: If -- if Thomas

3 had done what he needed to do, he would have --

4 both owners would have insured each other. They

5 would have paid the price and -- and gotten the

6 shares. What you did was to off that to the

7 corporation and give the corporation a benefit

8 that entitled Thomas to own the company a

9 hundred percent. I think that's where Justice

10 Thomas's question comes up.

11 MR. SHANMUGAM: Well, it wasn't --

12 JUSTICE SOTOMAYOR: The value of the

13 company is the value at which someone's going to

14 own a hundred percent shares of the stock.

15 MR. SHANMUGAM: So, Justice Sotomayor,

16 I think that that hypothetical which the

17 government uses actually helps our position, and

18 let me explain why.

19 The government acknowledges that if

20 you had a situation in which the individuals

21 themselves took out the insurance policies and

22 entered into a cross-purchase agreement, that it

23 would be subject to tax treatment along the

24 lines of what we are suggesting here.

25 Why should this situation be treated

1 differently? And -- and one reason
2 parenthetically why that alternative is
3 impractical is that if you have a company with
4 multiple owners, that gets very complicated, but
5 it's also distinguishable because, in that
6 situation, the individuals have to pay the
7 premiums.
8 Here, the reason why the corporation
9 is paying the premiums is precisely because the
10 corporation derives a benefit from this
11 arrangement, and that benefit, as I said in my
12 very first words, is continuity of ownership.
13 That is an incredibly valuable benefit to
14 closely-held corporations in this context.
15 And -- and so this is not a situation
16 in which the corporation itself derives any sort
17 of windfall. The corporation is paying premiums
18 and it gets the life insurance proceeds in
19 return.
20 I think what the government is really
21 bridling against --
22 JUSTICE SOTOMAYOR: Thank you.
23 JUSTICE BARRETT: Mr. Shanmugam, what
24 is the right perspective? So, when Justice
25 Thomas asked you the question, you know, he said

1 how much would you buy the company for, I think,
2 but regardless of how he asked it, I think that
3 would be one way to consider it, like what was
4 the whole value worth.
5 Or do we ask, if you had a stranger to
6 the situation, what would the price of one share
7 be? Is that the right way to think about it?
8 And then just kind of to build on to that, do
9 you assume the perspective of Thomas, you know,
10 someone who would buy one of Thomas's shares or
11 someone who would buy one of Michael's shares or
12 just someone like you could even pretend that
13 you had a third brother named Ralph who only had
14 one share?
15 Like, what's the right way to think
16 about it?
17 MR. SHANMUGAM: So, Justice Barrett,
18 it is a hypothetical buyer of the same
19 proportion of shares in the company. So it's a
20 hypothetical buyer of 77.18 percent of Crown's
21 shares.
22 Now I think the reason why we talk
23 about the value of a company here is that I
24 think we are in agreement that under the
25 relevant regulations -- and this is

1 2020-31(2)(f) -- we are really focusing on the
2 net worth of the company and then multiplying
3 the relevant percentage here. I think we and
4 the government are in agreement that that is the
5 correct approach here.
6 Now that will not always be true.
7 There may be circumstances in which, for
8 instance, that block of shares gives you a
9 control premium that needs to be valued. And
10 when you look at the lower court case law in
11 this area, often the price will then be adjusted
12 up or down.
13 But we're all in agreement that
14 there's no such adjustment here. And so,
15 really, the fundamental question here is what
16 was the net worth of the company. And to make
17 just two additional points about that, the first
18 is the reason why we're talking about a
19 hypothetical block of 77.18 percent of the
20 shares is precisely because, if we were talking
21 about Michael's actual shares, those shares are
22 about to be extinguished.
23 They're subject to the redemption
24 obligation. So I think there's really no good
25 conceptual way to do that. And I think that the

1 regulations recognize that when they talk about
2 the fact in 2020-31(1)(b) that you can look to
3 an equivalent asset, a comparable item in the
4 words of the regulation, when you're making this
5 determination.
6 And then I think the second thing that
7 I think is important to keep in mind here is,
8 when you're talking about the net worth of the
9 company, I don't really hear the government to
10 dispute the fact that an obligation to redeem
11 shares would be treated ordinarily -- and common
12 sense bears this out -- as a liability like any
13 other.
14 It's a legally-binding obligation.
15 The accounting standards treat it as a
16 liability. In fact, the accounting standards go
17 so far as to specifically enumerate stock to be
18 redeemed upon the death of the holder as giving
19 rise to a liability.
20 JUSTICE GORSUCH: So fair enough on
21 that, but I'll just see if I've got this right,
22 and tell me where I'm wrong.
23 You agree that the relevant value is
24 of the corporation as a whole. And, really, the
25 question is what do we do with the $3 million in

1 life insurance proceeds, how should that be
2 dealt with.
3 And I hear the government saying a
4 prospective buyer would consider that part of
5 the assets of the corporation, and, therefore,
6 it enhances the value of the company to five
7 point whatever it is. And I hear you saying no,
8 you really shouldn't count those insurance
9 proceeds because they're -- they're earmarked
10 for the redemption, and so no willing purchaser
11 would account for them in part of his assessment
12 of the value of the company.
13 Is that a fair assessment of the
14 difference between the two?
15 MR. SHANMUGAM: I would word the point
16 slightly differently, Justice Gorsuch, but I
17 think this difference is important. We're not
18 disputing that the life insurance proceeds are
19 an asset. What we're really debating here is
20 whether or not they are a net asset, whether --
21 JUSTICE GORSUCH: Whether a willing
22 buyer would consider them part of the value of
23 the company that he's going to obtain when
24 they're really earmarked for redemption.
25 MR. SHANMUGAM: And what a willing

1 buyer would do, I think, is to look at this and
2 to say: Yes, there are $3 million in life
3 insurance proceeds that are going to come into
4 the company, but those proceeds are going to
5 immediately go out again. They're going to go
6 out in order to fund this offsetting liability
7 which is on the books.
8 And under our approach, which, again,
9 I think accords with a healthy dose of common
10 sense here, when the parties entered into the
11 initial buy-sell agreement, that had the effect
12 of putting an asset and a liability on the books
13 at the same time.
14 JUSTICE GORSUCH: It offset one
15 another.
16 MR. SHANMUGAM: They offset each other
17 at every point.
18 JUSTICE GORSUCH: Okay. Now --
19 MR. SHANMUGAM: And that is precisely
20 why, as I said, in response to one of the
21 earlier questions, under our approach, the net
22 worth of the company is the same throughout. In
23 other words, it's the same before death, it's
24 the same at the moment of death, and it's the
25 same after the redemption obligation.

1 JUSTICE GORSUCH: Now one wrinkle to
2 that, though, is I don't think the life
3 insurance proceeds -- the only permitted use for
4 them was the redemption, and the government
5 makes something of that.
6 MR. SHANMUGAM: That is correct, and
7 that's why I didn't pick up on the word
8 "earmarked" in your question --
9 JUSTICE GORSUCH: Right. Right. And
10 -- yeah. And --
11 MR. SHANMUGAM: -- because money is
12 fungible.
13 JUSTICE GORSUCH: Yeah.
14 MR. SHANMUGAM: And so I think our
15 analysis would be the same if you were talking
16 about $3 million that happened to be some other
17 non-operating asset.
18 JUSTICE GORSUCH: It's still a $3
19 million liability.
20 MR. SHANMUGAM: It would still be
21 offset. And, indeed, in this case, the life
22 insurance policy was not for $3 million. It
23 turns out it was for $3.5 million. We're in all
24 -- we're all in agreement that the remaining
25 $500,000 is an asset, a non-operating asset that

1 should be on the company's books.

2 And so all we are doing here, I think,

3 is giving effect to the broader framework which

4 not just Congress but the Treasury and the IRS

5 has set up here, which is a framework that says

6 that when you are in the hypothetical world

7 conducting this analysis, you assume that the

8 hypothetical buyer and seller takes all relevant

9 facts into account.

10 JUSTICE KAVANAUGH: You -- you said --

11 MR. SHANMUGAM: And --

12 JUSTICE KAVANAUGH: Keep going, I'm

13 sorry.

14 MR. SHANMUGAM: And I think that the

15 problem with the government's approach is that

16 the government's approach requires you to do one

17 of two things: either to disregard the

18 offsetting liability or to assume -- and I

19 think, when you look at the government's

20 italicized hypotheticals, all of them

21 effectively do this -- to assume that your

22 hypothetical buyer is somehow going to be able

23 to capture the life insurance proceeds.

24 That was the flaw with the court of

25 appeals' reasoning because the court of appeals

1 posited a situation where you had a buyer not
2 just of the 77 percent of the shares but of the
3 entirety of the company. Of course, if a buyer
4 could get their hands on both Michael's shares
5 and Thomas's shares, presumably, the first thing
6 that buyer would do is to extinguish any
7 redemption obligation, not that that redemption
8 obligation would make any sense in that
9 hypothetical, and to have the benefit of the
10 $3.86 million in corporate value and the $3
11 million in life insurance proceeds.
12 JUSTICE KAVANAUGH: Something you said
13 that I think is critical to your position is
14 that the net worth before, on the day of, on the
15 day after, a month after, after the life
16 insurance and the -- and the redemption has
17 occurred or whenever after that, is -- is
18 constant.
19 MR. SHANMUGAM: Yes, and that is
20 different from a voluntary redemption. Much ink
21 is spilled both in the government's brief and --
22 and the briefs of the amicus law professors on
23 the fact that when you're dealing with a
24 voluntary redemption -- let's say a publicly
25 held company decides on the next day to redeem

1 shares, at that point, it is true that you are
2 going to have a diminution in the net worth,
3 which ensures that the remaining shareholders'
4 stock remains relatively constant.
5 That actually turns out not to be true
6 when you're dealing with publicly held companies
7 because often the stock will move up or down in
8 response to such an announcement, but I think
9 that basic principle is one that we don't
10 disagree with.
11 But everything in the government's
12 brief presupposes that a voluntary redemption
13 and a contractual obligation to redeem shares
14 are treated exactly the same way. And I think
15 the problem is that if you're a hypothetical
16 buyer looking at the company, a redemption
17 obligation is like any other debt. You see that
18 on the corporate books. And that is $3 million
19 that is going out the door.
20 Now, to be sure, this is a
21 hypothetical buyer, and so we are presupposing
22 that the buyer is not attempting to buy the
23 shares that are subject to the redemption
24 obligation. That would, again, be impossible
25 under the terms of the buy-sell agreement, and

1 even if they could, they would be entitled only
2 to $3 million, and we're disregarding that
3 figure.
4 JUSTICE KAVANAUGH: On -- on the
5 professors' -- Professor Chodorow and Professor
6 Hellwig's amicus briefs, obviously, they've
7 spent a lot of time thinking about this issue.
8 They're against you. Do you want to -- maybe
9 you just covered it in your view, but where do
10 they get it wrong? Maybe your point is the
11 voluntary redemption is where they -- where they
12 get it wrong, but I'd like some more explanation
13 because they -- they clearly have studied this.
14 MR. SHANMUGAM: I -- I -- I think that
15 that is -- the fundamental flaw is that they
16 really presuppose a voluntary redemption, and so
17 many of the principles that they set out and,
18 indeed, the four principles that the government
19 sets out are principles that we have no
20 objection to in that context.
21 In this context, by contrast, again,
22 it's that a hypothetical buyer would not somehow
23 disregard this redemption obligation. The
24 hypothetical buyer would take it into account
25 and recognize that the funds that are coming in

1 are going out the door again.

2 And to be clear, this results in no
3 windfall whatsoever to anyone other than the
4 benefit to Thomas that's going to be taxed.

5 I think, when the government says that
6 the purposes here are not legitimate, there's
7 nothing in the case that we disagree with more.
8 The reason that closely-held corporations engage
9 in these transactions, as the Chamber's amicus
10 brief explains at some length, is precisely
11 because this is a way of ensuring continuity of
12 operations without engaging in disruption.

13 If you don't have the life insurance
14 proceeds here, most of these companies, which
15 are typically very small, are going to have to
16 dip into operating assets or otherwise engage in
17 some sort of transaction to ensure continuity.
18 If you have an heir who doesn't want to run the
19 company or if the heir is someone outside the
20 family, you have a very real risk that that
21 person will not be interested in running the
22 company or that you'll have a disruption of
23 operations.

24 JUSTICE JACKSON: Mr. Shanmugam, can I
25 just ask you -- because I'm trying to follow.

1 So you've said many times that the money is
2 going out, but I guess I'm trying to figure out
3 whether the proceeds of the life insurance are
4 really going out when they're being used to
5 redeem the shares.
6 So what -- what is the effect on the
7 value of the remaining shares once the
8 redemption occurs?
9 MR. SHANMUGAM: So the remaining
10 shares effectively have a larger share of
11 ownership in the company. In other words --
12 JUSTICE JACKSON: Their value
13 increases. Is that where the four times that
14 Justice -- Justice Kagan was talking about -- is
15 that where that comes from?
16 MR. SHANMUGAM: Yes, that's correct.
17 And this is the contrast, I think, with a
18 voluntary redemption because, in the context of
19 a voluntary redemption, rather than these life
20 insurance proceeds, something else has to go out
21 of the company and you are getting the shares
22 back into the company.
23 And -- and the reason why that is
24 different is that, here, you are extinguishing
25 an existing liability. That is what makes this

1 different, is that you have a --
2 JUSTICE KAGAN: But you're treating
3 this --
4 MR. SHANMUGAM: -- liability on the
5 books.
6 JUSTICE KAGAN: -- you're treating
7 this redemption obligation like any other
8 redemption obligation, and it's really not like
9 any other redemption obligation because this
10 obligation is benefiting the equity interests
11 that we're trying to value. And so it -- it --
12 it just doesn't seem to make a lot of sense in
13 that context to say that the redemption
14 obligation simultaneously serves to reduce the
15 value of that interest.
16 MR. SHANMUGAM: I think that that's a
17 fair factual statement, but let me explain to
18 you why that should make no difference.
19 In our view, the -- the redemption
20 obligation is like any other debt from the
21 perspective of the hypothetical buyer. And I
22 recognize that this is the artificiality of the
23 case, but I think it's an artificiality of the
24 case that is inherent in the way that the
25 regulations work, and I think it's a problem

1 that the government has to come to terms with as
2 well.
3 Our view is that from the perspective
4 of a hypothetical third party, the fact that
5 this redemption obligation runs to somebody else
6 is of no moment. The hypothetical buyer here is
7 not in the same position as Michael. It's a
8 hypothetical buyer.
9 And so that is why we think that when
10 you're applying a regulation that requires you
11 to take into account all relevant facts, you've
12 got to look at the economic reality from the
13 position of the company.
14 And, again, the best way I think to
15 understand that is to think about whether or not
16 the government's fair market valuation would be
17 one that the parties would use. We know that
18 our fair market valuation, in fact, pretty
19 closely tracks the price that was agreed. Five
20 point three million dollars would have destroyed
21 Crown if Crown had spent that amount of money to
22 redeem the shares because, again, the life
23 insurance proceeds would not have covered that
24 amount. And I think that that illustrates why
25 the government's position cannot be correct.

1 CHIEF JUSTICE ROBERTS: Thank you,
2 counsel.
3 Justice Thomas?
4 Justice Alito?
5 Justice Sotomayor?
6 Justice Gorsuch?
7 Justice Kavanaugh?
8 Justice Barrett?
9 JUSTICE JACKSON: Can I just ask one
10 more question? Assume that the company doesn't
11 take out life insurance to fund the redemption.
12 The agreement just says the company promises to
13 redeem the shares at fair market value upon the
14 shareholder's death.
15 What, if anything, about your
16 treatment of the redemption obligation changes
17 in that circumstance?
18 MR. SHANMUGAM: So I think the
19 analysis is somewhat different, Justice Jackson.
20 And I think that that is similar to the two
21 sisters hypothetical that the government uses in
22 its brief, and that is for the simple reason --
23 and we've kind of been talking to some extent
24 about this -- that in that hypothetical, the
25 obligation to redeem shares actually has a

1 depressive effect on the company's future
2 earning capacity. Why? Precisely because the
3 company has to use other assets and typically
4 operating assets in order to fund the redemption
5 obligation.
6 And in that circumstance, there could
7 well be a depressive effect on the valuation,
8 and that depressive effect could, in fact, be
9 substantial. One reason why this circumstance
10 is different is precisely because, where you
11 have an offsetting life insurance policy and
12 redemption obligation, it actually makes sense
13 to think about valuation in terms of the net
14 worth of the company.
15 I think, once you start to get away
16 from that, the valuation of the company is
17 affected by its remaining operating assets, how
18 the business is going to do on a going-forward
19 basis. But, here, precisely because there's no
20 effect on the remainder of the company, it makes
21 sense to engage in the valuation by multiplying
22 the percentage of shares by the net worth.
23 JUSTICE JACKSON: Thank you.
24 CHIEF JUSTICE ROBERTS: Thank you,
25 counsel.

1 MR. SHANMUGAM: Thank you.
2 CHIEF JUSTICE ROBERTS: Ms. Dubin.
3 ORAL ARGUMENT OF YAIRA DUBIN
4 ON BEHALF OF THE RESPONDENT
5 MS. DUBIN: Mr. Chief Justice, and may
6 it please the Court:
7 The estate's evaluation of Michael
8 Connelly's shares contradicts basic math and
9 valuation principles. According to the estate,
10 before we can value Michael's shares in Crown,
11 we must first subtract the price that Crown paid
12 for Michael's shares. In other words, the
13 estate's theory is that before you can value
14 something, you must first subtract the price
15 paid for the very thing you are trying to value.
16 That makes no sense. Using the item
17 you're trying to value as a line item in its own
18 valuation will never give you the correct
19 answer, and it doesn't give the estate the right
20 answer here either.
21 The estate's contrary view rests on a
22 fundamental misunderstanding of the nature of a
23 redemption obligation. A redemption obligation
24 is not a corporate debt that reduces the
25 corporation's net worth or the value of the

1 shares to be redeemed. A debt owed to creditors
2 reduces corporate and shareholder value. A
3 redemption obligation divides the corporate pie
4 among existing shareholders without changing the
5 value of their interests.
6 And, here, the corporate pie was worth
7 6.86 million, not 3.86 million. And that's true
8 even if you look only at the estate's own
9 numbers. Petitioner admits that Michael's
10 estate walked away from the redemption with
11 approximately $3 million in cash, but Petitioner
12 also admits that Thomas walked away from the
13 redemption with $3.86 million in value.
14 And the estate doesn't dispute the
15 black-letter valuation principle that the
16 interest of each equity shareholder added
17 together has to equal the company's total value.
18 That defeats their position because that means
19 that Crown's total net worth before the family
20 divided the company was 6.86 million, the value
21 of the two equity slices put back together, and
22 that means that the estate's valuation of
23 Michael's 77 percent stake in Crown at $3
24 million came nowhere close to fair market value.
25 I welcome the Court's questions.

1 JUSTICE THOMAS: I think what
2 Petitioner is arguing is that, yes, we took the
3 insurance policy, the receipts, 3.5 million, we
4 paid out 3, and we received the shares, so it's
5 a wash. The 3 million, up to 3 million, is a
6 wash. So what do you do with that argument?
7 MS. DUBIN: Sure. So that argument
8 depends on the idea that the $3 million
9 redemption obligation is a debt, a liability,
10 and that's just not correct.
11 What it is is a promise to cash out
12 one of the existing shareholders' shares. So,
13 for example, in the two sisters hypothetical, on
14 page 27 of our brief, if you own 80 percent of a
15 company worth $5 million, you have a $4 million
16 stake in the company, a redemption obligation at
17 fair market value would be a promise to cash you
18 out for your shares for your stake in the
19 company.
20 It is not the same thing as the
21 corporation, for example, owing a mortgage or
22 some other debt. A mortgage or some other debt
23 like that would reduce the value of the company
24 and the value for its shareholders. That is
25 simply just not true of a redemption obligation.

1 And I think that, you know, it's sort
2 of important that Petitioner concedes that a
3 voluntary redemption obligation wouldn't
4 decrease the value of the company because, on
5 the date of Michael's death, it doesn't matter
6 whether the redemption obligation is voluntary
7 or mandatory.
8 Three million dollars is being paid to
9 Michael's shares, so that's where that money is
10 going. But it is going either whether that's
11 voluntary or mandatory. The point is that that
12 was part of the corporate assets here and it was
13 paid to Michael on the date of his death.
14 JUSTICE BARRETT: Do you agree that
15 none of the money escapes taxation because more
16 value -- I mean, the $3 million of the life
17 insurance proceeds didn't vanish. As you say,
18 it's retained by the company, and Mr. Shanmugam
19 was pointing out that Thomas will be taxed on
20 that as a capital gains tax when he sells out
21 his shares. So Mr. Shanmugam says that means
22 that the government is double dipping.
23 What do you have to say to that?
24 MS. DUBIN: A couple responses to
25 that. First of all, any sort of double dipping

1 allegation comes from the Connelly family's
2 decisions to value the shares at below fair
3 market value. Had these shares been redeemed
4 for fair market value, which is $5.3 million,
5 there would be no risk of double taxation. The
6 risk of double taxation comes because $2.3
7 million stayed in Crown and inured to Thomas's
8 benefit, but that money was really part of the
9 fair market value of Michael's shares.
10 In a normal -- in a transaction that
11 was done at fair market value, you would have
12 had 5.3 million go to Michael's estate, be
13 subject to the estate tax, and never be subject
14 to any possibility of future taxation through
15 capital gains on Thomas. So that's the first
16 answer, which is this problem comes because the
17 estate valued these shares below fair market
18 value.
19 But the second answer is that we just
20 simply can't know what will happen to Thomas's
21 shares in the future. Maybe they will be
22 subject to capital gains. It depends if he
23 bequeaths them. It depends what they're worth
24 at that time. That's a separate inquiry that
25 goes to the value of Thomas. The estate tax

1 cares about the value of Michael's shares at the
2 time of Michael's death and Michael's estate,
3 not what went to any of the particular heirs or
4 beneficiaries.
5 JUSTICE SOTOMAYOR: I thought -- am I
6 wrong that on -- on capital gains you pay the
7 tax when -- capital gain at the -- at the price
8 that you've gotten it?
9 MS. DUBIN: If -- if you get a
10 stepped-up basis.
11 JUSTICE SOTOMAYOR: And that's why he
12 won't pay on that.
13 MS. DUBIN: If he sells it during his
14 lifetime, he didn't get these shares as a
15 bequeathment, so he's not entitled to stepped-up
16 basis, but he could pass it on to his heirs with
17 a stepped-up basis.
18 JUSTICE SOTOMAYOR: Thank you.
19 JUSTICE KAVANAUGH: The net worth
20 question that Mr. Shanmugam said the net worth
21 stayed the same all the way through, A, do you
22 agree? B, why is that not relevant if it is
23 true?
24 MS. DUBIN: It's not true. The
25 corporation was worth 6.86 million on the date

1 of Michael's death. Our view is not that only
2 somehow Michael's shares had some value in them
3 that the corporation didn't have. Our view is
4 that the corporation's equity value is made up
5 by the equity stakeholder's value. Michael's
6 shares were entitled to a $5.3 million valuation
7 and Thomas's shares were a $1.5 million
8 valuation. That adds up to our $6.86 million
9 valuation.
10 JUSTICE KAVANAUGH: Why -- why is it
11 -- you said the redemption obligation is not a
12 debt. Just walk me through that if you can,
13 because I find this case extremely difficult.
14 So it seems like a key point and I'd like to
15 hear you explain it again.
16 MS. DUBIN: Sure. And I would just
17 start off with saying, I mean, I think
18 Petitioner agrees that a voluntary redemption is
19 not the paying of the debt.
20 JUSTICE KAVANAUGH: Yeah.
21 MS. DUBIN: So I think that sort of to
22 the extent we're --
23 JUSTICE KAVANAUGH: But he's saying
24 that's the key point in the case. I think
25 that's what he said. So I'd like to hear you

1 address that.

2 MS. DUBIN: Yeah. And I think that --

3 I think we've been talking a little bit about

4 the amicus briefs and they are very helpful in

5 explaining just the nature of a redemption

6 generally, but the nature of a redemption, what

7 a company is agreeing to do in a redemption is

8 to exchange one of the existing shareholders'

9 shares, so their stake in the company, their

10 equity stake in the company, in exchange for

11 cash.

12 So that's -- that's the promise. It's

13 we will get back your equity shares and we will

14 give you cash in exchange for it. If that were

15 done at fair market value, it would mean that if

16 you had an 80 percent stake in a $5 million

17 company, you would be entitled to $4 million in

18 cash.

19 What happens on the other side, your

20 shares are extinguished, so they no longer

21 exist. So the remaining shareholder, who was a

22 20 percent stakeholder in our $5 million

23 company, he had originally, to start, he had a

24 20 percent stake in a $5 million company, which

25 is a $1 million stake. Now, after this

1 redemption which is paid out at $4 million, he
2 would be left with sole ownership of a $1
3 million company.
4 So, in a redemption, both of the
5 corporate shareholders, if the redemption is
6 done at fair market value, they both walk away
7 with the same value they had before. By
8 contrast, in a debt situation where you're
9 paying a debt, the corporation pays money out of
10 its coffers to someone outside the corporation
11 and that will reduce both the corporate and the
12 shareholder value, and if this had been that
13 sort of $3 million debt, then Petitioner's
14 analysis would be right, but, here, the $3
15 million went into Michael's pocket, it went to
16 one of the equity shareholders. So that does
17 not decrease the value of the corporation or, of
18 course, the value of the shares to be redeemed.
19 And I think just to pause on that for
20 a second, you know, Petitioner says what we're
21 really valuing here is some theoretical stake in
22 the corporation, not Michael's shares. That's
23 not correct as a matter of the statute. The
24 statute tells us in 26 U.S.C. 2031, 2033, and
25 2036 that the relevant shares to be valued here

1 are the decedent's shares. That's, of course,
2 what we're valuing. So that's not correct.
3 But, even if you were going to value
4 some hypothetical 77 percent stake in the
5 company, some 70 percent seven -- 77 percent
6 stake in the company with a redemption
7 obligation or anything like that, you would
8 always get $5.3 million because $5.3 million is
9 what that stake is equivalent to.
10 The only way you get Petitioner's
11 numbers is if you treat it as if there's a
12 separate $3 million debt that you first take out
13 of the company and then you try to value
14 Michael's shares. But that just doesn't make
15 sense because that $3 million runs to the holder
16 of Michael's shares. It is not some
17 free-floating debt out there in the universe.
18 JUSTICE BARRETT: But it would work if
19 -- Petitioner's would work if it was a
20 free-floating debt somewhere outside in the
21 universe?
22 MS. DUBIN: Yes. If it were a debt
23 owed to creditors just generally when you're
24 doing a very simplistic valuation of a
25 corporation, you would subtract the liabilities

1 owed to creditors before you determine what is
2 the equity value remaining.
3 But, here, we're looking at an equity
4 stake and money paid to an equity stake, and you
5 can't say that that reduces the value of that
6 equity stake or the value of the corporation as
7 a whole.
8 JUSTICE GORSUCH: Would your answer
9 differ if the life insurance proceeds had been
10 earmarked for the redemption of Michael's
11 shares?
12 MS. DUBIN: No. The parties' intent
13 doesn't govern here. I think both we and
14 Petitioner agree that the $3 million is actually
15 an asset to the corporation. It does count.
16 And we both agree on that. The only question is
17 whether it's offset by a debt, offset by a
18 liability, and for that -- and for that purpose,
19 I think it doesn't matter.
20 JUSTICE GORSUCH: Well, help me on
21 that because I understand a hypothetical
22 purchaser of the company as a whole would say:
23 Ah, that $3 million is going to inure to my
24 benefit because I'm just going to extinguish the
25 redemption obligation and off we go.

1 But, if somebody's purchasing
2 Michael's shares at the time of his death, why
3 -- why isn't it different then and -- and --
4 because we're assessing his estate value, and
5 there you have an obligation to pay him out and
6 the insurance proceeds coming in to do that.
7 MS. DUBIN: Absolutely. And the
8 answer is that for all of the illustrations that
9 we've suggested, whether it's a buyer of Crown
10 as a whole, whether it's a buyer of just
11 Michael's shares, you will always be able to
12 capture the value of the insurance proceeds.
13 JUSTICE GORSUCH: Okay. But you agree
14 the relevant measure is the buyer of Michael's
15 shares?
16 MS. DUBIN: Yes, although, as
17 Petitioner mentioned, we agree that it's a pro
18 rata share of Crown as a whole, so you will get
19 the same number whether you value a buyer of
20 Crown as a whole and then take Michael's pro
21 rata share of that or value just Michael's
22 shares. Either way, a buyer who just buys
23 Michael's shares is going to get a 77 percent
24 stake in a company with total assets of $6.86
25 million. So, if that redemption obligation now

1 runs to him, he will get cash in exchange for
2 the 77 percent obligation. If the redemption
3 obligation is for some reason not honored or
4 whatever it is, then he has a 77 percent stake
5 in a company worth $6.86 million.
6 But the problem with Petitioner's case
7 is that he tries to take $3 million out of that
8 pot. But the problem is that that $3 million
9 goes to the holder of Michael's shares.
10 JUSTICE KAVANAUGH: Feel free to tell
11 me this is the wrong question, but what's the
12 net worth of the company after the shares are
13 redeemed?
14 MS. DUBIN: On Petitioner's view, it's
15 $3.86 million, and you see this in the pie
16 charts that they have on their reply brief on
17 page 6.
18 JUSTICE KAVANAUGH: Well, how about on
19 your view?
20 MS. DUBIN: On our view, had the
21 redemption been done at fair market value, which
22 it was not, had the redemption been done at fair
23 market value, it would be 1.53 million.
24 But I think that that picks up on a
25 critical point, which is our -- our view, the

1 government's view, here about how the estate tax
2 works doesn't change how the parties had to
3 structure their transactions. They are free to
4 redeem shares at below fair market value for
5 whatever business or idiosyncratic reasons they
6 want to. But the estate tax looks at what was
7 the fair market value of those shares.
8 JUSTICE KAVANAUGH: So, after they get
9 the life insurance proceeds and redeem the
10 shares, the net worth of the company's dropped
11 dramatically in your estimation?
12 MS. DUBIN: Yes. And that's the
13 fundamental way when you're --
14 JUSTICE KAVANAUGH: Doesn't that
15 seem that -- just explain that to me.
16 MS. DUBIN: Sure, and I think this
17 goes a little bit to your questions earlier
18 about how a redemption is supposed to work.
19 A redemption is a -- essentially, it's
20 sort of like a spinoff, right? You're dividing
21 the corporate assets among existing
22 shareholders. One is getting cash in exchange
23 for their share, and one gets sole ownership of
24 a company worth less.
25 It is a problem for Petitioner that

1 notwithstanding that that's how a redemption is
2 supposed to work in his view, the corporation
3 maintains the same amount before and after. And
4 the reason that the problem comes from is
5 because he's saying the corporation is worth
6 $3.86 million before, but it's actually worth
7 6.86 million.
8 JUSTICE KAVANAUGH: I think it's odd
9 that you have a net worth of the company --
10 what's the net worth of the company in your view
11 the day before he dies?
12 MS. DUBIN: So just -- I don't -- I
13 don't mean to pause, but the trickiness of it is
14 trying to value the life insurance policies the
15 day before he dies. There's a cash surrender
16 value of the life insurance policies, which is
17 approximately $500,000 the day before Michael
18 dies. So that's a little bit tricky.
19 But putting aside any interest in the
20 life insurance policies whatsoever, it's around
21 $3 million.
22 JUSTICE KAVANAUGH: Okay. And then,
23 after he dies, even though they've bought the
24 life insurance for exactly this purpose, the net
25 worth of the company has dipped in half, right?

1 MS. DUBIN: So two --
2 JUSTICE KAVANAUGH: That seems a
3 little -- I mean, maybe you say they just messed
4 up, but that -- the whole purpose of the life
5 insurance policy was to make sure that didn't
6 happen, right?
7 MS. DUBIN: So two responses to that.
8 On the first point, if you're only looking at
9 Crown, it is correct that after the redemption,
10 Crown becomes a smaller company. That's how
11 redemptions work. But, if you're looking at the
12 total value that the Connelly family walked away
13 with, they are going to walk away with a total
14 of $6.86 million. Some of it was used to buy
15 out Crown -- buy out Michael, and some of it was
16 used to Crown.
17 To your point about what the parties
18 want --
19 JUSTICE KAVANAUGH: The whole family
20 mean -- and Thomas got out of this -- well, I
21 think, but I'm not sure why the company's net
22 worth should dip in half when the whole purpose
23 of getting the life insurance policy, I think --
24 you've probably already answered this, but the
25 life insurance policy was meant to prevent that,

1 I thought.

2 MS. DUBIN: I think that -- my

3 understanding is that is what the parties

4 intended. Intent doesn't govern here.

5 JUSTICE KAVANAUGH: I -- I got it, but

6 it's weird to walk away the day after his death

7 with a company that's suddenly worth 50 percent

8 of what it had been worth the day before his

9 death, even though you bought a life insurance

10 policy to cover the redemption.

11 MS. DUBIN: Yeah. So two -- two

12 responses to that. One is it's really not

13 strange in the concept of what a redemption is.

14 That is what a redemption is supposed to do. A

15 redemption is supposed to give one shareholder

16 cash in exchange for their assets, and the other

17 one is supposed to maintain control of the

18 smaller company.

19 But, to your point about doesn't seem

20 like that's what the parties wanted to do here,

21 you're right, what the parties wanted to do here

22 was maintain Crown as a $3.86 million enterprise

23 and give Michael $3 million. That's what the

24 parties wanted. That means that there's $6.86

25 million of value in the estate tax because

1 Michael owned that $6.86 million of value. His
2 percentage stake of it says that was the fair
3 value -- market value of Michael's shares.
4 I think that sort of pulls up, you
5 know, Petitioner's points about continuity of
6 ownership. There are many ways in which to
7 arrange for continuity of ownership of a
8 closely-held corporation, but what you can't do
9 is have $6.86 million of corporate assets by
10 virtue of a life insurance proceed, take $3
11 million out and give it to one shareholder,
12 maintain the company at its $3.86 million size,
13 and then maintain for purposes of the estate tax
14 that the company wasn't worth $6.86 million.
15 JUSTICE GORSUCH: What do we --
16 CHIEF JUSTICE ROBERTS: Do you --
17 JUSTICE GORSUCH: I'm sorry, Chief.
18 CHIEF JUSTICE ROBERTS: Do you dispute
19 your friend's statement that this has been a
20 common way for family corporations to maintain
21 continuity of operations? And is -- if -- if
22 that's the case, how -- how long has the
23 government overlooked the fact that there was
24 this great pool of money out there waiting for
25 them to take?

1 MS. DUBIN: Sure. So our
2 understanding is not Petitioner's understanding.
3 This is what we know, and I'll tell you what we
4 know, which is there have only been these three
5 reported cases that we know of. So it's Blount
6 and Cartwright from 1999 and 2005 and then this
7 case. That's it. So, in terms of the litigated
8 cases, not very many.
9 We did ask at the cert stage the IRS
10 examiners who are charged with looking at estate
11 tax returns if they're seeing a lot of these in
12 the pipeline, and they are not. They couldn't
13 find any. So they didn't see any sort of
14 maneuvers like this in the fact patterns in what
15 they are looking at.
16 I understand that that's not, you
17 know, sort of a conclusive view of whether
18 people are doing it or not. My guess is that --
19 or my view is what should have been happening is
20 that tax advisors are looking at what you have
21 on the one hand is the Ninth and Eleventh
22 Circuit extremely thinly reasoned decisions on
23 this, and on the other hand, what you have is
24 the Tax Court's decision in Blount I, and the
25 Tax Court's decision in Blount I explains

1 extremes clearly that this doesn't make sense
2 because you are, you know, subtracting the value
3 of the very thing you're trying to price in
4 determining the value of that thing.
5 JUSTICE KAGAN: And so what do most --
6 CHIEF JUSTICE ROBERTS: So the -- I'm
7 sorry. I just was going to say, so the Ninth
8 and the Eleventh Circuits were on your friend's
9 side?
10 MS. DUBIN: That's right.
11 CHIEF JUSTICE ROBERTS: Which might
12 suggest that it is a common way of -- for family
13 corporations to maintain continuity of
14 operations.
15 MS. DUBIN: Right. So I would say my
16 best guess is that if -- if this is happening
17 often, it was probably happening in the Ninth
18 and Eleventh Circuits, which, of course, this
19 case doesn't arise from. This comes from the
20 Eighth Circuit. And that -- that might be one
21 way that advisors are saying they can do it in
22 those circuits.
23 Tax advisors tend to be risk averse.
24 I think they would be very well aware of the
25 fact that there are other ways to structure

1 this, like the cross-insurance agreement or held
2 by a trust or various ways in which the critical
3 piece is that the life insurance proceeds do not
4 go into the corporation, because the premise of
5 Blount and Cartwright, the court of appeals
6 decisions, is that somehow you can have money
7 come into a corporation and have it not count
8 when you're valuing shares in the corporation.
9 And there's no reasoning whatsoever to
10 explain why they think it's appropriate to treat
11 the redemption --
12 CHIEF JUSTICE ROBERTS: Well --
13 MS. DUBIN: -- obligation as a
14 liability.
15 CHIEF JUSTICE ROBERTS: Well, they
16 might think it's appropriate because the money
17 that comes in goes out fairly quickly.
18 MS. DUBIN: I agree that's definitely
19 the sort of initial appeal of what Petitioner is
20 saying and what the courts must have thought was
21 true in Blount and Cartwright. It's simply just
22 not correct, though, because the going out
23 matters. If it's going out to a creditor, it
24 reduces the corporation's net worth, and it
25 would reduce the shareholders' value. We

1 absolutely agree with that.
2 But, here, when it went out, it went
3 out to the holder of Michael's equity stake.
4 Michael has a stake, and we are cashing out his
5 shares. That's what's happening there. So it's
6 not something that reduces the value of the
7 shareholders' shares. It would not reduce the
8 value of Michael's shares, and it wouldn't
9 reduce Crown's net worth when we're looking at
10 it. It's not a debt owed to creditors. It is a
11 promise to exchange a shareholder's shares for
12 cash.
13 JUSTICE KAGAN: So, if the IRS doesn't
14 see many people doing this, what are they
15 seeing? What do families do instead?
16 MS. DUBIN: Our understanding is it is
17 much more common to do the cross-purchase
18 arrangement so you keep -- right. The two
19 brothers would cross-insure each other. The
20 life insurance proceeds would never come into
21 the corporation. And so you have a situation
22 where, if Thomas wanted to, he could buy Michael
23 out, and that would be a much simpler way of
24 accomplishing that, and you wouldn't have this
25 problem that we're dealing with here where you

1 have corporate assets that Petitioner has to
2 argue shouldn't be counted as corporate assets.
3 CHIEF JUSTICE ROBERTS: And the reason
4 that's not as attractive is because, in this
5 situation, it's the corporation that is paying
6 the premiums or --
7 MS. DUBIN: They're a different --
8 they're not economically exactly the same
9 transactions, of course. It's not us saying
10 that this is, you know, sort of just a
11 form-over-substance distinction. That's not
12 what's happening here. They're different.
13 In the situation that happened here,
14 you had Crown paying the premiums, Crown had the
15 benefits and burdens of ownership, and that's
16 why, in the end, when Crown then gets the
17 proceeds, it's treated as a corporate asset.
18 In the cross-insurance arrangement, it
19 would be the brothers personally responsible for
20 maintaining those life insurance policies. And,
21 no, there would not be the same confidence from
22 one brother to another that you will maintain
23 those policies.
24 So these -- these different tactics do
25 have different economic consequences, but those

1 are the choices taxpayers can make as they're
2 navigating how can we minimize the estate tax
3 consequences of a large estate.
4 JUSTICE KAVANAUGH: Your position
5 doesn't depend on this, but I think it's little
6 rough to tell a tax advisor, oh, figure out
7 whether the Ninth and Eleventh Circuit opinions
8 are thinly reasoned and don't follow them when
9 they're --
10 MS. DUBIN: So I don't -- I don't mean
11 to disparage those decisions in any way, but I
12 think that if Your Honor would look at them, I
13 don't think you would need to be a tax
14 specialist to think that they are not a fulsome
15 analysis of this issue. There's a few
16 sentences, and they don't engage at all with the
17 arguments that --
18 JUSTICE KAVANAUGH: Right, but the --
19 MS. DUBIN: -- the IRS had been
20 making.
21 JUSTICE KAVANAUGH: Right. That's
22 fair. But, normally, you'd rely on the bottom
23 line, I think, if you were in that business of
24 two -- two courts of appeals, but --
25 MS. DUBIN: Well, just to clarify that

1 --

2 JUSTICE SOTOMAYOR: But you have a

3 whole bunch of academics who for years have been

4 writing about this.

5 MS. DUBIN: There are many academics

6 writing about it, including one of the amicus

7 here, Professor Chodorow. There's also many,

8 many other articles that have come out since

9 those cases explaining why they're wrong,

10 including those by Delaney, Burke, and

11 Bogdanski, and other professors.

12 But I think just to go to sort of the

13 heart of your question, the Tax Court, you know,

14 is free -- it doesn't have to follow the Ninth

15 and Eleventh Circuit decisions. So, if you are

16 coming up in a circuit that is not the Ninth or

17 Eleventh, there is no reason for you to think

18 that those Ninth and Eleventh Circuit precedents

19 are governing. And I do expect that tax

20 advisors would know that.

21 JUSTICE KAVANAUGH: Mm-hmm.

22 JUSTICE KAGAN: But if I could just

23 sort of put this in most simple -- you know,

24 it's a little bit hard for me to get this

25 through my head, but your basic pitch is this is

1 not any old liability. This is a redemption
2 obligation. A redemption obligation is supposed
3 to split the pie, so you come away with a
4 smaller pie. That's because that's what
5 redemption obligations do.
6 MS. DUBIN: Yes, that's correct.
7 That's our basic pitch about a redemption
8 obligation. I would just add that the other
9 part of our pitch is that the hole in their case
10 is that they are trying to value Michael's
11 shares after Crown already redeemed them.
12 You can't do that. The price paid out
13 for Michael's shares is value that goes to
14 Michael's shares. If you subtract that as a $3
15 million liability before trying to value
16 Michael's shares, you will never get the correct
17 answer.
18 CHIEF JUSTICE ROBERTS: Thank you,
19 counsel.
20 Anyone, anything further? Anything
21 further? No?
22 Thank you.
23 Rebuttal, Mr. Shanmugam.
24
25

1 REBUTTAL ARGUMENT OF KANNON K. SHANMUGAM
2 ON BEHALF OF THE PETITIONER
3 MR. SHANMUGAM: So the gist of the
4 government's position is that it is not any old
5 obligation. But that's the fundamental problem
6 with the government's position.
7 You see, the government doesn't
8 dispute the fact that it is a liability in
9 common sense or accounting terms. They say:
10 Well, it's a liability that runs to an equity
11 holder. It's a liability that runs to the
12 Michael -- to Michael. But the problem here is
13 that we're analyzing this from the perspective
14 of a hypothetical buyer, not Michael.
15 And from the perspective of a
16 hypothetical buyer, this is, therefore, like any
17 other debt. The fact that the debt runs to one
18 of the other shareholders rather than to the
19 bank that holds the mortgage is of no moment.
20 It is a liability that does not inure to the
21 benefit of the hypothetical buyer.
22 And so, when valuing the company and
23 determining its net worth, you have to look at
24 it from the perspective of somebody who is
25 examining the entirety of the company and try to

1 figure out what he or she would pay for that
2 share.
3 And while it is true that we're trying
4 to value Michael's shares, we're not trying to
5 value Michael's actual shares because, after
6 all, those are the precise shares that are
7 subject to the $3 million redemption obligation
8 and are going to be extinguished. That's why
9 you have to make the move to a hypothetical
10 block of shares in the same proportion.
11 Now let's drill down a little bit
12 about the basic flaw in the government's
13 position. I think this flaw was illustrated in
14 the colloquy between my friend, Ms. Dubin, and
15 Justice Kavanaugh, and that is because the
16 government's position is not just that Michael's
17 shares are worth $5.13 million. It's that after
18 the redemption, the remaining shares, Thomas's
19 shares, would be worth $1.53 million.
20 What does that tell you? It tells you
21 that in order to engage in a redemption at fair
22 market value, the company would have to do
23 something that it would never do. This is a
24 $3.86 million company that would have to use
25 some of that corporate value and some of its

1 operating assets in order to redeem the shares
2 and thereby diminish the remainder of the
3 company and be left with a stub of a company.
4 And particularly for a company like
5 Crown in an industry like the construction
6 industry, where most of the assets are literally
7 bricks and mortar inventory, that is something
8 that is completely counterfactual and would
9 never take place in the real world.
10 And, parenthetically, to the extent
11 that the government comes back to the fact that
12 supposedly under our approach the two sets of
13 shares would add up to $6.86 million because
14 Thomas's shares would be valued at $3.86
15 million, the problem with that is that $3.86
16 million is the post-redemption value of Thomas's
17 shares.
18 Under our approach, as the pie charts
19 in our reply brief bear out, if you are valuing
20 Thomas's shares, those shares would be worth
21 only $880,000 at the time of Michael's death
22 precisely because what you're trying to do is to
23 value the entire company from the perspective of
24 a hypothetical buyer.
25 Now, to the extent that the government

1 says, well, you're getting a benefit here,
2 you're getting a $3 million redemption of shares
3 and Thomas is walking away with the same company
4 that existed beforehand, that is a feature of
5 the fact that the company is getting, through
6 awards of the life insurance, it is getting $3
7 million and that $3 million is being put to use.
8 But that is being accounted for by the
9 operation of the tax system and, in particular,
10 the operation of the capital gains tax. And to
11 the extent that Ms. Dubin today in response to
12 Justice Sotomayor said: Well, you may not get
13 that money right away, you only get it upon
14 realization, you only get the difference between
15 the value at the time of realization and the
16 value at the time that Thomas acquired the
17 shares, all of those are features of the capital
18 gains system.
19 In terms of whether or not this is a
20 common practice, that's obviously a hard thing
21 to quantify. I would respectfully submit that
22 the number of client alerts and -- and the
23 amount of froth in the industry in response to
24 the Court's grant of cert suggests that this is
25 a pretty common practice.

1 But, if we look at the reported cases,
2 I think the two critical facts are, first, that
3 the government, in fact, took the contrary
4 position in Estate of Cartwright, a case where
5 the contrary position benefitted the government
6 because we were dealing with income tax rather
7 than the estate tax; second, that the government
8 never indicated its non-acquiescence in those
9 decisions as the IRS sometimes does when it
10 disagrees with them; and, third, that I think
11 it's a little bit unfair to disparage the Ninth
12 and the Eleventh Circuits here because it isn't
13 as if the Eighth Circuit offered more extended
14 reasoning.
15 The sum total of the Eighth Circuit's
16 reasoning was that if you posited a buyer of the
17 entirety of the company, that buyer could
18 capture the value of the life insurance
19 proceeds. And, ultimately, that analysis is
20 fundamentally flawed.
21 And none of the alternative ways of
22 attempting to achieve the same result that the
23 government posits, in fact, are successful. I
24 think Ms. Dubin actually herself illustrated the
25 flaws with individuals cross-purchasing

1 insurance in order to conduct this arrangement
2 off the corporate books. Individuals could, of
3 course, charge their minds. There would be the
4 lack of certainty. But, fundamentally, the
5 corporation would not be paying the premiums,
6 and the corporation is the one who benefits from
7 continuity of ownership.
8 Thank you.
9 CHIEF JUSTICE ROBERTS: Thank you,
10 counsel.
11 The case is submitted.
12 (Whereupon, at 12:35 p.m., the case
13 was submitted.)
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## $

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