No. 23-146

In The
Supreme Court of the United States

THOMAS A. CONNELLY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Eighth Circuit

BRIEF FOR AMICUS CURIAE BRANT HELLWIG IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*[1]

Professor Brant Hellwig serves as a Professor of Tax Law and Faculty Director of the Graduate Tax Program at NYU School of Law. He teaches and writes in a broad range of tax specialties, including federal estate and gift taxation. Having authored a casebook on this subject, he has an academic interest in the sound interpretation of the estate tax regime. In addition to offering his perspective on the doctrinal issue before the Court, *amicus* submits this brief to highlight anomalies in the application of the estate tax and the potential for estate tax avoidance that would result from a ruling in petitioner's favor.

SUMMARY OF ARGUMENT

This case concerns the estate tax valuation of stock of a closely held corporation in what appears to be a fairly narrow context: the shares being valued are redeemed by the corporation pursuant to a binding agreement using proceeds of an insurance policy on the deceased shareholder's life. As described in petitioner's brief, the central issue is whether the proceeds of the insurance policy should be considered a "net corporate asset" under these circumstances. Pet. Br. (I). The "net

[1] No counsel for any party authored this brief in whole or in part, and no person or entity other than *amicus* made any monetary contribution intended to fund the preparation or submission of this brief. The institutional affiliation of *amicus* is listed for purposes of identification only. The opinions expressed are those of *amicus* individually and do not represent the views of his affiliated institution.

corporate asset" framing, however, combines two distinct inquiries pertaining to the determination of the value of the corporation as a whole: (1) whether the proceeds of the insurance policy constitute an asset of the corporation that increases corporate net worth; and (2) whether the corporation's contractual obligation to redeem a deceased shareholder's stock constitutes a liability that decreases corporate net worth.

As the first inquiry is rather easily resolved in the affirmative, the case ultimately turns on the proper treatment of a redemption obligation when determining the value of a closely held corporation. This issue is not limited to closely held corporations that invest in life insurance as a means of generating liquidity to fund redemption obligations. Rather, resolution of this issue would affect the estate tax valuation of all closely held corporations having contractual redemption obligations, whether funded through insurance, other investments, or even future operating income of the entity. The potential reach of this case therefore is not as narrow as it may first appear.

Resolution of the second inquiry turns out to be not much more difficult than the first. As a broad starting point, a corporation's contractual obligation to purchase property at its fair market value is neither value enhancing nor value diminishing. Rather, such a transaction is value preserving, as the asset value of the corporation remains the same. Only the precise make-up of assets on the balance sheet changes.

In a sense, a corporation's obligation to redeem the stock of a shareholder falls within this same asset-purchase framework: the corporation is purchasing stock at its fair market value. Yet because a corporation's own stock cannot constitute an asset of the corporation, the mechanics of the transaction differ. Rather than preserving gross asset value within the corporation, the redemption retires a residual equity claim to corporate assets. Nonetheless, the net worth existing within the corporation prior to the redemption is preserved in total. The redeemed shareholder exchanges stock for cash, and the value of equity held by the continuing shareholders remains unchanged. In this manner, a redemption transaction does not deplete corporate value in total. It merely divides it.

If the Court were to hold that a corporation's obligation to redeem a shareholder's stock at fair market value constitutes a value-reducing liability for purposes of valuing the stock to be redeemed, a host of anomalous results would follow. To start, a redemption based on a corporate valuation determined in this manner operates to increase the value of equity held by continuing shareholders. That result alone raises a red flag. A redemption of one shareholder for fair market value should not affect the value of the stock held by continuing shareholders. Any enhancement in the value of the shares of the continuing shareholders indicates that the redemption price was below the true value of the redeemed stock.

Furthermore, treating a redemption obligation as a value-reducing corporate liability leads to different

estate tax valuations of the identical equity interest based on whether the estate disposes of the stock and, if so, the manner of the disposition. Specifically, stock redeemed by the corporation pursuant to a binding agreement would be assigned a lower value for estate tax purposes than if the estate distributed the stock to the decedent's heirs or sold the stock to another shareholder. Focusing on the redemption context alone, stock redeemed by a corporation pursuant to a binding agreement as of the shareholder's death would have a lower estate tax value than stock redeemed by the corporation pursuant to an agreement negotiated by the parties after the shareholder's death.

The discrepancies in estate tax valuations across these alternative scenarios are difficult if not impossible to justify. And the resulting estate tax preference for redemptions of stock pursuant to binding agreements (in comparison to directly passing ownership of the stock to family members) would only complicate estate planning for owners of closely held businesses.

Lastly, a ruling in favor of petitioner—from this Court in particular—would create a glaring opportunity for estate tax avoidance. If a binding redemption obligation were held to reduce corporate net worth for estate tax valuation purposes, taxpayers would flock to this arrangement. At the extreme, a corporation obligated to redeem the stock of its sole shareholder for fair market value upon the shareholder's death (effecting a liquidation in that case) would be valued at zero for estate tax purposes. That valuation would hold regardless of the sums being transferred to the deceased

shareholder's estate in satisfaction of the redemption obligation.[2] A ruling in favor of petitioner therefore would undermine the integrity of the federal estate tax base.

ARGUMENT

I. Determining the value of a closely held corporation as a whole serves as the starting point for valuing shareholder equity for estate tax purposes.

Stock of a closely held corporation is included in the gross estate of a deceased shareholder at its fair market value as of the decedent's date of death. 26 U.S.C. 2031(a), 2033. Fair market value for this purpose is determined by reference to "the net amount which a willing purchaser whether an individual or a corporation, would pay for the interest to 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. 20.2031-3. Specific factors to consider in determining fair market value of stock include the company's net worth, demonstrated and prospective earning capacity, and capacity to pay dividends. 26

[2] Of course, one need not go to this extreme to produce considerable estate tax savings. Rather, an individual could simply form a corporation with family members or other intended beneficiaries to enable those continuing shareholders to benefit from the increase in wealth resulting from the redemption of the individual's stock at death under the framework advanced by petitioner.

C.F.R. 20.2031-3(a), (b); 26 C.F.R. 20.2031-2(f)(2). To the extent not included in the determination of value based on the preceding elements, the value of the company's non-operating assets must be taken into consideration as well. 26 C.F.R. 20.2031-2(f). Non-operating assets for this purpose specifically include "proceeds of life insurance policies payable to or for the benefit of the company." *Ibid*.

With this framework in mind, the valuation of stock in a closely held corporation starts with a determination of the value of the corporation as a whole. Depending on the nature of the corporation's business or investments, that valuation could proceed through a capitalization of earnings or a determination of net asset value. *See* Rev. Rul. 59-60, § 5, 1959-1 C.B. 237. To the extent non-operating assets did not factor into the preliminary determination of corporate value, they will be added to the corporate valuation at that point. 26 C.F.R. 20.2031-2(f). In this manner, the value of non-operating assets such as life insurance proceeds are included in the determination of a corporation's value without being effectively double counted.

Once the value of the corporation as a whole has been determined, that figure serves as the starting point in determining the value of stock owned by a deceased shareholder.[3] The pro-rata value of the

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[3] If the decedent's stock interest were subject to a transfer agreement binding at death, a fixed price set forth in the agreement may be determinative for estate tax valuation purposes if certain statutory and regulatory conditions are satisfied. *See* 26 U.S.C. 2703; 26 C.F.R. 20.2031-2(h). The district court and the

corporation attributable to the decedent's equity interest could be increased due to practical advantages associated with the decedent's holdings, for instance to reflect a premium for voting control or swing-vote potential. Conversely, the pro-rata value attributable to the decedent's equity interest could be decreased to reflect practical disadvantages relating to the decedent's holdings, such as a discount for the lack of meaningful voting power or the absence of a market on which to liquidate the interest. All of these factors affect the price at which the decedent's stock would change hands between a hypothetical willing buyer and willing seller. While these interest-specific valuation adjustments serve as a frequent source of contention in estate and gift tax cases, none are implicated here. Rather, the present dispute focuses on the proper valuation of the closely held corporation as an initial matter.

II. Proceeds of a corporate-owned insurance policy constitute a corporate asset for purposes of determining the estate tax value of corporate equity.

The regulatory guidance of 26 C.F.R. 20.2031-2(f) clarifies the logical intuition that proceeds of a corporate-owned policy insuring a deceased shareholder's life are included on the asset side of the corporate balance sheet when determining the corporation's net worth. Petitioner's brief concedes as much: "[A] valuation of a company as of the date of an insured's death

court of appeals concluded that the terms of 26 U.S.C. 2703 were not satisfied in this case, and that issue is not before the Court.

would consider life-insurance proceeds expected to flow in" to the corporation.[4] Pet. Br. 24.

For purposes of clarity, it is worth highlighting why a corporate-owned life insurance policy in this setting is valued by reference to the policy proceeds. Valuation for purposes of the federal estate tax looks forward, taking into account changes in the value of property resulting from the decedent's death. See *United States v. Land*, 303 F.2d 170, 172-173 (5th Cir. 1962); see also John A. Bogdanski, *Federal Tax Valuation* ¶ 2.01[3][c][vi] (2023). At times, these changes can be value depleting, such as when a corporation valued on a going-concern basis loses the expertise of a key shareholder-employee. However, in this context, the death of an insured shareholder operates to increase the value of the corporation's assets. Looking forward, the death of the insured entitles the corporation to receive the proceeds of its insurance policy. The policy therefore is appropriately valued at its face amount as of the insured-shareholder's death.

III. The valuation issue in this case is not confined to redemption obligations funded by life insurance.

Petitioner attempts to sidestep a determination that the proceeds of a corporate-owned life insurance policy constitute a corporate asset for valuation

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[4] Petitioner's brief makes this concession to frame its contention that any contemplated outflow of the insurance proceeds to fund a redemption obligation must also be considered when valuing the corporation. Pet. Br. 24.

purposes by contending that the proceeds do not constitute a "net asset" for this purpose. Pet. Br. 16. Petitioner suggests that, because the insurance proceeds were earmarked by the parties to fund the corporation's redemption obligation, the insurance proceeds themselves are effectively encumbered.[5]

Framing the inquiry as whether the insurance proceeds constitute a "net asset" in this setting, however, distorts the relevant issue. To start, money is fungible. Even if a corporation is obligated to purchase stock of a deceased shareholder, nothing requires the corporation to use specific assets to fund its obligation. The corporation could use insurance proceeds, other liquid assets, or even proceeds of the sale of other corporate property to do so. More broadly, there exists no basis for differentiating the estate tax treatment of corporate redemption obligations based on the manner in which the corporation finances them. For instance, a corporation could self-insure its obligation to redeem stock of a deceased shareholder by investing would-be insurance premiums on its own behalf, amassing a pool of assets over time for this purpose. Those assets unquestionably would constitute general assets of the

[5] Petitioner's argument has superficial appeal. When the insurance proceeds are received by the corporation, the corporation intends to use them to satisfy its obligation to redeem the deceased shareholder's stock so as to preserve the corporation's other assets (perhaps operating assets) for continued use. The transitory nature of the insurance proceeds within the corporation makes it easier to view the cash flows as offsetting for purposes of valuing the corporation as a whole. The superficial appeal of petitioner's argument, however, is grounded in logical flaws.

corporation, regardless of their intended use by the corporation.

In short, if a mandatory redemption obligation operates to reduce the value of the corporation for estate tax purposes as petitioner contends, that result does not depend on the actual dollars or assets used by the corporation to fulfill its commitment. Rather than focusing on whether life insurance proceeds constitute a "net asset" in this setting, proper resolution of this case turns on whether a corporation's contractual obligation to redeem a deceased shareholder's stock constitutes a liability of the corporation when determining the estate tax value of the shares to be redeemed. That inquiry is not limited to redemption obligations funded by the proceeds of life insurance.

IV. A redemption obligation is not properly regarded as a liability that reduces corporate net worth.

Obligations on behalf of a corporation to pay salaries, operating expenses, contractual damages, or even claims registered in tort all constitute liabilities that reduce corporate net worth. A contractual agreement on behalf of a corporation to redeem the stock of a shareholder at fair market value, however, is a qualitatively different matter.

No one would assert that a corporation's binding commitment to purchase property at fair market value operates to reduce corporate net worth. Rather, one asset on the balance sheet (cash) is simply replaced with a different asset (purchased property) having the same

value. In a sense, a corporation's obligation to redeem its shares falls within this same broad framework. The corporation is simply purchasing its own shares for fair market value. Yet because a corporation's own stock cannot constitute an asset of the corporation, the mechanics of the transaction differ. Rather than preserving gross asset value within the corporation, the redemption retires a residual equity claim to corporate assets. Nonetheless, the net worth existing within the corporation prior to the redemption is preserved in total. The redeemed shareholder exchanges stock for cash, and the value of equity held by the continuing shareholders remains unchanged. In this manner, a redemption transaction does not deplete corporate value in total. It merely divides it.

Treating a corporation's binding obligation to redeem stock being valued for estate tax purposes as a value-diminishing liability (or, similarly, disregarding an asset of a corporation on account of its intended use to redeem the shares being valued) yields illogical results. Borrowing with slight modification an example employed in Adam Chodorow, *Valuing Corporations for Estate Tax Purposes: A* Blount *Reappraisal*, 3 Hastings Bus. L.J. 1, 20 (2006),[6] suppose A and B are equal shareholders of X Corp., which owns operating assets valued at $10 million. Additionally, the corporation has set aside a pool of non-operating investment assets

[6] This article persuasively identifies the logical flaws of the Eleventh Circuit's opinion in *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005), and the anomalous results flowing from the analysis employed by that court.

which it intends to use to finance its obligation to redeem A's shares at death.[7] Those investment assets have a value of $5 million as of A's death.

When A dies, X Corp.'s assets include the $10 million operating assets and the $5 million in investment assets intended to provide liquidity for the redemption, for a total of $15 million. Yet if petitioner's argument prevails, X Corp. will be determined to have a net worth of only $10 million for purposes of determining the fair market value of A's shares. Continuing with petitioner's framework, X Corp. then would redeem A's shares for $5 million, leaving B with 100% ownership of X Corp. The redemption transaction thus produces miraculous results for B, as the value of B's shares increases from an asserted value of $5 million before A's redemption to $10 million afterward.[8] That result alone indicates a fundamental flaw of this analytical approach.[9] Redemptions at fair market value should

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[7] Instead of self-insuring in this manner, X Corp. could have invested in life insurance on A's life to provide the desired pool of liquidity.

[8] Even if B's shares were properly valued at $7.5 million, the result to B from the redemption of A's shares remains phenomenal if short of miraculous.

[9] Petitioner is well aware of this anomaly: "To be sure, Thomas's shares 'skyrocketed in value' as a result of the redemption, because the life-insurance proceeds allowed Crown to redeem Michael's stock without expending preexisting resources." Pet. Br. 37. Petitioner is not bothered by this anomaly, however, believing it inappropriate to tax the decedent's estate on this effective transfer of value. *Ibid.*

have minimal if any effect on the value of equity held by continuing shareholders.

Of course, the proper result in this example is obtained by valuing A's equity interest at $7.5 million, one-half of X Corp.'s $15 million value (determined by including the $5 of earmarked non-operating investment assets as a corporate asset and not treating the redemption obligation as a corporate liability). A's estate receives the $7.5 million payment for the value of its shares, and B comes away owning 100% of X Corp. having a value of $7.5 million. In this manner, X Corp.'s $15 million net worth is divided, not depleted.

The Tax Court in *Estate of Blount v. Commissioner*, T.C. Memo. 2004-116, 87 T.C.M. (CCH) 1303, *rev'd*, 428 F.3d 1338 (11th Cir. 2005), succinctly identified the logical flaw in the analysis advanced by petitioner in this case. A corporate redemption obligation cannot be treated "as a claim on corporate assets when valuing the very shares that would be redeemed with those assets." *Id.* at 1320. Doing so would effectively value stock held by a decedent at the time of death by reference to the profile of the corporation *subsequent* to its redemption. The Court should recognize the logical flaw in petitioner's position and avoid sanctioning it.

V. Reducing a corporation's net worth on account of a binding redemption obligation would yield divergent estate tax consequences across economically similar transactions.

Petitioner's contention that a corporation's obligation to redeem a deceased shareholder's stock functions to reduce corporate net worth turns on the timing of the redemption agreement. Specifically, the redemption must proceed pursuant to an agreement in effect as of the shareholder's death. That is the only basis on which to argue that insurance proceeds or other corporate assets are encumbered by the redemption obligation as of the critical valuation date.

Petitioner's argument assigns different estate tax valuations to the same equity interest in a closely held corporation based on the manner in which the decedent's estate disposes of the stock. To illustrate, take as a baseline the estate tax value (as advanced by petitioner) of stock redeemed by the corporation pursuant to a binding agreement in effect as of the shareholder's death. The estate tax value of the stock would be greater if the stock were sold back to the corporation pursuant to an agreement negotiated by the parties *subsequent* to the decedent's death. Similarly, the estate tax value of the stock would be greater if the decedent's estate sold the stock to an existing shareholder pursuant to a cross-purchase agreement. Lastly, the estate tax value of the stock would be greater if the estate declined to sell altogether and instead distributed the stock to the decedent's heirs.

The difference in estate tax values assigned to the identical equity interest in a corporation across these alternative dispositions cannot be supported. Sanctioning these valuation discrepancies would create a clear estate tax advantage for disposing of interests in closely held businesses through pre-arranged redemptions. Owners of closely held businesses who prefer simply to pass their holdings to family members directly would face an effective estate tax toll for that choice. By creating an unwarranted estate tax preference for corporate redemptions, petitioner's intended outcome would further complicate the estate planning landscape for closely held business owners.

VI. Reducing the estate tax value of stock on account of a corporation's redemption obligation would jeopardize the estate tax base.

A determination from this Court that a corporation's binding obligation to redeem a shareholder's equity interest at death operates to reduce the estate tax value of the redeemed shares would create a glaring opportunity to avoid federal estate taxation. Taxpayers would exploit the estate tax valuation flaw, transferring wealth to closely held business entities—whether corporations or partnerships—with binding redemption obligations for the estate tax savings alone. Considering the most extreme example of such planning, an individual could transfer wealth to a wholly owned corporation and enter into an agreement requiring the corporation to redeem the shareholder's stock at death (effecting a liquation in that instance) for an amount

equal to the value of the property then held by the corporation. If the redemption obligation were treated as a charge on the corporation's assets for purposes of valuing the decedent's shares, the estate tax value of the stock would be zero. In this manner, wealth transferred by reason of death could rather easily be removed from the reach of the federal estate tax.

If a ruling in favor of petitioner somehow could be limited to the context of corporate-owned life insurance, the prospect of considerable estate tax avoidance remains. Individuals could capitalize closely held business entities to serve as wealth management vehicles, assigning minority interests to family members or other intended beneficiaries in the process. The entity then would invest a significant portion of those assets in life insurance on the principal owner's life, creating a pool of liquidity to fund the entity's obligation to redeem the principal owner's interest at death. If the insurance proceeds were disregarded in determining the net worth of the entity, the redemption transaction would effectively transfer value equal to the insurance proceeds (through enhancement of the continuing owners' equity interests) free of estate taxation. Individuals far beyond any notion of a small business owner could, and likely would, exploit that advantage.

CONCLUSION

From the standpoint of both legal doctrine and common sense, a corporation's obligation to redeem a shareholder's equity interest cannot be interpreted as

reducing corporate net worth when determining the estate tax value of the redeemed shares. Treating a transaction that divides corporate value as one that reduces it for estate tax purposes would produce a range of anomalous results while jeopardizing the federal estate tax base. The Court therefore should affirm the decision of the United States Court of Appeals for the Eighth Circuit below.

Respectfully submitted,

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