No. 23-146

In the Supreme Court of the United States

THOMAS A. CONNELLY, PETITIONER

v.

UNITED STATES OF AMERICA

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

REPLY BRIEF FOR THE PETITIONER

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Life-insurance proceeds used by a closely held corporation to fulfill a contractual obligation to redeem the insured's corporate shares do not increase the corporation's net worth and thus do not increase the estate tax owed on those shares. A contractual obligation to redeem shares is a corporate liability because it represents a legally enforceable claim against the corporation's assets. And that liability offsets the increase in corporate assets occasioned by the receipt of the life-insurance proceeds. Based on that economic reality, a hypothetical willing buyer and willing seller of a block of the corporation's

stock would not treat the life-insurance proceeds as increasing the value of the stock; to the contrary, the buyer would recognize that he cannot capture the value of the insurance proceeds before the proceeds exit the company.

The government largely agrees with petitioner on the legal principles that govern this case. And it does not dispute the basic reality that a redemption obligation represents a claim to corporate assets and thus a liability that decreases the corporation's net worth. Nor does the government dispute that a court should consider the existence (if not the agreed-upon price) of the redemption obligation when assessing the value of the company.

Instead, the government's whole argument boils down to the assertion that a redemption obligation should be ignored when the assets being valued are the redeemed shares. The government attempts to prove that contention through a series of elaborate "illustrations," but those illustrations are all flawed. Some assume the conclusion that Michael and Thomas Connelly's company, Crown C Supply, was worth \$6.86 million and ignore the redemption obligation. Others defy the willing-buyer/willing-seller test by failing to consider the valuation from the perspective of hypothetical parties. Still others posit transactions that are not economically equivalent to the one at issue.

At its core, the government's position is simply an expedient one that maximizes tax revenue. On the facts of this case, the government would tax Michael's estate on a \$5.3 million valuation of his shares, treating Crown's life-insurance proceeds as a corporate asset but ignoring the corresponding redemption obligation. The government would then be able to impose capital-gains tax on Thomas based on the increase in the value of his shares to \$3.86 million after the redemption—an increase occasioned by the receipt of the insurance proceeds. That is effectively

double taxation, which is inconsistent with the structure and intent of the tax code and makes no sense as a matter of basic fairness.

The government's approach to valuation here threatens a longstanding planning practice used by closely held corporations to ensure the continuity of ownership when a shareholder dies, without spending critical assets that could endanger the company's ability to operate as a going concern. It is contrary to the interest of small businesses across the Nation, and it defies common sense. The Court should reverse the judgment below and require the government to refund the taxes paid by Michael's estate above the $3.1 million valuation to which the parties stipulated.

A. The Willing-Buyer/Willing-Seller Test Accounts For All Relevant Facts Concerning The Relevant Property

As the case is now presented to the Court, there is significant agreement among the parties over the "applicable valuation framework." U.S. Br. 18. All agree that, under 26 U.S.C. 2031 and 26 C.F.R. 20.2031-1 and 20.2031-2, the value of Michael's shares is the price a hypothetical willing buyer and willing seller would reach in an arm's-length negotiation. See U.S. Br. 18. All agree that the price here would be based on Crown's net worth. See *id.* at 19. All agree that the Court should consider "the fact of" the redemption obligation in calculating Crown's net worth, even if 26 U.S.C. 2703(a) dictates that the agreed-upon price for the redemption does not "control[] the valuation." U.S. Br. 9, 34 n.8. And all agree that, when assessing Crown's net worth, a court must consider not only Crown's assets but also its liabilities—at least its "ordinary" ones. See *id.* at 19, 29 n.5.

The government thus does not dispute that, if Crown had an "ordinary" $3 million liability, petitioner's position

would be correct. The liability would offset $3 million of the life-insurance proceeds, and Crown would be worth $3.86 million. Because Michael's estate paid taxes on Michael's shares based on a $6.86 million valuation, the estate would be owed a refund. See J.A. 106. And the parties stipulated that, if the estate is owed a refund, the value of Michael's shares at the time of his death was $3.1 million. See J.A. 37. The dispute between the parties is thus whether a redemption obligation constitutes a liability that reduces a closely held corporation's net worth, which in turn would "reduce[] the value of the to-be-redeemed shares" where, as the parties have agreed here, net worth receives dispositive weight in the valuation analysis. U.S. Br. 21, 26.

B. An Obligation To Redeem A Shareholder's Stock Constitutes A Corporate Liability That Offsets The Value Of Life-Insurance Proceeds Received Upon The Shareholder's Death

It is well established that any demand against a corporation's assets is considered a corporate liability. See Pet. Br. 22. And as petitioner has explained, a redemption obligation constitutes just such a demand. See *id.* at 22-24.

Notably, the government itself acknowledges that "a redemption obligation is a contractual obligation that expends company resources." Br. 26. And the government does not dispute that such a contractual obligation is enforceable under applicable state law. See Pet. Br. 22. It thus follows that a redemption obligation reduces a company's net worth and offsets any gain created by the receipt of life-insurance proceeds upon the insured shareholder's death.

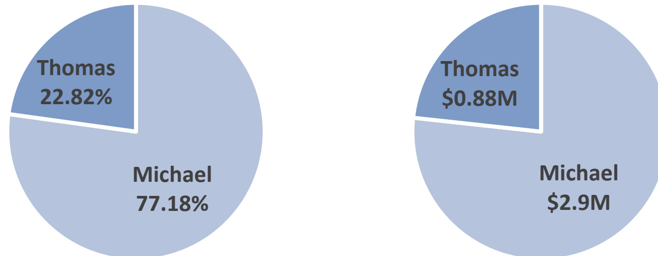
That is all that is required to resolve this case. Both petitioner and the government have litigated the case on the premise that Michael's shares are valued at 77.18% of Crown's net worth at the time of Michael's death. See J.A.

88, 102; D. Ct. Dkt. 53, at 6. Because the redemption obligation constitutes a corporate liability that offsets $3 million of the life-insurance proceeds, Crown's net worth at the time of Michael's death was $3.86 million. Michael's estate thus overpaid taxes based on a $5.3 valuation of his shares, and he is owed a refund based on the stipulated $3.1 million valuation. See J.A. 37.

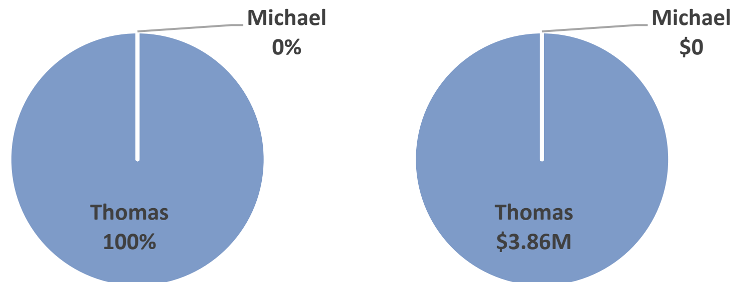
The government offers a panoply of counterintuitive arguments and convoluted hypotheticals designed to demonstrate that petitioner's valuation approach is incorrect. But none undermines the logic—much less the common sense—of petitioner's position.

1. The government first argues that petitioner's valuation of Crown is inconsistent with certain "black-letter valuation principles." Br. 19. For example, according to the government (Br. 22), petitioner's valuation cannot be accurate because it would result in Crown's maintaining the same value both before and after the redemption. But there is nothing strange about a company's maintaining consistent value after satisfying a preexisting contractual obligation. Because a proper calculation of present value incorporates future liabilities, see, *e.g.*, *Commissioner* v. *Estate of Hubert*, 520 U.S. 93, 101-102 (1997), any valuation of the company before the mandatory redemption occurred would naturally take into account the future obligation. See Pet. Br. 24.

The government also argues (Br. 22-23) that petitioner's approach improperly attributes different prices to Michael's and Thomas's shares at the point of valuation. That is incorrect. At the time of Michael's death, each of Crown's 500 outstanding shares—whether owned by Michael or Thomas—was worth approximately $7,727 (with Michael's shares worth approximately $2.9 million and Thomas's worth approximately $880,000):



It is only *after* elimination of Michael's shares that Thomas's shares (now 100% of the outstanding shares) increased to a value of approximately $3.86 million:



It is the government that is mixing apples and oranges, comparing the estate's *pre*-redemption shares with Thomas's *post*-redemption shares. See Br. 23 (pie chart).[1]

2. The government next argues that a redemption obligation "cannot be a value-depressing corporate liability in valuing the very shares that are the subject of the redemption obligation," because the corporate resources expended to fund the redemption "go to the holder of the shares." Br. 26 (internal quotation marks, citation, and emphasis omitted). That argument lacks merit.

As an initial matter, the government is not actually disputing that a redemption obligation represents a value-

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[1] Nor is the government correct that the additional value gained by Thomas "c[a]me for free." Br. 41. Crown paid life-insurance premiums in order to maintain the policy and ensure that ownership of Crown would transfer to Thomas upon Michael's death.

reducing claim on the corporation's resources. See Br. 26. Instead, the government is seemingly arguing that net worth should not be given *dispositive weight* in determining the value of the redeemed shares, because that figure undervalues those shares. But here, the parties have consistently litigated this case on the basis that Michael's shares were worth 77.18% of Crown's net worth. And Crown's obligation to repurchase Michael's shares obviously reduces Crown's net worth as an entity: the company's assets are encumbered by that obligation. The resulting liability cancels out $3 million of the insurance proceeds and results in a corporation worth $3.86 million—making Michael's shares worth $3.1 million under the parties' stipulation. See J.A. 37.

Even setting that aside, the government's argument lacks merit. As petitioner has explained (Br. 22-23, 26), the proper analysis is to consider a hypothetical purchase of a 77.18% interest in Crown. And a hypothetical buyer of such a stake would not treat the insurance proceeds as increasing Crown's value, because he could not capture the value of those insurance proceeds before they exit the company. See *ibid*.

The government protests that petitioner is "chang- [ing] the identity of the property that is being valued" by focusing on a hypothetical 77.18% interest in Crown. Br. 28. Not so. Petitioner is valuing Michael's shares, but is arguing that the way to do so is to ask what a willing buyer would have paid for the *same percentage of the company that Michael owned*. Positing a transaction in Michael's actual shares is nonsensical, because state law would thwart any such transaction and because the shares are destined to vanish from existence.

Petitioner's approach is the only one consistent with this Court's pathmarking decision applying the willing-buyer/willing-seller test, *United States* v. *Cartwright*, 411

U.S. 546 (1973)—a case the government barely acknowledges. See Pet. Br. 19-20; U.S. Br. 30. It is also consistent with the regulation codifying that test, which provides that property should be valued based not on the particular item at issue, but instead on an equivalent item that "could be purchased by a member of the general public." 26 C.F.R. 20.2031-1(b). The government criticizes petitioner for invoking that provision, given the lack of a distinction between "retail" and "dealer" prices for Crown stock, Br. 29, but the government has no answer to the regulation's focus on valuing a hypothetical, equivalent asset rather than the particular asset held by the estate.

In any event, valuing Michael's actual shares does not change the fact that the redemption obligation is a "value-depressing liability." U.S. Br. 26 (citation omitted). Because a corporate liability encumbers a company's "assets and income-generating potential," *ibid.*, it depresses the value of shares in that corporation, no matter whom the liability runs to. Accordingly, even the holder of shares subject to a redemption obligation would recognize that, from the perspective of Crown, every dollar it paid for the redemption would decrease its value and thus decrease the value of the shares to be redeemed. The hypothetical willing-buyer/willing-seller negotiation would account for that fact; the government ignores it entirely.

The government's proposed \$5.3 million redemption is thus grossly overinflated. Crown's value derives from its ability to generate future profits, and its \$3.86 million valuation was arrived at using an income-based approach that projected future cash flows by averaging its previous five years of net earnings. See D. Ct. Dkt. 53-5, at 4. But if the company had redeemed Michael's shares for \$5.3 million, those projections would have been inaccurate, be-

cause Crown would not have been able to fund the redemption without liquidating assets necessary to maintain its future earning capacity.

3. The government's "two sisters" hypothetical (Br. 27) does not support its position. The government posits a $5 million company with an 80% shareholder and a 20% shareholder, with each shareholder's ownership stake subject to a mandatory redemption obligation not funded by life insurance. See *ibid*. The government argues that petitioner's approach to valuation, as applied to that hypothetical, results in a "mathematical glitch": the 80% shareholder's stake is worth $4 million (80% of the company's net worth) and $800,000 (80% of the company's net worth after accounting for the redemption obligation) at the same time. *Ibid*.

That hypothetical is inapposite for an obvious reason: the redemption obligation is not funded by insurance proceeds. Assuming that the hypothetical $5 million company is an operating rather than a holding company, it is highly unlikely the company would ever agree to redeem 80% of its stock in exchange for $4 million in the absence of insurance proceeds covering the cost of the redemption; without the benefit of insurance, the company would presumably need to liquidate operating assets in order to fund the redemption obligation, which would in turn decrease its future earning capacity (and thus its valuation). Accordingly, the redemption obligation would result in a new valuation lower than $5 million. And the government acknowledges as much when it notes that a real-world investor would "reasonably account for any effects that the change in ownership and reduction in assets as a result of the redemption might have on [a] corporation's ongoing operations." Br. 41 n.9.

For that reason, the real redemption value of the shares in the government's hypothetical is well below $4

million; indeed, depending on the particular characteristics of the company at issue, it may well be the $800,000 figure that the government derides as a "mathematical glitch." Br. 27. The government's assumed $4 million valuation of the hypothetical company is thus "unlikely and plainly contrary to the economic interest of a hypothetical buyer," in contravention of the willing-buyer/willing-seller test. *Estate of Curry* v. *United States*, 706 F.2d 1424, 1429 (7th Cir. 1983).

If anything, the government's hypothetical demonstrates precisely why companies enter into insurance arrangements similar to the one at issue here. Without the benefit of insurance, "fair market value" in the context of an agreement to redeem shares "usually means something less than a pro rata proportion of the total enterprise value." Shannon P. Pratt, *Valuing a Business* 59 (6th ed. 2022) (emphasis omitted). But with offsetting insurance proceeds, a company can avoid that complication and measure fair market value by multiplying an individual's percentage of ownership by corporate net worth.

4. The government separately invokes (Br. 38-39) an example of the accounting of a stock redemption from a corporate-law treatise. In that example, a company has $100,000 in assets; $50,000 in liabilities; and $50,000 in shareholder equity, with 4,000 shares outstanding. See Stephen M. Bainbridge, *Bainbridge's Corporate Law* § 13.4, at 507 (4th ed. 2020) (Bainbridge). The company then redeems 1,000 shares at $10 a share, which results in its having $90,000 in assets; $50,000 in liabilities; and $40,000 in shareholder equity. See *ibid.* As the government points out (Br. 39), the stock redemption is not accounted for as affecting the hypothetical company's liabilities, which remain at $50,000 both before and after the redemption.

That is exactly as it should be—because the example from the treatise reflects a *voluntary* stock redemption. As petitioner has explained (Br. 24), only a *contractual obligation* to redeem stock constitutes a corporate liability. To be sure, the "effect on the corporate coffers" is the same "whether a stock redemption is required by contract or not," U.S. Br. 39, but there is a crucial difference between the two expenditures: a voluntary redemption is merely an expense, which creates a loss only at the moment of redemption, whereas a mandatory redemption satisfies a preexisting legal claim on the corporation's assets.

Not only is the example from the treatise inapposite; it affirmatively undermines the government's position. In the example, a company with a book value of $50,000 redeems 25% of its shares (1,000 of 4,000) for $10,000, rather than 25% of book value ($12,500). See Bainbridge § 13.4, at 507. Under the government's approach, that transaction is inexplicable. But under petitioner's, it makes perfect sense: the $10,000 expenditure is 25% of the company's $40,000 book value after the redemption.

What is more, before the redemption, each of the 4,000 shares was worth $12.50 ($50,000 in book value ÷ 4,000). But after the redemption, each of the remaining 3,000 shares was worth $13.33 ($40,000 in book value ÷ 3,000). The example thus demonstrates that there is nothing untoward about a remaining shareholder's shares increasing in value after a redemption. See pp. 5-6, *supra*.

5. As petitioner explained in his opening brief (at 23-24), generally accepted accounting principles confirm that a redemption obligation constitutes a corporate liability. The government challenges petitioner's reliance on those principles (Br. 34-38), but its efforts are unavailing.

The government first contends (Br. 35) that petitioner somehow forfeited the right to invoke those standards by

failing to cite them below. The government should know better. It is a familiar principle that a party is permitted to raise a "new argument" to "support what has been his consistent claim." *Lebron* v. *National Railroad Passenger Corp.*, 513 U.S. 374, 379 (1995). And the accounting standards are not even a new "argument"; they are simply additional authorities in support of petitioner's longstanding argument that a redemption obligation constitutes a corporate liability that offsets insurance proceeds.

The government's attempt to dismiss the relevance of the accounting standards is equally unpersuasive. Although generally accepted accounting principles may not "dictate federal tax treatment," U.S. Br. 36, they have persuasive value in appropriate tax cases. See *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 577 (1978); 26 C.F.R. 1.446-1(a)(2) (providing that the application of generally accepted accounting principles "will ordinarily be regarded as clearly reflecting income" for purposes of federal income tax). And the accounting standards are particularly persuasive here, where the narrow question is whether a particular claim on corporate assets constitutes a corporate liability. Cf. 1 F. Hodge O'Neal & Robert B. Thompson, *Close Corporations and LLCs: Law and Practice* § 7:29, at 7-139 to 7-140 (rev. 3d ed. 2020) (stating that a corporation's book value is the "most frequently used [method] to set the transfer price of shares in a share restriction or buyout agreement" and is "presented in accordance with accounting conventions"); 12 William M. Fletcher, *Cyclopedia of the Law of Corporations* § 5460.50, at 185 (rev. ed. 2017) (noting that "book value is a common method of valuation" for buy-sell agreements); Rev. Rul. 59-60, §§ 4.01, 4.02(c), 1959-1 C.B. 237, 238, 240 (identifying book value and corporate balance sheets as relevant factors for purposes of valuation).

Tellingly, the government does not dispute petitioner's interpretation of the relevant accounting standards, conceding that their application would lead to the redemption obligation at issue here being reflected "as a kind of 'liability' on [Crown's] balance sheet." Br. 37. Rather than following that principle to its logical conclusion, however, the government reverts to its argument that redemption obligations do not constitute ordinary liabilities because they are owed to holders of equity, rather than holders of debt. See *ibid*. As already explained, see pp. 7-9, that argument lacks merit.

The government also makes much of the fact that the example in Accounting Standard 480-10-55-64 lists "[s]hares subject to mandatory redemption" separately from "[l]iabilities other than shares." See Br. 38. But the government fails to note that the same example then adds the two categories into a single category of "total liabilities." Financial Accounting Standards Board, *Accounting Standards Codification* ¶ 480-10-55-64 (Feb. 2023 ed.); see *id*. ¶ 480-10-25-8 (affirmatively stating that an entity's "obligation to repurchase the issuer's equity shares" constitutes a liability). What is more, the text of the example makes clear that a redemption obligation need only be recorded separately from other liabilities when the shares "represent[] the *only* shares in the entity." *Id*. ¶ 480-10-55-64 (emphasis added).

C. The Willing Buyer And Willing Seller Valuing A Closely Held Corporation Would Treat Life-Insurance Proceeds As Offset By The Corporation's Obligation To Redeem The Insured's Stock

Because an obligation to redeem a shareholder's stock constitutes a corporate liability, a hypothetical willing buyer and willing seller would take that liability into account when purchasing a block of the company's stock. The value of that liability would thus offset the value of

life-insurance proceeds received by the company upon the shareholder's death. The government offers a series of illustrations (Br. 29-34) that supposedly demonstrate that a willing buyer and willing seller would ignore the redemption obligation. Those illustrations are unavailing.

1. The government begins by positing a hypothetical third-party buyer of Michael's actual shares. See Br. 30-31. The government contends that such a buyer would not have treated the redemption obligation as a true corporate liability because the buyer "would receive the payment from the stock redemption." Br. 31 (citation omitted). But that hypothetical involves an impossible transaction: the contractual redemption obligation is enforceable under state law, with the result that any third-party transaction in Michael's shares could be blocked or unwound. See Pet. Br. 25. That is why it is necessary to consider a willing buyer of a *hypothetical* 77.18% of Crown, rather than Michael's particular shares. See pp. 7-8, *supra*. In any event, Crown would never offer $5.3 million for Michael's shares, because doing so would require a liquidation of operating assets that would reduce Crown's own value. See p. 9, *supra*.

2. The government next imagines a hypothetical in which Thomas exercised his right to buy Michael's shares before the redemption occurred. See Br. 31. The government argues that Thomas would have been willing to pay $5.3 million for Michael's shares because doing so would have allowed him to capture the value of the insurance proceeds and gain control of a company worth $6.86 million in total. See *ibid*.

That is true—but irrelevant. As the government concedes, the willing-buyer/willing-seller test requires the use of "a hypothetical buyer and seller" and not the "actual parties." Br. 3. Not only is Thomas an actual person,

but he has a particular contractual right that a hypothetical buyer would not: the exclusive right to buy Michael's shares before any redemption occurs. See J.A. 10-11. The exercise of the right would have canceled the redemption obligation, which explains why Thomas would have been willing to pay $5.3 million for Michael's shares. But Thomas's idiosyncratic right does not affect the "fair market value" of Michael's stock, which requires an objective inquiry into the price at which the shares would be sold "to the public." 26 C.F.R. 20.2031-1(b). That focus makes particular sense here, where the parties have stipulated that the brothers always intended for Crown, not Thomas, to purchase Michael's shares. See J.A. 34.

3. The government next relies (Br. 32) on the same hypothetical as the court of appeals: namely, a third-party purchase of Crown as a whole. But as petitioner has explained (Br. 28-32), that approach smuggles in an improper control premium, incorporating value available only to a purchaser of the whole company rather than the 77.18% at issue.

The government does not dispute two basic premises supporting that point. The government acknowledges (Br. 43) that the fair market value of a block of shares often differs substantially from a simple proportion of the price a buyer might pay for the whole company. And the government does not dispute that, aside from Thomas, only a purchaser of the *entirety* of Crown would be able to cancel the redemption obligation and thereby pocket the $3 million in insurance proceeds. Together, those premises compel the conclusion that assessing the value of Michael's stock based on a hypothetical purchase of Crown

as a whole would incorporate an improper control premium.[2]

The government contends that the court of appeals did not actually apply a control premium, because it merely added the value of the insurance proceeds to petitioner's valuation of Crown and then "multiplied that value by 77.18%." Br. 42-43. But it was precisely that addition that *gave rise to* the improper control premium. And while the government suggests that petitioner is retreating from its position that the "starting point" for valuing the estate's shares "is the value of Crown as a whole," Br. 44, the government fails to distinguish between a valuation of Crown's total equity based on its prospects as an operating company (petitioner's approach), and a valuation based on what an individual might pay for the entire company in a single unified purchase (the court of appeals' approach and seemingly the government's).[3]

4. Finally in its series of illustrations, the government posits a hypothetical *seller* of Michael's shares. Br. 32. In

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[2] The government contends (Br. 42) that petitioner forfeited that argument below. But while petitioner may not have used the precise phrase "control premium" in the lower courts, he has consistently maintained that it is improper to ascribe to the estate the value of insurance proceeds that a hypothetical purchaser could never capture. See, *e.g.*, Pet. C.A. Br. 25-26; Pet. C.A. Reply Br. 7-8.

[3] The government briefly suggests that, because Michael's 77.18% stake in Crown represents a substantial majority interest, the consideration of control premiums "would likely increase, not decrease, the fair market value of his shares." Br. 43. But as the government acknowledges in the same paragraph, the courts below never addressed the "factually intensive issue" of whether some sort of control premium was warranted due to the size of Michael's stake in the company. Br. 44. And more importantly, "the parties' stipulations limited the valuation dispute to whether, in valuing Michael's shares, Crown's value included the life-insurance proceeds." *Ibid.*

the government's view, such a seller "would not have accepted less than $5.3 million," because that is "77.18% of $6.86 million." *Ibid.*

Again, that argument assumes the conclusion by building in a $6.86 million valuation of Crown. But a willing seller would have insisted on 77.18% of $3.86 million, not $6.86 million, because that is the true worth of the company in light of the preexisting redemption obligation. It is irrelevant that there is "no evidence in the record regarding how the Connelly family reached" its decision to value Michael's shares at $3 million. U.S. Br. 33. While it is telling that the agreed-upon price for the shares is much closer to petitioner's proposed fair market value than the government's, the salient point is simply that the redemption obligation represents an enforceable liability against Crown—a liability that offsets the value of the insurance proceeds.

D. Increasing The Value Of An Estate's Stock Based On Corporate Insurance Proceeds Designated For A Stock Redemption Would Create Negative Practical Consequences

Confronted with the prospect of substantial negative consequences flowing from its illogical approach to valuation (Pet. Br. 33-39), the government has little to say.

1. The government does not dispute that, under its approach, a closely held corporation purchasing insurance to cover the cost of redeeming a decedent's shares would be forced to buy insurance far exceeding the value of the shares it plans to redeem. See Pet. Br. 33-34 & n.5. In the face of that absurd result, the government insinuates that the need to purchase such a large insurance policy suggests that petitioner's "ultimate objective" was not "legitimate." Br. 46. That is nonsense. The arrangement employed here is a well-established and critical tool for

preserving the character of small businesses. See Chamber Br. 9-15, 19-21. And the government never disputes the value to the American economy of ensuring the viability of such businesses. See, *e.g.*, 88 Fed. Reg. 27,677 (Apr. 28, 2023) (proclamation of President Biden stating that small businesses are "the backbone of our economy and the glue of our communities" and account for "almost half of our Nation's gross domestic product").

Nor is a company's desire for continuity of ownership "in tension with" the principles that a stock redemption should result in a "smaller company" or that "a decedent's share of corporate assets is included in the value of his gross estate." U.S. Br. 46. To the contrary, it is precisely *because* closely held companies recognize that a stock redemption entails a loss of corporate assets that they enter into arrangements such as the one at issue here, thereby spreading the costs of redemption over years of insurance premiums rather than suddenly and precipitously shrinking the company by using operating assets to redeem shares.

2. As it did at the certiorari stage, the government proposes a variety of alternative arrangements that it claims Crown could have pursued in lieu of the arrangement used here. See Br. 45-47. But none of those proposed alternatives would accomplish the same objectives: namely, to preserve the viability and closely held nature of the company while compensating uninvolved heirs for the value of the decedent's ownership stake.

For example, the government suggests that "a shareholder can bequeath his shares to another family member or to someone already involved in the business, and that bequest can include restrictions on further transfer of the shares." Br. 45. Bequeathing shares to another family member, however, would introduce a new shareholder

into the business. And bequeathing shares to someone already involved in the business would prevent a shareholder from passing on value to his chosen heirs.

The government's suggestion that family members "could directly take out life-insurance policies on the shareholder" in order to receive cash is similarly misguided. Br. 45. That would not ensure continuity of ownership for the company at issue—which is the other primary purpose of the arrangement the Connelly family used. It also makes little sense for two estate-planning options that yield a substantively identical economic result to receive vastly different tax treatment. See Pet. Br. 37-38.

The government further proposes that a shareholder could arrange for life insurance to be held by a "trust, escrow, partnership, or limited liability corporation created solely for that purpose." Br. 45. But the government is tellingly silent about whether those arrangements would avoid the tax consequences imposed by the IRS here. See *ibid.* A shareholder adopting that alternative strategy would thus run the risk that the policy would be deemed to exist "for the benefit of the company," which would require its inclusion in the company's valuation. 26 C.F.R. 20.2031-2(f)(2). Worse still, the IRS could argue that the shareholder himself holds "incidents of ownership" in the proceeds, such that his estate would be liable for taxes on the entirety of those proceeds. 26 U.S.C. 2042(2).

Last among its proffered alternatives, the government suggests that shareholders employ "a cross-purchase arrangement, in which shareholders buy life-insurance policies on each other and agree to purchase each other's shares at death." Br. 46. But that approach quickly becomes unwieldy whenever "there are more than a few shareholders." Samuel M. Fahr, *The Business Purchase Agreement and Life Insurance*, 15 Law & Contemp.

Probs. 319, 331 (1950). And it would unfairly require the shareholders rather than the company to purchase the insurance, even though the company benefits by maintaining its closely held character while avoiding a liquidity crisis.

3. Despite the longstanding consensus on the question presented created by the decisions in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (11th Cir. 2005), and *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034 (9th Cir. 1999), the government insists (Br. 48) that its approach here does not disrupt settled understandings, because the IRS has never expressed agreement with those decisions. Of course, until this case, the IRS never previously expressed its disagreement, either. See Pet. Br. 36. And while the government cites two recent news articles, written after this Court granted review, in which wealth advisers express caution about the estate-planning arrangement at issue here, see Br. 49, that sort of Monday-morning quarterbacking hardly establishes a lack of clarity in the law, especially in the face of decades of reliance. See Chamber Br. 13-14.

The government's insistence (Br. 29 n.5) that it has not reversed positions from *Estate of Cartwright* is mystifying. There, the government argued that the full $5 million of insurance proceeds at issue was "offset" by the company's liabilities. See Br. at 39-41, *Estate of Cartwright*, *supra* (No. 97-70032). And the government further argued that those liabilities included not only nearly $4 million for "work in process," but also $1 million owed to the decedent's estate in fulfillment of a contractual obligation to "redeem [the] decedent's stock." *Id.* at 17-18. That position is flatly inconsistent with the government's position here (except that both positions would conveniently maximize tax revenue).

The government also resists application of the principle that ambiguity in a tax statute "must be resolved against the government," arguing that petitioner has not identified "any purportedly doubtful words in any statute relevant here." Br. 48. But this case turns on the appropriate interpretation and application of the word "value" in 26 U.S.C. 2031(a) and the phrases "net worth" and "taken into account" in 26 C.F.R. 20.2031-2(f). The principle thus plainly applies. And notably, the government is not seeking deference to its interpretation of those provisions.

4. Finally, the government takes issue with petitioner's argument that, because of the capital-gains tax, imposing estate tax on Michael's estate based on the increase in value of Thomas's shares would result in improper double taxation. See U.S. Br. 49-50. The government does not dispute, however, that Thomas's gains from the arrangement at issue would be subject to capital-gains tax upon sale. Instead, the government seeks to excuse any double taxation as having been "caused by the Connelly family's agreement to undervalue Michael's shares." Br. 49. Again, however, the government simply assumes the correctness of its own conclusion: Michael's shares were undervalued only if the government's valuation is correct. And if the $3 million redemption price were an underpayment and facilitated a transfer of value from Michael to Thomas, that may justify taxation of Thomas's gain once—but not twice.

The government's fallback argument (Br. 50) is that any double taxation is justified because Thomas could avoid capital-gains taxes by bequeathing his shares to an heir. Br. 50. But that proves far too much: capital-gains tax can *always* be avoided through inheritance on a stepped-up basis. It also proves too little: it does not address situations in which the surviving shareholder *does*

sell his shares, in which case he would be taxed on capital gains facilitated by the same insurance proceeds that increased the decedent's estate tax.

Nor can that unfair result be defended as the result of "congressional choice." U.S. Br. 50. As petitioner has explained (Br. 38-39), Congress intended for the estate tax and the capital-gains tax to be mutually exclusive. And in interpreting and applying 26 U.S.C. 2042, which governs the estate taxes on life-insurance proceeds, the IRS has specified that corporate insurance proceeds are to be considered when valuing the estate's stock only "to the extent such nonoperating assets have not been taken into account in the determination of net worth." 26 C.F.R. 20.2031-2(f)(2); see 26 C.F.R. 20.2042-1(c)(6). Where, as here, the life-insurance proceeds are treated as a corporate asset but are offset by a corresponding redemption obligation, the proceeds have already been "taken into account." The government points to no evidence of any congressional intention to deviate from that common-sense approach.

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The judgment of the court of appeals should be reversed.

Respectfully submitted.

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