No. 23-146

In the Supreme Court of the United States

THOMAS A. CONNELLY, PETITIONER

v.

INTERNAL REVENUE SERVICE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

The federal estate tax is assessed on the fair market value of all property that passes from the decedent. See 26 U.S.C. 2001(a). The fair market value of the decedent's property "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." 26 C.F.R. 20.2031-1(b). Regulations provide that when valuing property that is not freely traded, such as stock in a closely held corporation, various factors must be considered, "including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such [proceeds] have not been taken into account" in the valuation. 26 C.F.R. 20.2031-2(f)(2).

The question presented is whether the lower courts erred by including the proceeds of a life-insurance policy used to redeem decedent's shares in a closely held corporation when valuing that corporation for purposes of the federal estate tax.

TABLE OF CONTENTS

Page

Opinions below 1
Jurisdiction 1
Statement 2
Argument 9
Conclusion 21

TABLE OF AUTHORITIES

Cases:

Ahmanson Found. v. *United States*, 674 F.2d 761 (9th Cir. 1981) 15

Consove v. *Cohen* (*In re Roco Corp.*), 701 F.2d 978 (1st Cir. 1983) 12

Dorn v. *United States*, 828 F.2d 177 (3d Cir. 1987) 2

Dreiseszun v. *FLM Indus., Inc.*, 577 S.W.2d 902 (Mo. Ct. App. 1979) 11

Estate of Blount v. *Commissioner*, 428 F.3d 1338 (11th Cir. 2005) 8

428 F.3d 1338 (11th Cir. 2005) 8, 18, 19

Estate of Bright v. *United States*, 658 F.2d 999 (5th Cir. 1981) 2

Estate of Cartwright v. *Commissioner*, 183 F.3d 1034 (1999) 16, 17

Estate of Huntsman v. *Commissioner*, 66 T.C. 861 (1976) 19

Estate of Jelke v. *Commissioner*, 507 F.3d 1317 (11th Cir. 2007), cert. denied, 555 U.S. 826 (2008) 14

Estate of True v. *Commissioner*, 390 F.3d 1210 (10th Cir. 2004) 2

Graver Tank & Mfg. Co. v. *Linde Air Prods. Co.*, 336 U.S. 271 (1949) 15

Cases—Continued: Page

Ithaca Trust Co. v. *United States*,
279 U.S. 151 (1929) 15
Kyles v. *Whitley*, 514 U.S. 419 (1995) 14
United States v. *Cartwright*, 411 U.S. 546 (1973) 2
United States v. *Johnston*, 268 U.S. 220 (1925) 14
YMCA v. *Davis*, 264 U.S. 47 (1924) 16

Statutes and regulations:

Internal Revenue Code (26 U.S.C.):
§ 162(a)(1) 17
§ 2001 10
§ 2001(a) 2
§ 2031(a) 2, 10
§ 2031(b) 10
§ 2033 10
§ 2033 (Supp. II 1954) 2
§ 2051 10
§ 2703 6
§ 2703(a) 6

26 C.F.R.:
Section 20.2031-1 .... 2, 10
Section 20.2031-1(b) 2, 10
Section 20.2031-2 10
Section 20.2031-2(a) 10, 11
Section 20.2031-2(f) 14
Section 20.2031-2(f)(2) 3, 7, 10, 13, 18
Section 20.2031-2(h) 18

Miscellaneous: Page

3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 21:2 (3d ed. Dec. 2022 update) 15

6A Fletcher Cyclopedia of the Law of Corporations:

Vol. 6A (Sept. 2022) 9

Vol. 12B (Sept. 2023) 17

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 70 F.4th 412. The order of the district court granting respondent's motion for summary judgment (Pet. App. 16a-55a) is unreported but is available at 2021 WL 4281288.

JURISDICTION

The judgment of the court of appeals was entered on June 2, 2023. The petition for a writ of certiorari was

* The caption in the petition names the "Internal Revenue Service" as respondent. The caption in the court of appeals, however, identified the defendant-appellee as "United States of America, Department of Treasury, Internal Revenue Service." The proper defendant in a tax-refund action such as this case is the United States. See 26 U.S.C 7422(f)(1); 28 U.S.C. 1346(a)(1).

filed on August 15, 2023. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. "The estate of every decedent who is a United States citizen or resident is subject to tax" under 26 U.S.C. 2001(a). *Estate of True* v. *Commissioner*, 390 F.3d 1210, 1217 (10th Cir. 2004). The value of a decedent's gross estate is "the starting point for the calculation of the amount of [estate] tax to be paid" and "includes 'the value of all property to the extent of the interest therein of the decedent at the time of his death.'" *Dorn* v. *United States*, 828 F.2d 177, 180 (3d Cir. 1987) (quoting 26 U.S.C. 2033 (Supp. II 1954)); see also 26 U.S.C. 2031(a); 26 C.F.R. 20.2031-1. "[T]he valuation is to be made as of the moment of death and is to be measured by the interest that passes." *Estate of Bright* v. *United States*, 658 F.2d 999, 1006 (5th Cir. 1981).

Regulations promulgated by the Department of the Treasury provide that the value of the gross estate is determined by the "fair market value" of the property, which "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." 26 C.F.R. 20.2031-1(b). The willing buyer and willing seller in the test are not the actual parties but are instead a hypothetical buyer and seller who must agree to a transaction. See *Bright*, 658 F.2d at 1005-1006. "The willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves[.]" *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973).

This case involves valuation of a decedent's shares in a closely held corporation, that is, a corporation owned

by a small group of shareholders. Often with closely held corporations, there are no arm's-length sales or bid-and-asked stock prices that can be used to value the corporation's shares. In such circumstances, the decedent's shares are valued by considering "the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors." 26 C.F.R. 20.2031-2(f)(2). The regulations further specify that "consideration shall also be given to nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such nonoperating assets have not been taken into account in the determination of net worth, prospective earning power and dividend-earning capacity." *Ibid.*

2. a. Crown C Supply, Inc. (Crown) is a closely held corporation. Pet. App. 16a. Petitioner's brother, Michael Connelly, was the President and Chief Executive Officer of Crown until his death on October 1, 2013. *Id.* at 2a, 18a; C.A. App. 264-265. At the time of his death, Michael owned 77.18% of Crown's shares (385.9 out of 500 shares), and petitioner Thomas Connelly owned the remaining 22.82% (114.1 shares). Pet. App. 2a, 18a; C.A. App. 265.

In 2001, Michael, Thomas, and Crown entered into a stock-purchase agreement. Pet. App. 2a; C.A. App. 73-95. The agreement provided that upon the death of a Crown shareholder, any surviving shareholders had the option to purchase the decedent's Crown shares. Pet. App. 2a; C.A. App. 81-82. If they declined to do so, Crown was required to redeem the decedent's shares. Pet. App. 2a; C.A. App. 82. The agreement provided two mechanisms for determining the price at which Crown would redeem the shares: First, the agreement said that the shareholders "shall, by mutual agreement,

determine the agreed value per Share by executing a new Certificate of Agreed Value" after the end of every tax year. C.A. App. 83. Second, as an alternative, the agreement provided that if the shareholders failed to execute a timely "Certificate of Agreed Value," they would determine the "Appraised Value Per Share" by securing two or more appraisals. *Id.* at 82-83. It is undisputed that the parties to the agreement never complied with either of those two valuation requirements. Pet. App. 20a; Gov't C.A. App. 30-32.

Crown obtained $3.5 million in life insurance on each brother to fund the anticipated stock redemptions. Pet. App. 3a, 18a; C.A. App. 218, 266-267. When Michael died in October 2013, Crown was entitled to receive and did receive approximately $3.5 million in life-insurance proceeds. Pet. App. 3a, 10a n.4, 20a; C.A. App. 270. His brother opted not to purchase Michael's shares. Instead, in November 2013, he agreed with Michael's son that Crown would redeem Michael's 77.18% interest. Pet. App. 3a; C.A. App. 96-101. Rather than perform an appraisal to determine the value of those shares, however, petitioner and Michael's son simply "agreed that the value of the stock" was $3 million. Pet. App. 3a; C.A. App. 96. As a result of the stock redemption, and without any additional investment, Thomas obtained 100% ownership of Crown. Pet. App. 15a; Gov't C.A. App. 34-35.

b. Petitioner, in his capacity as executor of Michael's estate, filed an estate-tax return reporting the value of Michael's Crown shares as $3 million. Pet. App. 3a, 20a-21a; Gov't C.A. App. 26. That reported value was based on the agreed-upon redemption price for Michael's shares.

The Internal Revenue Service (IRS) audited the estate's return. Pet. App. 21a. During the audit, petitioner obtained a report on Crown's fair market value from an accounting firm. C.A. App. 102-129. The firm determined a date-of-death value of Crown of $3,863,819. See *id.* at 129; Gov't C.A. App. 20. Although that valuation purported to include the "non-operating assets" of Crown, C.A. App. 106, it did not include the $3 million in life-insurance proceeds that were used after Michael's death to redeem his shares, Gov't C.A. App. 85.[1] The IRS determined that the life-insurance proceeds needed to be included in Crown's valuation, yielding a date-of-death value of $6.86 million. Pet. App. 4a. The IRS further determined that the fair market value of Michael's shares was approximately $5.3 million ($6.86 million × 77.18%) and that the estate therefore owed additional tax of $889,914. Pet. App. 3a-4a; C.A. App. 54, 59.

3. The estate paid the additional amount and then brought this tax-refund suit in the United States District Court for the Eastern District of Missouri. Pet. App. 4a.

The parties filed cross-motions for summary judgment. Pet. App. 23a. Petitioner primarily contended that the stock-purchase agreement and the resulting redemption transaction between Thomas and Michael controlled the valuation of the shares for estate-tax purposes, and that there was accordingly no need to conduct a fair-market-value analysis. Pet. App. 24a. The district court rejected that argument, finding that the

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[1] The valuation did include the balance (approximately $500,000) of the insurance proceeds remaining after the redemption. Gov't C.A. App. 84. For ease of reference in this brief, we refer to the excluded $3 million as "the life-insurance proceeds."

stock-purchase agreement should be disregarded because the estate had not shown that "the [agreement] was not a device to transfer wealth to Michael's family members for less than full-and-adequate consideration," *id.* at 30a, nor had it shown "that the [agreement] is comparable to similar agreements negotiated at arms' length," *id.* at 34a; see 26 U.S.C. 2703(a) (listing circumstances under which the value of property "shall be determined without regard to" agreements covering the property).[2]

Petitioner separately argued that even if the stock-purchase agreement were disregarded, the value of Michael's Crown shares was only $3.1 million. Pet. App. 42a. Petitioner did not dispute that Crown's value was approximately $3.86 million if the life-insurance proceeds were excluded and approximately $6.86 million if the proceeds were included. See *id.* at 4a & n.2, 11a, 45a. Petitioner also did not dispute that Michael's shares should be valued by determining Crown's value on the date of Michael's death and then multiplying that value by 77.18%, the percentage of shares held by Michael. See, *e.g.*, C.A. App. 106, 129, 282-283, 287-288, 291, 296, 352-353; C.A. Gov't App. 20. But petitioner contended that the life-insurance proceeds should not be included in Crown's fair market value because those proceeds "were off-set dollar for dollar by the obligation to redeem Michael's shares." Pet. App. 45a (brackets and citation omitted).

The district court disagreed and found that the fair market value of Crown at Michael's death included the

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[2] The court of appeals affirmed the district court's holding that the stock-purchase agreement did not satisfy the requirements of Section 2703. See Pet. App. 6a-9a. Petitioner does not seek this Court's review of that holding. Pet. 10 n.1.

life-insurance proceeds. Pet. App. 45a-55a. The court explained that under customary valuation principles, "[a] redemption obligation is not an ordinary corporate liability" because a stock redemption merely "involves a change in the ownership structure of the company." *Id.* at 54a. As a result, "a redemption obligation does not change the value of the company as a whole *before the shares are redeemed*." *Ibid.* The court noted that subtracting the life-insurance proceeds from Crown's value before determining the value of Michael's shares, as petitioner proposed, would "impermissibly treat[] Michael's shares as both outstanding and redeemed at the same time, reducing [Crown's] value by the redemption price of the very shares whose value is at issue." *Id.* at 50a.

4. The court of appeals affirmed. Pet. App. 1a-15a. The court acknowledged the parties' agreement that, setting aside the life-insurance proceeds, Crown's value on Michael's date of death was "about $3.86 million." *Id.* at 11a; see also *id.* 4a n.2. The court emphasized, however, that the applicable regulations require that, when a closely held corporation is being valued, "consideration shall also be given to nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such nonoperating assets have not been taken into account in the determination of net worth, prospective earning power and dividend-earning capacity." *Id.* at 11a (quoting 26 C.F.R. 20.2031-2(f)(2)). The court determined that the valuation "must therefore consider the value of the life insurance proceeds intended for redemption insofar as they have not already been taken into account in Crown's valuation and in light of the willing buyer/seller test." *Id.* at 12a.

Applying that test, the court of appeals concluded that a willing buyer of Crown at the time of Michael's death would have paid up to $6.86 million to acquire all of Crown's shares—thereby obtaining both Crown and the insurance proceeds. Pet. App. 14a. Similarly, the court reasoned that a willing seller holding all shares of Crown would never have accepted $3.86 million to sell the shares at the time of Michael's death "knowing that the company was about to receive $3 million in life insurance proceeds, even if those proceeds were intended to redeem a portion of *the seller's own shares*." *Ibid.*

The court of appeals further observed that excluding the life-insurance proceeds from the value of Crown would result in a windfall to petitioner, whose shares would quadruple in value solely because of the stock redemption. Pet. App. 14a-15a. In the court's view, that windfall illustrated "the illogic of the estate's position," *id.* at 14a, and also "contradict[ed] the estate's position that the proceeds were offset dollar-by-dollar by a 'liability'" because "[a] true offset would leave the value of Thomas's shares undisturbed," *id.* at 15a. The court thus concluded that "the brothers' arrangement had nothing to do with corporate liabilities." *Ibid.* "The proceeds," the court stated, "were simply an asset that increased shareholders' equity. A fair market value of Michael's shares must account for that reality." *Ibid.*

In reaching its conclusion, the court of appeals rejected petitioner's invocation of the Eleventh Circuit's decision in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (2005), which held that "life insurance proceeds *had* been accounted for by [a] redemption obligation" contained in a stock-purchase agreement, Pet. App. 13a. The court explained that the Eleventh Circuit in *Blount* had "viewed the life insurance proceeds as an 'asset' di-

rectly offset by the 'liability' to redeem shares, yielding zero effect on the company's value." *Id.* at 14a. In the decision below, however, the court observed that "[a]n obligation to redeem shares is not a liability in the ordinary business sense." *Ibid.* (citing 6A *Fletcher Cyclopedia of the Law of Corporations* § 2859 (Sept. 2022)). The court accordingly determined that *Blount*'s "flaw lies in its premise," and the court declined to "distort[] the nature of the ownership interest represented by [Michael's] shares" by treating the redemption obligation as a liability. Pet. App. 14a (citation and internal quotation marks omitted).

ARGUMENT

Petitioner renews his contention (Pet. 15-21) that, for purposes of the federal estate tax, the value of Michael Connelly's shares in a closely held corporation must exclude the value of the life-insurance proceeds to which the corporation was entitled on the date of Michael's death. The court of appeals correctly rejected that contention, which is contrary to the text of the relevant regulations and defies customary valuation principles. And although petitioner contends that the decision below conflicts with decades-old decisions of the Ninth Circuit and Eleventh Circuit, he overstates the extent of any disagreement in the lower courts. Any disagreement, moreover, is of limited practical significance. Owners of closely held corporations have multiple options for limiting the taxability of life-insurance proceeds under circumstances like these—including options that Michael and petitioner were aware of but chose not to pursue. No further review is warranted.

1. As the court of appeals recognized (Pet. App. 5a), the federal estate tax applies to the transfer of the decedent's gross estate (minus applicable deductions),

measured by the value of his interest in all property, including stocks, on the date of the decedent's death. 26 U.S.C. 2001, 2031(a), 2033, 2051; 26 C.F.R. 20.2031-1, 20.2031-2. Valuation of property in the estate-tax context is governed by the longstanding willing buyer–willing seller test set forth in 26 C.F.R. 20.2031-1(b).

In the context of a closely held corporation, "fair market value" for federal-estate-tax purposes is "determined by taking into consideration" various factors, including the company's net worth, prospective earning power, and dividend-paying capacity. Pet. App. 10a-11a (quoting 26 U.S.C. 2031(b) and 26 C.F.R. 20.2031-2(a)). The governing regulation, which petitioner did not challenge, requires that consideration also be given to "nonoperating assets," and it specifically identifies "proceeds of life insurance policies payable to or for the benefit of the company" as falling within the category of nonoperating assets. 26 C.F.R. 20.2031-2(f)(2).

Applying those well-established legal standards, the lower courts correctly concluded that a hypothetical willing buyer would have paid $6.86 million for 100% of Crown, taking into account Crown's estimated value of $3.86 million plus the $3 million in life-insurance proceeds that Crown used to redeem Michael's shares from the estate. Pet. App. 14a, 49a. As the court of appeals explained, a hypothetical buyer of Crown could either (1) cancel the redemption obligation, leave the $3 million in Crown, and own a company worth $6.86 million; or (2) have Crown redeem the shares for $3 million, receive $3 million in cash, and own a company worth $3.86 million post-redemption. *Id.* at 14a. Either way, the willing buyer would get $6.86 million in total value and would be willing to pay $6.86 million for that value.

For similar reasons, the lower courts were correct in determining that a willing seller would not have accepted only $3 million for Michael's shares. The redemption transaction effectively valued each of Michael's 385.9 shares at $7,774 ($3,000,000 ÷ 385.9) and each of Thomas's 114.1 shares at $33,863 ($3,863,819 ÷ 114.1). Pet. App. 50a. In other words, it was treating a share owned by Michael as worth only 23% of the value of one owned by Thomas at the exact same time. *Ibid.* But in Missouri as elsewhere, "a share of common stock is evidence of unit ownership of the whole, each unit being of equal value such that their sum equals the value of the whole." *Dreiseszun* v. *FLM Indus., Inc.*, 577 S.W.2d 902, 908 (Mo. Ct. App. 1979). Simultaneously valuing each of Thomas's shares at more than four times the value of each of Michael's shares violates the basic principle that equal shares have equal value. See 26 C.F.R. 20.2031-2(a) (providing that a stock's fair market value "is the fair market value per share"). The lower courts did not err in recognizing that a hypothetical willing seller would not tolerate that substantial disparity in the value of Crown's shares.

2. Petitioner's justifications for excluding the life-insurance proceeds from the valuation of Crown lack merit.

a. Petitioner primarily contends (Pet. 15-16) that the life-insurance proceeds had to be excluded from Crown's valuation because they were earmarked for the stock redemption. But as the court of appeals explained, an obligation to redeem stock is not a corporate "liability" under traditional valuation principles. Pet. App. 14a-15a. It is, instead, a claim against equity and should not be subtracted before valuing that equity. *Ibid.*; see Gov't C.A. App. 95, 96. And even if an asset

might be used to pay a corporate liability, that fact does not automatically justify excluding the asset from a valuation of the company. Rather, as the IRS's expert in this case explained, the valuation would account for both the asset and the liability by including the former in the company's assets and the latter in the company's liabilities. See Gov't C.A. App. 95.

The petition illustrates the error of petitioner's analysis. As petitioner concedes, "[a] company's own equity is 'not an asset to the corporation,' * * * which is why corporate redemptions result in a net loss to the corporation." Pet. 18-19 (citation omitted); see *Consove* v. *Cohen* (*In re Roco Corp.*), 701 F.2d 978, 982 (1st Cir. 1983) ("When a corporation purchases treasury stock it reduces its capitalization."). Redemption of Michael's stock should therefore reduce the value of Crown by trading Michael's shares for a corresponding portion of Crown's value. But as petitioner's own expert confirmed, under petitioner's faulty analysis, Crown's value remained the same before and after the redemption: $3.86 million. See Gov't C.A. App. 72. The estate's arrangements thus allowed the Connelly family to continue to control Crown after Michael's death, while attempting to have $2.3 million of Michael's interest in Crown escape the federal estate tax. The lower courts correctly rejected that position as untenable.

b. Petitioner also contends (Pet. 17-18) that the court of appeals misapplied the willing buyer–willing seller test. According to petitioner, the court of appeals should have considered how an objectively reasonable person seeking to buy or sell *Michael's shares* would value them, rather than asking how an objectively reasonable person seeking to buy or sell *Crown* would view the insurance proceeds. Petitioner asserts (Pet. 17)

that the court of appeals, as a consequence of its approach, did not consider whether such a hypothetical sale of Crown would command a premium above the fair market value for only some of the stock. Petitioner also says (*ibid.*) that a hypothetical buyer could not assume that petitioner would be willing to sell his stock. Those arguments are flawed for several reasons.

To begin with, petitioner never objected in the lower courts to the propriety of valuing Crown as a whole as a means of determining the value of Michael's stock. Indeed, petitioner agreed that the critical issue in this case is whether the insurance proceeds should be included *in valuing Crown*, in order to value Michael's shares. See, *e.g.*, Pet. C.A. Br. 2 (statement of the issue: "Did the district court err in holding that the value of the life insurance proceeds is included in the valuation *of the company* for estate tax purposes?") (emphasis added); C.A. App. 282-283, 287-288, 291, 296, 352-353. There was no dispute that Crown was worth either $3.86 million or $6.86 million, depending on whether the life-insurance proceeds are included, see Pet. 24, and petitioner made no attempt to submit evidence of any other value, much less any "premium" that he now implies (Pet. 17) the court of appeals should have considered.

Petitioner's argument also misunderstands the way that the willing buyer–willing seller test is applied when, as here, a decedent held stock in a closely held corporation whose stock does not trade on the open market. In that situation, the regulations provide that the stock is valued by first considering "*the company's* net worth," including (to the extent not otherwise considered) "proceeds of life insurance policies payable to or for the benefit of the company." 26 C.F.R. 20.2031-2(f)(2) (emphasis added). The regulations thus direct

the IRS and the courts to use the company's valuation as a starting point. Indeed, where, as here, the decedent held stock for which "actual sale prices and bona fide bid and asked prices are lacking," 26 C.F.R. 20.2031-2(f), starting the analysis by valuing the company as a whole is the only reasonable means of valuing the decedent's shares. Those shares, after all, merely represent the decedent's interest in his portion of the entire company's value.

Similarly, whether petitioner would *actually choose to sell* his shares in the company is irrelevant. To determine the value of Crown for estate-tax purposes (in order to value Michael's shares), the regulations require the assumption of a hypothetical sale between hypothetical, objective, knowledgeable buyers and sellers, operating at arm's length. The hypothetical buyer and seller, in other words, do not have the option of holding out for the best possible deal. See, *e.g.*, *Estate of Jelke* v. *Commissioner*, 507 F.3d 1317, 1331 (11th Cir. 2007) ("We are dealing with hypothetical, not strategic, willing buyers and willing sellers."), cert. denied, 555 U.S. 826 (2008).

In any event, the lower courts' granular determinations as to how to apply the willing buyer–willing seller test are highly factbound and do not warrant further review. See *United States* v. *Johnston*, 268 U.S. 220, 227 (1925) ("We do not grant a [writ of] certiorari to review evidence and discuss specific facts."); see also *Kyles* v. *Whitley*, 514 U.S. 419, 456-457 (1995) (Scalia, J., dissenting) ("[U]nder what we have called the 'two-court rule,' the policy [in *Johnston*] has been applied with particular rigor when district court and court of appeals are in agreement as to what conclusion the record re-

quires.") (citing *Graver Tank & Mfg. Co.* v. *Linde Air Prods. Co.*, 336 U.S. 271, 275 (1949)).

c. Finally, petitioner asserts (Pet. 20-21) that the court of appeals should not have considered whether exclusion of the life-insurance proceeds resulted in a windfall to Thomas. Again, petitioner's argument misses the mark. The court of appeals did not cite the undoubted windfall to Thomas in order to say that the *proceeds* were a windfall, contra Pet. 20, or to say that Thomas should be taxed as the beneficiary of this sweetheart deal, contra Pet. 21. Rather, the court of appeals cited the benefits of the transaction to Thomas—whose shares skyrocketed in value because the company's acquisition of Michael's stock left Thomas as the sole shareholder—as evidence that the insurance proceeds were not "offset dollar-by-dollar by a 'liability,'" because "[a] true offset would leave the value of Thomas's shares undisturbed." Pet. App. 15a. In support of that claim, the court of appeals cited a treatise, elsewhere cited by petitioner, for the concept that a stock redemption should reduce the company's assets but increase the remaining shareholders' proportional interest in the company. *Ibid.* (citing 3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporation*s § 21:2 (3d ed. Dec. 2022 update)). But, if that form of redemption had occurred, then 77.18% of Crown's net assets would have evaporated, and Thomas would have been left owning 100% of a much-less-valuable company.

Beyond misreading the court of appeals' opinion, petitioner also misunderstands the function of the estate tax. The estate tax "is a tax on the privilege of passing on property, not a tax on the privilege of receiving property." *Ahmanson Found.* v. *United States*, 674 F.2d 761, 768 (9th Cir. 1981) (citing *Ithaca Trust Co.* v.

United States, 279 U.S. 151, 155 (1929), and *YMCA* v. *Davis*, 264 U.S. 47, 50 (1924)). Valuation in an estate-tax case is thus intended to determine the value that property had in the hands of the decedent at the time of his death. If an estate disposes of property in a transaction that unduly benefits a recipient, the recipient's windfall indicates that the estate undervalued the property. Pet. App. 15a. The court of appeals did not err in acknowledging that basic principle of estate tax law.

3. The decision below does not implicate a circuit conflict warranting this Court's review.

a. Petitioner contends (Pet. 11-13) that the decision below is inconsistent with the Ninth Circuit's decision in *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034 (1999). *Cartwright*, however, involved materially different facts than this case.

In *Cartwright*, a law firm entered into a buy-sell agreement with its majority shareholder to purchase approximately $5 million in life insurance. 183 F.3d at 1035-1036. The agreement provided that upon the shareholder's death the law firm would use the insurance proceeds to purchase his estate's shares *and* the shareholder's interest in the fees that the firm was due for work in progress at his death. *Id.* at 1036. After the shareholder's death, his estate took the position that the entire amount of the life-insurance proceeds was paid for the shareholder's stock. *Ibid.* The IRS, by contrast, determined that under the terms of the buy-sell agreement, approximately $4 million of the insurance proceeds had been used to compensate for the fees owed to the shareholder, and was taxable as income. *Ibid.* The Tax Court agreed with the IRS and therefore declined to treat the entirety of the $5 million insurance proceeds

as a nonoperating asset that could be added to the value of the law firm. *Ibid.*

The Ninth Circuit affirmed the Tax Court's conclusion that the buy-sell agreement controlled the valuation question and its determination that the insurance proceeds were not used solely to satisfy an obligation to redeem stock. *Cartwright*, 183 F.3d at 1036-1037. The Ninth Circuit further held that the Tax Court did not err by excluding the life-insurance proceeds from the law firm's assets, reasoning that the insurance policy "would not necessarily affect what a willing buyer would pay for the firm's stock because it was offset dollar-for-dollar by [the law firm's] obligation to pay out the entirety of the policy benefits to [the decedent's] estate." *Id.* at 1038.

Cartwright differs from petitioner's case in at least two respects. First, most of the insurance proceeds in *Cartwright* were used to pay for the decedent's work in progress, not for the withdrawal of his equity through a stock redemption. See 183 F.3d at 1037. In contrast to a stock-redemption obligation, an obligation to pay for a decedent's work in progress is a standard corporate liability. See 26 U.S.C. 162(a)(1) (permitting a business to take a business expense deduction for "compensation for personal services actually rendered"); see also 12B *Fletcher Cyclopedia of the Law of Corporations* § 5733, at 42 (2017) (noting that a corporation's shareholder may receive compensation from the corporation for services). *Cartwright*'s statement that the insurance policy "would not necessarily affect," 183 F.3d at 1038, the willing buyer–willing seller analysis is therefore best understood as reflecting the unusual facts of that case, where the vast majority of the insurance proceeds were used for a purpose that was taxed as income and ex-

cluded from the value of the company for estate tax purposes. Second, unlike in this case, the buy-sell agreement creating the stock-purchase obligation in *Cartwright* was not disregarded. The Ninth Circuit therefore had no occasion to confront the issue decided by the court of appeals here, *i.e.*, how a fair-market-value analysis might apply in the *absence* of a valid buy-sell agreement.[3]

b. Petitioner also contends (Pet. 13-14) that the decision below conflicts with the Eleventh Circuit's decision in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (2005). In *Blount*, the Eleventh Circuit acknowledged that "[i]n valuing * * * corporate stock, 'consideration shall * * * be given to nonoperating assets, including proceeds of life insurance policies." *Id.* at 1345 (quoting 26 C.F.R. 20.2031-2(f)(2)). But, relying on the Ninth Circuit's decision in *Cartwright* and what it deemed "common business sense," the Eleventh Circuit asserted that "insurance proceeds are not the kind of ordinary nonoperating asset that should be included in the

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[3] Petitioner errs in claiming (Pet. 12) that the IRS's position in *Cartwright* is inconsistent with the position taken in this case. The IRS's primary argument in *Cartwright* was that the value of the decedent's stock was governed by a formula in the buy-sell agreement, pursuant to 26 C.F.R. 20.2031-2(h). IRS Br. at 34-35, *Estate of Cartwright* v. *Commissioner*, No. 97-70032 (Apr. 29, 1998). That formula did not include insurance proceeds. *Id.* at 40. In the alternative, the IRS argued that Section 20.2031-2(f)(2) "does not mandate that all insurance proceeds payable to the corporation be included as an asset of the corporation for the purposes of valuing the decedent's stock," but that it "sets forth a discretionary standard to be applied according to the circumstances of each case." *Ibid.* As discussed, the circumstances of the transaction in *Cartwright* were materially different from the circumstances of this case.

value of [a company] under the treasury regulations." *Id.* at 1345-1346.[4]

The courts below correctly rejected the Eleventh Circuit's "limited," two-paragraph analysis in *Blount* as inconsistent with the regulatory text and customary valuation principles. Pet. App. 13a n.5; see *id.* at 13a-14a, 54a. In practice, however, the difference between the Eleventh Circuit's approach and that of the court of appeals here is not likely to prove significant. The question presented is not one that often recurs. Indeed, petitioner identifies only three cases, including this one, that have considered it over the past two decades. And the government is not aware of any other cases pending before the IRS or in the lower courts that address the same issue. Petitioner attempts to inflate the import of the issue by asserting (Pet. 22-23) that it is not unusual for a closely held company to use life-insurance policies to fund the redemption of shares after a shareholder dies. But none of petitioner's cited authorities involved estate-tax disputes regarding the question presented in the petition.

Nor is it the case that agreements providing for the use of life-insurance proceeds to redeem stock in a closely held corporations will inevitably raise estate-tax disputes. At the threshold, the estate tax does not apply if the value of a decedent's estate is below the statutory minimum for the estate tax (currently set at $12.92 million per taxpayer). And even for the small number of estates subject to the estate tax, companies and share-

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[4] The Eleventh Circuit also cited the Tax Court's decision in *Estate of Huntsman* v. *Commissioner*, 66 T.C. 861 (1976). As the court of appeals noted below, *Huntsman* "merely emphasized that life insurance proceeds are to be considered according to § 20.2031-2(f)(2)." Pet. App. 13a n.5.

holders in closely held corporations can (and do) plan around the issues raised in this case.

For example, a company can follow the example of the law firm in *Cartwright* and draft a stock-purchase agreement that sets a value for the stock that is to be redeemed. The Connelly brothers and Crown entered into such an agreement, but failed to follow the procedures it provided for valuing Michael's stock at the time it was purchased from the estate, instead fixing a redemption price of $3 million. Had petitioner followed the procedures outlined in the agreement, along with all of the applicable requirements, including those in Section 2703, the estate might have avoided the need for a court to calculate a fair market value for Michael's shares.

Alternatively, Michael could have bequeathed his shares to an heir, rather than requiring the company to redeem the shares. The brothers also could have explored the option of using a trust to hold insurance policies for redemption purposes. To be sure, there may be reasons why shareholders might prefer to have the company hold life-insurance policies. But that merely reflects the unremarkable reality that taxpayers have choices about how to structure their transactions, which can in turn lead to different taxable outcomes.

Given the infrequency with which the question presented arises, its limited real-world importance, and the correctness of the decision below, the difference between that decision and the Eleventh Circuit's decision in *Blount* does not warrant this Court's review at this time.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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