No. 23-146

In the Supreme Court of the United States

THOMAS A. CONNELLY, AS EXECUTOR OF THE ESTATE OF MICHAEL P. CONNELLY, SR., PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether the proceeds of a life-insurance policy that will be used to redeem a decedent's shares in a closely held corporation should be included when valuing the decedent's interest in that corporation for purposes of the federal estate tax.

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OPINIONS BELOW

The opinion of the court of appeals (J.A. 104-118), is reported at 70 F.4th 412. The order of the district court (J.A. 119-158) 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 filed on August 15, 2023, and was granted on December 13, 2023. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent statutory and regulatory provisions are reprinted in the appendix to this brief. App., *infra*, 1a-5a.

STATEMENT

A. Legal Background

1. Congress first enacted the modern estate tax in 1916, imposing a tax "upon the transfer of" a decedent's "net estate." Revenue Act of 1916, ch. 463, Tit. II, § 201, 39 Stat. 777. Since its inception, the federal estate tax has operated "upon the right to *transmit*," rather than the "right to *receive*." 1 Randolph E. Paul, *Federal Estate and Gift Taxation* 20 (1942). The estate tax, accordingly, is not an inheritance tax; it operates "on the act of the testator," "not on the receipt of property by the legatees." *Ithaca Trust Co.* v. *United States*, 279 U.S. 151, 155 (1929).

Today, the estate tax is "imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." 26 U.S.C. 2001(a). But because certain credits are "allowed * * * against" the estate tax, any estate valued below a certain threshold is not subject to the estate tax. See 26 U.S.C. 2010(a). For 2024, that threshold is approximately $13.6 million per taxpayer (plus any unused exclusion amount from a spouse who died before the decedent, see 26 U.S.C. 2010(c)(4), which could increase the threshold up to $27.2 million). Rev. Proc. 2023-34, at § 3.41, 2023-48 I.R.B. 1287, 1294. From 2011 to 2017, roughly 0.2% of estates—or about 5000 each year—were subject to the estate tax, and those figures have since declined. See Internal Revenue Service (IRS), *Taxable Estate Tax Returns as a Percentage of Adult Deaths, Selected Years of Death (1934-2019)*, https://www.irs.gov/statistics/soi-tax-stats-historical-table-17.

The "starting point" for calculating the estate tax owed is the value of the decedent's gross estate, *Dorn* v. *United States*, 828 F.2d 177, 180 (3d Cir. 1987); 26

U.S.C. 2051, which includes the "value of all property to the extent of the interest therein of the decedent at the time of his death," 26 U.S.C. 2033; see 26 U.S.C. 2031(a), 2036; 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) (en banc). After applicable deductions are subtracted from the value of the gross estate, the estate tax is imposed on the remainder, *i.e.*, the "taxable estate." 26 U.S.C. 2001(a), 2051; see Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 120.2.2 (Nov. 2023 update).

As reflected in regulations promulgated by the Department of the Treasury (Treasury), the guiding principle in valuing property for estate-tax purposes is its "fair market value," 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" are not the actual parties but instead a hypothetical buyer and seller who agree to a transaction. See *Bright*, 658 F.2d at 1005, 1007. "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).

2. 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. Such shareholders sometimes enter into agreements to restrict share ownership to family members, while setting a low price for any sale or transfer of shares from one holder

to another. 3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 14:9 (3d ed. Nov. 2023 update). Although such agreements may serve legitimate purposes, they "generally tend to depress the value of the property," and as a result, are subject to abuse by improperly "minimiz[ing] the tax consequences of gifts or transfers." *Holman* v. *Commissioner*, 601 F.3d 763, 768 (8th Cir. 2010). For instance, if an agreed-upon but artificially low price were treated as the final word in valuing a decedent's shares for estate-tax purposes, "huge * * * tax savings could result." John A. Bogdanski, *Federal Tax Valuation* ¶ 6.04[2][a] (Oct. 2023 update).

In part to combat such abuses, Congress enacted specific valuation rules for estate-tax purposes. See Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, Tit. XI, § 11602(a), 104 Stat. 1388-491 to 1388-501. As relevant here, Congress has specified that the value of a decedent's property is to be "determined without regard to" any "agreement[] or other right to acquire or use the property at a price less than the fair market value of the property" and without regard to "any restriction on the right to sell or use such property." 26 U.S.C. 2703(a). To be excepted from that "[g]eneral rule," *ibid.* (emphasis omitted), an agreement must (among other things) be a "bona fide business arrangement" that is "not a device to transfer [the decedent's] property" to family members "for less than full and adequate consideration," and its terms must be "comparable to similar arrangements entered into by persons in an arms' length transaction," 26 U.S.C. 2703(b).

When a private agreement does not satisfy Section 2703(b)'s requirements and there are no arms-length transactions or bid-and-asked prices that can be used to

value a decedent's corporate shares, regulations specify that the shares are to be 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 specifically provide that "consideration shall also be given to non-operating 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." 26 C.F.R. 20.2031-2(f) (emphasis added). As the IRS explained when adopting the regulations, those proceeds need not be included directly in the decedent's gross estate, see 26 U.S.C. 2042(2) (providing that the gross estate shall include life-insurance proceeds over which the decedent possessed "incidents of ownership"), because their value is reflected in "the value of the stock that is included in the decedent's gross estate." *Treatment of Corporate-Owned Life Insurance Where the Decedent is a Shareholder*, 39 Fed. Reg. 14,947, 14,948 (Apr. 29, 1974); Bittker & Lokken ¶ 127.4.8; 26 C.F.R. 20.2042-1(c)(6).

B. The Present Controversy

1. Crown C Supply Co., Inc. (Crown) was a closely held corporation that sold building materials in St. Louis, Missouri. J.A. 105, 119. Petitioner's brother, Michael Connelly, was the President and Chief Executive Officer of Crown until his death on October 1, 2013. J.A. 120, 123. At the time of his death, Michael owned 77.18% of Crown's shares (385.9 out of 500 shares), and petitioner Thomas Connelly, who is also the executor of Michael's estate, owned the remaining 22.82% (114.1 shares). J.A. 105, 121.

In 2001, Michael, Thomas, and Crown entered into a stock-purchase agreement, commonly referred to as a "buy-sell" agreement. J.A. 1-24, 32, 105, 121. That agreement provided that if either Michael or Thomas died, the surviving brother had the option to purchase the decedent's shares. J.A. 10-11, 105, 121. If the survivor declined to do so, Crown itself was required to redeem the decedent's shares. J.A. 11, 105, 121. The agreement provided two mechanisms for determining the redemption price. First, the agreement stated that the shareholders "shall, by mutual agreement, determine the agreed value per Share by executing a new Certificate of Agreed Value" at the end of every tax year. J.A. 12. Second, 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 written appraisals of "the fair market value of the Company" and dividing the resultant binding appraisal of Crown's total value by the number of outstanding shares. J.A. 12-14. It is undisputed that neither of those two valuation methods was ever used here. J.A. 105, 123.

Crown obtained $3.5 million in life insurance on each brother to fund the anticipated stock redemptions. J.A. 33, 105, 121. When Michael died, Crown received approximately $3.5 million in life-insurance proceeds. J.A. 106, 113 n.4, 121, 123.

Thomas opted not to purchase Michael's shares. Instead, in November 2013, Thomas entered into a "sale and purchase agreement" with Michael's son (Thomas's nephew), providing that Crown would redeem Michael's 77.18% interest. J.A. 25-31, 106, 123. Rather than secure appraisals to determine "the fair market value of the Company," as the 2001 buy-sell agreement had

contemplated, J.A. 12-14, Thomas and Michael's son "resolved the issue of the sale price of the stock in as amicable and expeditious manner as is possible," "agree[ing] that the value of [Michael's] stock" was $3 million, J.A. 25, 106; see J.A. 26, 123. There is no evidence in the record regarding how they reached that valuation. But the 2013 agreement also provided that Michael's son would "have the right to eventually purchase all of [Thomas's] shares in Crown," and that his purchase right would be triggered either by Thomas's death or Thomas's determination that Michael's son "ha[d] achieved the experience and ability to capably manage the company effectively." J.A. 26, 29; see J.A. 27, 145-146.

Crown paid Michael's estate for his stock using $3 million of the life-insurance proceeds, extinguishing Michael's 77.18% equity interest in Crown. J.A. 34. After the redemption, Thomas owned 100% of the company. J.A. 117-118, 153.

2. In his capacity as the executor of Michael's estate, Thomas filed an estate-tax return reporting the value of Michael's Crown shares as $3 million. J.A. 106, 123. The IRS audited the return. *Ibid.*

During the audit, petitioner obtained a calculation-of-value report from a valuation firm. C.A. App. 102-129. The firm's analyst determined that, at Michael's death, Crown's value was $3.86 million. *Id.* at 103-107. Although that valuation purported to include Crown's "non-operating assets," *id.* at 106, it included only approximately $500,000 of the life-insurance proceeds Crown received at Michael's death, *id.* at 129; Gov't C.A. App. 20, 25. In excluding the remaining $3 million of the proceeds used to redeem Michael's shares, the analyst relied—at petitioner's instruction, see D. Ct. Doc. 55-2,

at 63-64 (Dec. 22, 2020); Gov't C.A. App. 67-68—on the Eleventh Circuit's decision in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (2005), which held that insurance proceeds should be "deduct[ed] * * * from the value" of a corporation when they are "offset by an obligation to pay those proceeds to the estate in a stock buyout." *Id.* at 1345. Because Michael's shares reflected his 77.18% ownership interest in Crown, the analyst calculated the value of Michael's shares as approximately $3 million ($3.86 million × 0.7718). C.A. App. 107, 129; Gov't C.A. App. 20.

The IRS rejected that analysis and determined that, in valuing Michael's shares for estate-tax purposes, Crown's value included the entirety of the life-insurance proceeds. J.A. 106, 123. Because the IRS did not dispute that Crown's value without the proceeds was $3.86 million, counting those proceeds yielded a $6.86 million date-of-death value for Crown. J.A. 37, 106-107, 123-124. Like the analyst petitioner hired, the IRS then multiplied Crown's total value by 77.18%, concluding that the fair market value of Michael's shares was approximately $5.3 million ($6.86 million × 0.7718). Because that was nearly $2.3 million more than the estate had reported in its return, the IRS determined that the estate owed additional tax in the amount of $889,914. *Ibid.*; C.A. App. 54, 59.

3. The estate paid the deficiency and filed a refund claim with the IRS. J.A. 107. In May 2019, the estate brought this tax-refund suit in the United States District Court for the Eastern District of Missouri. J.A. 107, 124; see 26 U.S.C. 6532(a)(1). After the parties cross-moved for summary judgment, the district court granted summary judgment to the government. J.A. 125-126, 158.

Petitioner primarily contended that the stock-purchase agreement and the $3 million redemption price, set after Michael's death, satisfied Section 2703(b)'s requirements and controlled the valuation of Michael's shares for estate-tax purposes. J.A. 127; see p. 4, *supra*. The district court rejected that argument, agreeing with the government that the family's private agreements did not satisfy the requirements to control valuation set forth in Section 2703(b), because (among other reasons) the agreements "transfer[red] wealth to Michael's family members for less than full-and-adequate consideration" and were not "comparable to similar agreements negotiated at arms' length." J.A. 133, 136-137; see J.A. 128-146.

Petitioner alternatively argued that the fair market value of Michael's shares was approximately $3 million, based on petitioner's analyst's valuation of Crown at approximately $3.86 million—that is, a valuation that excluded $3 million in life-insurance proceeds. J.A. 145.[1] Petitioner argued that $3 million of 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." J.A. 148 (brackets and citation omitted). In response,

[1] During the district court proceedings, the parties stipulated that the value of Michael's shares, excluding the life-insurance proceeds, was $3.1 million. J.A. 36-37. Based on that valuation, the value of Crown, excluding the relevant life-insurance proceeds, was approximately $4 million, rather than $3.86 million ($3,100,000 ÷ 0.7718 = $4,016,585). The court of appeals, however, stated that the value of Michael's shares was $2.98 million, and that the value of Crown was $3.86 million. Because such minor calculation disparities do not affect the outcome of the question presented (as petitioner agrees, Br. 12 n.1), this brief uses the court of appeals' calculations for ease of reference.

the government did not dispute that Crown's value, excluding the life-insurance proceeds, was approximately $3.86 million. But the government submitted a declaration from a corporate finance and valuation expert explaining that "a proper valuation" of Crown "should include all [of Crown's] assets *before* calculating the residual value held by the equity holders"—including the entirety of the life-insurance proceeds. J.A. 87; see J.A. 84. The valuation expert explained that Crown's obligation to redeem Michael's shares did not "offset" those proceeds because the redemption payment "was compensation for a transfer of Company shares, an equity asset"; "[a]s such, this payment represents a payment *to* equity rather than a non-equity claim" that would reduce the value of Michael's equity. J.A. 73, 87 (emphasis added); see J.A. 87-88.

The district court agreed with the government that an accurate valuation of Michael's shares at his death would not exclude $3 million of the life-insurance proceeds that Crown received upon Michael's death. J.A. 146-158. The court explained that, under customary valuation principles, "[a] redemption obligation is not an ordinary corporate liability." J.A. 156. Because "the shareholder is essentially 'cashing out' his share of ownership in the company and its assets," a stock redemption cannot "diminish the value of the same shares being redeemed." J.A. 156-157. The court observed that subtracting the life-insurance proceeds from Crown's value before calculating the value of Michael's shares, as petitioner urged, 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." J.A. 152-153.

4. The court of appeals affirmed. J.A. 104-118.

The court of appeals first held, in agreement with the district court, that the family's private stock-purchase agreements did not satisfy Section 2703(b)'s requirements and therefore did not control the value of Michael's shares for estate-tax purposes. See J.A. 109-112.[2]

To determine the fair market value of Michael's shares, the court of appeals began by assessing the value of Crown. J.A. 112-113. The court acknowledged the parties' agreement that Crown's value was approximately $3.86 million without $3 million of the life-insurance proceeds, as the estate calculated, and approximately $6.86 million with the proceeds. See J.A. 106-107 & n.2, 114. But the court rejected petitioner's argument that the life-insurance proceeds should be excluded, explaining that a willing buyer of Crown would "control[] the life insurance proceeds," leaving "no liability to be considered." J.A. 117. Accordingly, the court explained, a willing buyer would have paid up to $6.86 million for Crown ($3 million for the excluded life-insurance proceeds plus $3.86 million for Crown's undisputed other value). See J.A. 112-117. Similarly, the court reasoned that a willing seller of Crown would not have accepted $3.86 million at the time of Michael's death, "knowing that the company was about to receive $3 million in life insurance proceeds," because "those proceeds were intended to redeem a portion of *the seller's own shares.*" J.A. 117. Accepting $3.86 million for Crown, the court explained, would "ignore," rather than "'take[] into account'" the life-insurance proceeds. *Ibid.* (quoting 26 C.F.R. 20.2031-2(f)).

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[2] Petitioner did not seek this Court's review of that holding. Pet. 10 n.1.

As further evidence of "the illogic of the estate's position," the court of appeals observed that excluding the life-insurance proceeds from Crown's value would result in a windfall to Thomas, whose shares would "quadruple[] in value" solely because of the stock redemption. J.A. 117-118. In the court's view, that "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." J.A. 118. The court concluded that "the brothers' arrangement had nothing to do with corporate liabilities." *Ibid.* Rather, "[t]he proceeds were simply an asset that increased shareholders' equity," and the "fair market value of Michael's shares must account for that reality." *Ibid.*

In reaching that conclusion, the court of appeals declined to follow the Eleventh Circuit's contrary reasoning in *Blount*, 428 F.3d at 1345-1346, and the Ninth Circuit's "similar" decision in *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034, 1038 (1999). J.A. 116 & n.5. The court of appeals explained that the Eleventh Circuit had erroneously "viewed the life insurance proceeds as an 'asset' directly offset by the 'liability' to redeem shares, yielding zero effect on the company's value." J.A. 116. "*Blount*'s flaw lies in its premise," the court of appeals explained, because "[a]n obligation to redeem shares is not a liability in the ordinary business sense." J.A. 116-117 (citing 6A *Fletcher Cyclopedia of the Law of Corporations* § 2859 (Sept. 2023)). And *Estate of Cartwright*, the court explained, "employed similar reasoning" with "limited" analysis. J.A. 116 n.5.

SUMMARY OF ARGUMENT

A. At fair market value, Michael Connelly's shares were worth $5.3 million. By now, the relevant valuation

framework is largely uncontested. Petitioner agrees that the fair market value of Michael's shares at the time of his death is determined by the willing-buyer–willing-seller test; the value of Michael's shares in Crown depends on the value of Crown; a corporation's value must reflect the value of life-insurance proceeds payable to the company; and Crown's value was $6.86 million if the life-insurance proceeds to which the company was undisputedly entitled upon Michael's death are included. Petitioner does not dispute, moreover, the basic corporate valuation principles articulated by the government's expert: (1) valuation of the company must take into account all of the company's assets; (2) the sum of the interests of each equity shareholder must equal the total equity value of the corporation; (3) each individual equity share should be worth the same as any other; and (4) fair-market-value transactions do not leave either party worse off.

A straightforward application of those settled principles requires Michael's Crown shares to be valued at $5.3 million. The life-insurance proceeds that flowed into Crown upon Michael's death were a new corporate asset, worth millions of dollars, that increased the company's equity value. An accurate valuation of Crown must include the full $3.5 million in life-insurance proceeds that the company received—both the $500,000 that petitioner's analyst included *and* the roughly $3 million that the analyst excluded. When those proceeds are included, Crown's total value is $6.86 million, the fair market value of Michael's 77.18% interest is $5.3 million, and the fair market value of Thomas Connelly's 22.82% interest is $1.56 million. That result is consistent with each fundamental valuation principle—

including, critically, the principle that each individual equity share should be worth the same as any other.

By contrast, any valuation of Crown that excludes the life-insurance proceeds (as petitioner's does) violates those well-established valuation principles. Petitioner maintains that Michael's 77.18% equity interest in Crown was correctly valued at $3 million. But petitioner simultaneously maintains that Crown was worth $3.86 million in Thomas's hands after Michael's interest was extinguished, meaning that Thomas walked away from the redemption with $3.86 million in value. In other words, Thomas received $3.86 million for his 22.82% stake, but Michael's estate received only $3 million for his much larger, 77.18% stake. That gross mismatch—resulting in each of Thomas's shares being worth quadruple the value of each of Michael's shares—underscores that the estate seriously undervalued Michael's shares on its tax return by excluding the life-insurance proceeds.

B. Petitioner does not dispute that, in general, a corporation's entitlement to millions of dollars in life-insurance proceeds must be accounted for in valuing the corporation's shares. Instead, petitioner principally contends that $3 million of the life-insurance proceeds that Crown received here were offset by Crown's obligation to redeem Michael's shares—and should therefore be excluded in valuing Michael's shares. That is incorrect. Critically, the company resources expended in a redemption *go to the holder of the shares* being redeemed; the owner of those shares receives any assets used to satisfy the obligation. A redemption obligation, accordingly, cannot be treated as a value-depressing liability in valuing the very shares that are the subject of that obligation.

Here, Crown's promise to pay for Michael's shares did not reduce the value of those shares, and no real-world buyer or seller would have viewed the redemption obligation as an offsetting liability in pricing Michael's shares or all of Crown. To the contrary, a willing third-party buyer of Michael's interest in Crown would have acquired a 77.18% ownership stake in a company worth $6.86 million ($3 million in excluded life-insurance proceeds + $3.86 million in other value), and would have paid up to $5.3 million for Michael's shares—*i.e.*, the value he could have expected to receive in exchange, including a proportional share of the life-insurance proceeds. Similarly, had Thomas exercised his contractual right to purchase Michael's shares, Crown's value would have been $6.86 million: Crown would still have received the entire $3.5 million in life-insurance proceeds, but Crown would not have been obligated to redeem Michael's shares. At fair market value, then, Thomas should have paid up to $5.3 million for Michael's shares (77.18% of $6.86 million). Likewise, a third-party buyer of the entire company at the time of Michael's death would have paid $6.86 million for Crown, taking into account Crown's estimated value of $3.86 million plus the $3 million in life-insurance proceeds earmarked for the redemption, which the buyer would be entitled to receive. And finally, a hypothetical willing seller of Michael's shares would not have ignored $3 million in cash that Crown—in which Michael was a 77.18% equity shareholder—was entitled to receive. Rather, in exchange for Michael's shares, the seller would have demanded 77.18% of Crown's total value, including the life-insurance proceeds, for a total of $5.3 million.

Against all that, petitioner principally relies on two accounting standards that he claims require redemption

obligations to be treated as "liabilities" for accounting purposes. But that argument was neither pressed nor passed upon below. No lower court has considered either standard, and neither party has submitted any evidence or expert testimony regarding those standards, including their context, use, and interaction with valuation and taxation principles. This Court has consistently recognized that accounting rules do not generally dictate federal tax treatment, particularly where (as here) variations in corporate law across different States can result in divergent accounting treatment. In any event, the accounting standards that petitioner identifies suggest, at most, that Crown might have reflected its obligation to redeem Michael's shares as a kind of "liability" on its balance sheet—but that would be an obligation that Crown owed *to* the owner of Michael's equity interest, not an obligation that reduced the value *of* his equity interest. Indeed, it is petitioner's approach—valuing Crown at $3.86 million both before and after the redemption—that cannot be reconciled with the fundamental nature of a stock redemption, which reduces a corporation's net assets (while leaving the remaining shareholders with larger proportional interests in the less-valuable company).

Petitioner's remaining arguments lack merit. The lower courts did not apply a "control premium" in valuing Michael's shares, but rather calculated the value of his shares to include the proportional share of the life-insurance proceeds reflected in his ownership stake in Crown. Including life-insurance proceeds owed to a corporation in valuing a decedent's shares for estate-tax purposes will not threaten the ability of small businesses to engage in succession planning. And petitioner's concern about double taxation is speculative

and, in any event, caused by the Connelly family's non-arms-length agreement to redeem Michael's shares at less than fair market value, not by any valuation error on the government's part.

ARGUMENT

WHEN VALUING A DECEDENT'S SHARES IN A CLOSELY HELD CORPORATION, THE CORPORATION'S VALUE INCLUDES LIFE-INSURANCE PROCEEDS OWED TO THE CORPORATION, EVEN IF SUCH PROCEEDS WILL BE USED TO REDEEM THE DECEDENT'S SHARES

When calculating federal estate taxes, the value of a decedent's shares in a closely held corporation must reflect the corporation's own value, including all assets to which the corporation is entitled upon the decedent's death. Here, a fair market valuation of Crown necessarily includes the life-insurance proceeds that Crown received upon Michael's death—a cash payment worth millions that nearly doubled the value of Crown's equity. Any valuation of Michael's shares must account for that reality.

Petitioner seemingly agrees that, in general, a willing buyer and willing seller would include such proceeds when valuing a corporation and its equity shares. But petitioner contends that where, as here, the corporation has already promised to redeem the decedent's shares, the life-insurance proceeds designated for that redemption are offset by that obligation and do not increase the value of the decedent's shares for estate-tax purposes. That is incorrect as a matter of valuation: A redemption obligation is not a value-depressing liability in valuing the very shares that are the subject of that obligation, and no buyer or seller of those shares would consider a redemption obligation *running to those shares* as a liability that lowers the value of those shares *to him*. Pe-

titioner resorts to accounting rules and policy considerations, but those arguments fail on their own terms and cannot, in any event, overcome a straightforward application of the willing-buyer–willing-seller test that controls here.

A. The Fair Market Value Of Michael's Shares Was $5.3 Million

For purposes of the federal estate tax, the value of Michael's gross estate includes all of his property "to the extent of [his] interest therein * * * at the time of his death." 26 U.S.C. 2033; see 26 U.S.C. 2031(a), 2036. This dispute concerns the value, for estate-tax purposes, of a single property interest: Michael's shares in Crown. The value of those shares, all agree, turns on the value of Crown. The lower courts correctly concluded that Crown's value on the date of Michael's death included the life-insurance proceeds to which the company was undisputedly entitled. That gave the company a value of $6.86 million. Because Michael's shares reflected his 77.18% equity ownership in Crown, they were worth approximately $5.3 million.

1. Much of the applicable valuation framework is uncontested. Petitioner does not challenge the lower courts' holdings that the Connelly family's private agreements do not resolve the value of Michael's shares. Pet. 10 n.1. Petitioner agrees that the fair market value of Michael's shares at the time of his death is instead determined by the willing-buyer–willing-seller test. Pet. Br. 4. Under that test, as petitioner acknowledges (*id.* at 6), "fair market value 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).

Petitioner likewise does not dispute that where (as here) "prices on the open market or bona fide bid and asked prices * * * are unavailable," the fair market value of a decedent's corporate shares depends on, among other things, "'the company's net worth.'" Br. 20-21 (quoting 26 C.F.R. 20.2031-2(f)(2)). As petitioner recognizes (Br. 14), "[b]ecause stock constitutes a fractional interest in a company, a willing buyer and willing seller of stock in a company would reach an agreed-upon price that is based primarily on the value of the company as a whole." And petitioner acknowledges that the value of the company "takes into account '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 connection with other factors." Br. 21 (quoting 26 C.F.R. 20.2031-2(f)). Petitioner thus recognizes that, in general, "a valuation of a company as of the date of an insured's death would consider life-insurance proceeds expected to flow in." Br. 24; see Br. 26 n.3. And the parties have agreed that Crown's value was approximately $3.86 million if $3 million in life-insurance proceeds is excluded, as the estate calculated, and $6.86 million if those proceeds are counted. See J.A. 106-107 & n.2, 114, 147-148.

Finally, petitioner nowhere disputes the black-letter valuation principles enumerated by the government's expert. First, "valuation of the firm needs to take into account all assets." J.A. 101; see J.A. 83. Second, the interests of each equity shareholder, added together, must equal the total equity value of the corporation. J.A. 85, 100. Third, no individual equity share is worth

more than any other. J.A. 85, 91.[3] And fourth, "fair market transactions do not make either party worse off." J.A. 85 (capitalization and emphasis omitted).

2. Those principles resolve this case. Petitioner's valuation analyst valued Crown's equity—*i.e.*, 100% of the company's shares—at $3.86 million, which (at petitioner's instruction) included approximately $500,000 of the life-insurance proceeds the company received upon Michael's death, while excluding approximately $3 million of those same life-insurance proceeds. C.A. App. 107, 129; Gov't C.A. App. 20. But as petitioner concedes (Br. 24), ordinarily, "a valuation of a company as of the date of an insured's death would consider life-insurance proceeds expected to flow in." Pet. Br. 24. As the court of appeals explained, the life-insurance proceeds "were simply an asset that increased shareholders' equity," J.A. 118, to the tune of $3.5 million in cash. Or as the government's valuation expert put it, "[t]he insurance payment is a new asset owned by the equity holders, who should divide it based on their ownership shares." J.A. 101; see J.A. 84 (expert explaining that "[l]ife insurance proceeds, such as the proceeds at issue here, provide a lump-sum cash payment to a company and represent such a non-operating asset that must be added to [the] firm's operating value in any firm valuation"). Because a proper corporate valuation must account for all assets, see p. 19, *supra*, an accurate valua-

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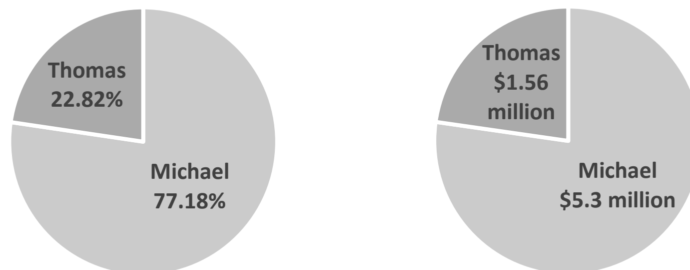
[3] In some circumstances, a willing buyer might offer a premium on top of the individual share value to purchase a block of stock representing a controlling interest in a corporation. Here, however, neither party urged that any sort of control premium—or comparative discount—should apply; rather, the parties' stipulations limited the valuation dispute to whether the life-insurance proceeds should be excluded in valuing Michael's shares. See pp. 42-44, *infra.*

tion of Crown must include the full $3.5 million in life-insurance proceeds the company received upon Michael's death—both the $500,000 that petitioner's analyst included *and* the roughly $3 million that the analyst excluded on the ground that they would be needed to redeem Michael's shares if Thomas did not buy those shares. As the government's expert explained, Crown's total equity value, accounting for this correction, is $6.86 million ($3 million in excluded life-insurance proceeds + $3.86 million in other value). J.A. 88.

From there, the math is straightforward. At his death, Michael owned shares that entitled him to 77.18% of Crown's total equity value. J.A. 105. Had Crown been valued correctly at $6.86 million, the fair market value of Michael's 77.18% interest would have been $5.3 million, and the fair market value of Thomas's 22.82% interest would have been $1.56 million:



That result comports with each of the four fundamental valuation principles. See pp. 19-20, *supra*. When the life-insurance proceeds that Crown received upon Michael's death are included, the $6.86 million valuation reflects all of the company's assets. The sum of Michael's shares and Thomas's shares equals Crown's total equity value ($5.3 million + $1.56 million = $6.86 million). An individual share owned by Michael's estate

is worth the same as one owned by Thomas (approximately $13,700).[4] And the inclusion of the life-insurance proceeds has made neither owner better or worse off; the estate and Thomas are each entitled to the portion of Crown's total value corresponding to the relevant equity interest.

3. By contrast, any valuation of Crown that excludes the life-insurance proceeds—such as the $3.86 million valuation urged by petitioner here—violates those well-established valuation principles. Petitioner contends that, because (in his view) Crown was worth only $3.86 million, Michael's shares were correctly valued at $3 million when they were redeemed. Yet petitioner simultaneously maintains—as his analyst confirmed, Gov't C.A. App. 72—that Crown was also worth $3.86 million immediately *after* Michael's 77.18% equity interest was extinguished in the redemption. Cert. Reply Br. 8. Upon redemption, however, Thomas owned all of Crown. As a result, under petitioner's view, at the time of the redemption, Thomas's 22.82% interest was worth $3.86 million (as reflected in Crown's residual value), but Michael's much larger, 77.18% interest was worth only the $3 million paid for his shares.

That increase in the value of Thomas's stake cannot be attributed to the fact of the redemption; to the contrary, a redemption is supposed to leave the value of the remaining shareholders' stakes undisturbed. In a redemption, as explained in more detail below, see pp. 25-27, 39-41, *infra*, a corporation "spend[s] cash from the company's coffers" to buy out a shareholder's stake, "thereby reduc[ing] the company's assets," Pet. Br. 22,

[4] With less rounding, at $13,727 per share, Michael's 385.9 shares are worth $5.297 million, and Thomas's 114.1 shares are worth $1.566 million, summing to $6.863 million.

and leaving the remaining shareholders with greater ownership stakes in a company worth proportionately less. Thomas's shares thus should not have "skyrocketed in value as a result of the redemption." *Id.* at 37 (internal quotation marks omitted). That "quadrupl[ing]" in value, J.A. 118, instead reflects petitioner's calculation error in valuing Michael's shares, such that millions of dollars improperly remained in Crown (and inured to Thomas's benefit) after the company underpaid for Michael's shares.

In other words, petitioner's valuation of Michael's shares at $3 million caused a gross mismatch between the brothers' relative interests in the company and the absolute value of those interests:

By redeeming Michael's shares for $3 million, petitioner effectively valued each of Michael's 385.9 shares at $7,774 ($3 million ÷ 385.9) and each of Thomas's 114.1 shares at approximately $33,850 ($3.86 million ÷ 114.1). That violates the basic principle that no equity share is worth more than any other. See, *e.g.*, *Dreiseszun* v. *FLM Indus., Inc.*, 577 S.W.2d 902, 908 (Mo. Ct. App. 1979) ("[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.").

The estate tax is, of course, "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). Thus, for estate-tax purposes, the value that matters is the fair market value of the decedent's property, in his hands, at the time of his death—and not the value that ultimately ends up in others' pockets. See p. 2, *supra*; Pet. Br. 37. But the fact that petitioner's calculations would cause each of Thomas's shares to be worth quadruple the value of one of Michael's shares underscores the error in the estate's math, which fundamentally undervalued Michael's shares on the estate's tax return by excluding the life-insurance proceeds. See J.A. 153 (district court's explanation that petitioner's position "violates customary valuation principles because Thomas's shares would be worth 336% more than Michael's *at the exact same time*").

B. Crown's Obligation To Redeem Michael's Shares Does Not Diminish The Value Of Those Shares

Petitioner rightly does not dispute that a corporation's entitlement to millions of dollars in life-insurance proceeds must ordinarily be accounted for when the corporation's shares are valued. See pp. 19-20, *supra*. Instead, petitioner principally contends that $3 million of the life-insurance proceeds that Crown received were offset, dollar-for-dollar, by Crown's obligation to redeem Michael's shares—and should therefore be excluded in valuing Michael's shares. That is incorrect; Crown's promise to pay for Michael's shares did not reduce the value of those shares, and no real-world buyer or seller would have priced Michael's shares at such a steep discount. At Michael's death, a hypothetical willing buyer would have paid $5.3 million for his Crown

shares, to account for the incoming proceeds, and a hypothetical willing seller of those shares would have accepted no less. The accounting standards that petitioner belatedly invokes have no bearing on that valuation question and do not, in any event, suggest that a redemption obligation would ever be treated as a liability that diminishes the value of the very shares that are to be redeemed (*i.e.*, exchanged for a payment reflecting their proportion of the corporation's total value).

1. A redemption obligation does not diminish the value of the shares to which that obligation runs

Petitioner contends (Br. 17)—echoing the Ninth and Eleventh Circuits—that "[t]he redemption obligation constitutes a liability that offsets the value of the insurance proceeds, and a purchaser of a subset of the corporation's shares would treat the two as canceling each other out." See *Estate of Blount* v. *Commissioner*, 428 F.3d 1338, 1345-1346 (11th Cir. 2005) (*Blount II*) (holding that a redemption obligation is "an enforceable liability against the valued company" and that, in valuing the to-be-redeemed shares, "the insurance proceeds are offset dollar-for-dollar" by that "liability"); *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034, 1038 (9th Cir. 1999) (holding that life-insurance proceeds would not affect "what a willing buyer would pay" for the decedent's stock because the proceeds were "offset dollar-for-dollar" by the company's obligation to pay the proceeds to the decedent's estate). Petitioner, like the Ninth and Eleventh Circuits, misunderstands the nature of a redemption obligation, which *benefits* an equity interest and cannot be the basis for reducing the value of the very interest to which that obligation runs.

A redemption is "a partial repurchase of stock by the continuing corporate enterprise." *Commissioner* v.

Clark, 489 U.S. 726, 741 (1989); see 3 Cox & Hazen § 21:7 (explaining that "redemption" is included in the "generic" term "[r]epurchase of shares"). In a redemption, a shareholder's stock is "surrendered to the corporation in return for cash or other property." *Commissioner* v. *Fink*, 483 U.S. 89, 99 n.14 (1987). By redeeming his shares, "the shareholder is essentially 'cashing out' his share of ownership in the company and its assets." J.A. 156-157. A redemption thus is "one significant way * * * in which shareholders participate financially in the enterprise," Richard A. Booth, *Financing the Corporation* § 6:2 (Oct. 2022 update); it "is simply a method of distributing a proportion of the assets to the stockholder," *Robinson* v. *Wangemann*, 75 F.2d 756, 757 (5th Cir. 1935).

Accordingly, contrary to petitioner's contentions (Br. 17), a redemption obligation is not a "liability" that reduces the value of the to-be-redeemed shares. Although a redemption obligation is a contractual obligation that expends company resources, critically, those company resources *go to the holder of the shares* being redeemed. A redemption therefore cannot be a "value-depressing corporate liability" in valuing "the very shares that are the subject of the redemption obligation." J.A. 151 (quoting *Estate of Blount* v. *Commissioner*, 2004 WL 1059517, at *25 (T.C. May 12, 2004) (*Blount I*), aff'd in part and rev'd in part, 428 F.3d 1338 (11th Cir. 2005)).

As the Tax Court explained in *Blount I*, the decedent's shares reflect an "interest in all of the assets and income-generating potential of [the corporation] on the valuation date, including any assets that might be used to satisfy the actual redemption obligation." 2004 WL 1059717, at *25. "To treat the corporation's obligation to redeem the very shares that are being valued as a

liability that reduces the value of the corporate entity thus distorts the nature of the ownership interest represented by those shares." *Ibid.*; see *id.* at *26 ("The error * * * lies in the treatment of [a] redemption obligation as a claim on corporate assets when valuing the very shares that would be redeemed with those assets.").

A hypothetical scenario assuming a similar redemption obligation (but, for the moment, setting aside any life-insurance proceeds) illustrates the point: Two sisters who own 80% and 20%, respectively, of a company worth $5 million execute a stock-redemption agreement like the one at issue here. When the 80% shareholder dies, her shares are worth $4 million ($5 million × 0.80). To prevent the shares from going to somebody else, the company would need to pay $4 million to redeem them from her estate, leaving the surviving sister as the sole shareholder of a company worth only $1 million (because $4 million left the corporate treasury to buy back the shares). If the redemption obligation were considered a corporate liability that must be taken into account when valuing the decedent's shares, however, then the company would ostensibly be worth only $1 million at the time of the decedent's death ($5 million less the $4 million redemption obligation). Yet if the company is worth only $1 million, then the deceased sister's shares should be worth only $800,000 ($1 million × 0.80). And if that were the case, satisfying the redemption obligation would cost only $800,000—not $4 million. The redemption obligation cannot be $4 million and $800,000 at the same time, but that mathematical glitch reflects the error in petitioner's theory, which treats the very thing being valued as a line item in its own valuation.

Petitioner's error rests in part on his mistaken belief that "[t]he hypothetical willing-buyer/willing-seller test posits hypothetical shares that make up the same percentage of the corporation as a whole, *not the decedent's actual shares*." Pet. Br. 26 (emphasis added). In that vein, petitioner suggests (Br. 25-26) that a buyer of some hypothetical 77.18% interest in Crown would discount the infusion of life-insurance proceeds to the extent that Crown would be using them to redeem some other hypothetical shares. While it is true that the willing-buyer–willing-seller test makes it possible to disregard certain real-world restrictions on the property's sale, it does not change the identity of the property that is being valued. Here, the property in question is *Michael's own shares*, to the extent of his interest in them at the time of his death. See, *e.g.*, 26 U.S.C. 2033 (relevant property is the "[p]roperty in which the decedent had an interest") (emphasis omitted); see also 26 U.S.C. 2031(a), 2036. There is accordingly no basis for valuing some other hypothetical shares of Crown, rather than Michael's actual shares.

Petitioner invokes (Br. 25-26) the principal regulation about valuation of property, 26 C.F.R. 20.2031-1(b). But that regulation similarly emphasizes that the "value of every item of property includible in a decedent's gross estate * * * is *its* fair market value at the time of the decedent's death." *Ibid.* (emphasis added); see *ibid.* (stating that "fair market value is the price at which *the property* would change hands between a willing buyer and a willing seller") (emphasis added). As petitioner notes (Br. 25-26), the regulation requires resort to the price at which the item in question would sell in the market "in which such item is most commonly sold to the public," rather than some other market that would not

be accessible to "the general public" (such as one used "by a dealer in used automobiles"). 26 C.F.R. 20.2031-1(b). But that is irrelevant here: Crown shares were not commonly sold to the public, and there was no distinction between "retail" and "dealer" prices. And, again, the need to identify the appropriate market for the hypothetical sale does not change *which* property is being valued. Here, it is Michael's own shares, which were not diminished in value by their potential redemption by Crown.[5]

2. *No willing buyer would have excluded $3 million in life-insurance proceeds in valuing Michael's shares or all of Crown*

Three illustrations confirm that no willing buyer of Michael's shares or of Crown itself would have treated the redemption obligation—*i.e.*, Crown's promise to pay

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[5] Contrary to petitioner's suggestion (Br. 36), the government did not change positions after *Estate of Cartwright*. As relevant here, the government told the Ninth Circuit that insurance proceeds could be offset by a "liability, such as one to pay a decedent's estate *for his work in process*," Gov't Br. at 40-41, *Estate of Cartwright*, *supra* (No. 97-70032) (emphasis added)—not by a redemption obligation. The obligation to pay for a decedent's "work in process" is an ordinary corporate liability to pay for work performed on behalf of the corporation, just as it must pay outstanding salary. In *Estate of Cartwright*, the decedent was not just an equity shareholder but also a creditor of sorts (who was owed money for his work in process). Moreover, the government's position was not that the life-insurance proceeds received by the corporation should not be taxed at all, but rather that—because most of the proceeds were offset by the corporation's debt to the decedent—they should be treated as "income in respect of the decedent" and subject to the income tax (at a higher effective tax rate than the estate-tax treatment urged by the estate). *Id.* at 50-51; see 26 U.S.C. 691(a) and (c).

for Michael's shares—as a liability that offset the value of the life-insurance proceeds.

a. *Third-Party Buyer Of Michael's Shares.* Most directly, a willing third-party buyer of Michael's 77.18% interest in Crown would not have treated Crown's obligation to pay for Michael's shares as a factor that reduced the value of those shares *to him*. A buyer of Michael's shares, at the time of Michael's death, would have acquired a 77.18% ownership stake in a company worth $6.86 million (again, $3 million in excluded life-insurance proceeds + $3.86 million in other value), along with Crown's obligation to redeem those shares. "Since the buyer would receive the payment from the stock redemption, the buyer would not consider the obligation *to himself* as a liability that lowers the value of the company *to him*." J.A. 151 (citing *Blount I*, 2004 WL 1059517, at *25). A third-party buyer would thus have paid up to $5.3 million for those shares—*i.e.*, the value he could have expected to receive in exchange for those shares when Crown redeemed them ($6.86 million × 0.7718).

That approach—as contemplated by this Court's invocation of the willing-buyer–willing-seller test in *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973)—appropriately "account[s] for the legal and practical limitations" that are relevant to valuing Michael's shares. Pet. Br. 20. Petitioner is correct in observing (Br. 24) that, at the time of Michael's death, the life-insurance proceeds were "expected to flow in" to Crown as an asset and then "to flow out" of Crown to redeem Michael's shares. But when the assets flow out of Crown to redeem Michael's shares, they necessarily flow to the owner of Michael's equity interest—and so

the outflow would not reduce the value of that interest to any potential buyer of that very interest.[6]

b. *Thomas Connelly As Purchaser Of Michael's Shares*. Second, under the Connelly brothers' 2001 agreement, Thomas held the right of first refusal to purchase Michael's shares. See p. 6, *supra*. Had Thomas exercised that right, he would have eliminated Crown's obligation to redeem Michael's shares, but the life-insurance payment would still be due to Crown, because it was not contingent on Thomas's decision about whether to purchase the shares or to let Crown redeem them. In that scenario, as the government's expert explained, no one would dispute that Crown's value would be $6.86 million: Crown would still have received the entire $3.5 million in life-insurance proceeds, but Crown would not have been obligated to redeem Michael's shares. J.A. 89-93. At fair market value, then, Thomas should have paid up to $5.3 million for Michael's shares (77.18% of $6.86 million). Michael's shares cannot be worth one amount if Thomas is the buyer, and millions less if the buyer is Crown (especially when, post-redemption, Crown itself was wholly owned by Thomas).

[6] Petitioner suggests (Br. 23) that "if the estate had sold Michael's shares to a third party," "Crown could have moved to unwind the transaction under the doctrine of constructive trust." But the government has never suggested that the estate could have sold Michael's shares to a third party, free and clear. The point is simply that in valuing Michael's shares, as petitioner concedes (Br. 6, 17-18), the applicable regulations ask what a hypothetical third-party buyer would have paid for those shares. See pp. 4-5, 18-19, *supra.* And in calculating that value, Congress directed the IRS to disregard "any restriction on the right to sell or use such property." 26 U.S.C. 2703(a)(2); see Pet. Br. 25 (recognizing that "the unavailability of the precise shares at issue does not matter").

c. *Third-Party Buyer Of Crown*. Finally, a third-party buyer of the entire company, at the time of Michael's death, would have paid $6.86 million for Crown, regardless of the redemption obligation. J.A. 93-95, 117, 151-152. As the lower courts recognized, 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. J.A. 117, 152. As the court of appeals explained, a hypothetical buyer of Crown could then 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. J.A. 117. Either way, the willing buyer would receive $6.86 million in total value and would be willing to pay for that value.

3. *No willing seller would have excluded $3 million in life-insurance proceeds in valuing Michael's shares*

For similar reasons, the lower courts correctly concluded that a hypothetical willing seller of Michael's shares would not have accepted less than $5.3 million for them. J.A. 117, 153-154. A hypothetical willing seller of Michael's Crown shares would not have ignored $3 million in cash that Crown—in which Michael was a 77.18% equity shareholder—was entitled to receive. Rather, the seller would have demanded 77.18% of Crown's total value, including the life-insurance proceeds, in exchange for Michael's shares—for a total of $5.3 million (77.18% of $6.86 million). J.A. 117-118, 153-154. A seller who excluded $3 million in life-insurance proceeds in valuing Michael's shares of Crown would effectively be gifting 100% of the value of those proceeds

to Thomas's 22.82% stake in Crown, rather than demanding a price for Michael's stake that "account[s]" for Michael's entitlement to 77.18% of the life-insurance proceeds, a substantial "nonoperating asset[]" belonging to Crown. 26 C.F.R. 20.2031-2(f).

It does not matter that, under the agreement that Thomas made with Michael's son, Crown actually redeemed Michael's shares for only $3 million (well below their fair market value). There is no evidence in the record regarding how the Connelly family reached an "amicable and expeditious" agreement to price Michael's shares at $3 million, which may have resulted from idiosyncratic or personal reasons apart from a true valuation. J.A. 25.[7] In any event, valuation for estate-tax purposes is determined "without regard" to the parties' agreement that Crown would redeem the shares "at a price less than the fair market value." 26 U.S.C. 2703(a)(1). The willing buyer and willing seller, as petitioner agrees (Br. 6, 18), are hypothetical parties and not the actual parties to any actual transaction. See, *e.g.*, *United States* v. *Simmons*, 346 F.2d 213, 217 (5th Cir. 1965); *Estate of Bright* v. *United States*, 658 F.2d 999, 1005-1006 (5th Cir. 1981) (en banc); Bittker & Lokken ¶ 135.1.2. It is "improper to ascribe motivations that are personal and reflective of the idiosyncra[s]ies of particular individuals"; rather, the willing buyer and seller should be viewed "as economically rational actors possessing all relevant information and seeking to max-

[7] The record reflects that, in the same agreement, Thomas and Michael's son agreed that ownership of Crown could ultimately return to Michael's son. See p. 7, *supra*. That condition—or other considerations specific to the Connelly family—may have played a role in Michael's son agreeing to a below-market-value redemption price for Michael's shares.

imize their gains." *Holman* v. *Commissioner*, 601 F.3d 763, 775 (8th Cir. 2010). And a rational actor seeking to maximize the gains from selling Michael's shares would have demanded \$5.3 million in exchange.[8]

4. The accounting standards that petitioner identifies do not alter that conclusion

Petitioner invokes (Br. 23) two accounting standards that he claims require redemption obligations to be treated as "liabilit[ies]" for accounting purposes. Petitioner failed to advance that contention, or expert support for it, in the courts below, and accounting standards do not control valuation for federal-estate-tax purposes. In any event, the accounting standards that petitioner belatedly identifies do not support his claim that Crown's obligation to redeem Michael's shares

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[8] Contrary to petitioner's suggestion (Br. 27-28), the government's position is not that the Court should "*ignore*" the fact of the buy-sell agreement or, specifically, its redemption obligation. Rather, as explained above, see pp. 25-27, *supra*, that redemption obligation—which benefits Michael's shares—is not a "liability" that cancels out the value of the life-insurance proceeds in valuing Michael's shares. Relatedly, in seeking certiorari, petitioner suggested that Crown could be valued at \$6.86 million only "by excluding the redemption obligation from the company's balance sheet and then valuing the company at the fleeting point in time after it has received the insurance proceeds but before it has redeemed Michael's shares." Cert. Reply Br. 6. Petitioner (rightly) does not renew that claim in his merits brief. The willing-buyer–willing-seller test properly considers only the value of Michael's shares at the time of his death—when, as petitioner does not dispute, Crown was certain to receive \$3.5 million in life-insurance proceeds (as it later did). That valuation, of course, looks at the value of Michael's shares before they are redeemed and thus extinguished; that is precisely the valuation question that must be resolved.

should be treated as a liability that diminishes the value of those same shares.

a. Petitioner invoked two accounting standards—issued by the Financial Accounting Standards Board—for the first time in his reply brief in support of his petition for a writ of certiorari. Cert. Reply Br. 7. Petitioner bears the burden in this tax-refund suit, see *United States* v. *Janis*, 428 U.S. 433, 440 (1976), but he failed to identify these standards in the lower courts or to submit any evidence or expert testimony regarding the standards, including as to their context and force. Petitioner's delay in raising this issue also deprived the government of that opportunity. The lower courts have not considered the standards, including how they interact with other accounting standards, valuation principles, Missouri law, or federal tax law. See Shannon P. Pratt & Alina V. Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 351-352 (5th ed. 2008) ("Under any standard of value, the true economic value of a business enterprise equals the company's accounting book value only by coincidence. * * * There is no theoretical support, conceptual reasoning, or empirical data to suggest that the value of a business enterprise * * * will necessarily equal the company's accounting book value."). This Court ordinarily will not "address a question neither pressed nor passed upon below," *Timbs* v. *Indiana*, 139 S. Ct. 682, 690 (2019), and there are no "unusual circumstances" warranting a departure from that rule here, *OBB Personenverkehr AG* v. *Sachs*, 577 U.S. 27, 38 (2015); see *NCAA* v. *Smith*, 525 U.S. 459, 469-470 (1999) (declining to address "alternative theories" because this Court "do[es] not decide in the first instance issues not decided below").

b. Accounting rules, in any event, do not dictate federal tax treatment. As this Court has explained, generally accepted accounting principles "tolerate a range of 'reasonable' treatments, leaving the choice among alternatives to management." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). Different corporations can make different accounting choices; if those choices governed tax consequences, a company "could decide unilaterally * * * the tax it wished to pay." *Ibid.* This Court has thus declined to find any "presumptive equivalency" between accounting rules and tax consequences, recognizing that "would create insurmountable difficulties of tax administration." *Ibid.* Even in tax cases that consider accounting treatment as relevant evidence, this Court and lower courts have acknowledged that the characterization of a transaction need not be the same for both taxation and accounting purposes. See, *e.g.*, *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 577 (1978); *JPMorgan Chase & Co.* v. *Commissioner*, 458 F.3d 564, 569 (7th Cir. 2006) (distinguishing between tax and accounting rules in valuing interest swaps).

That is particularly true where variations in corporate law across different States can lead to (or require) divergent accounting treatment—as with share redemptions and repurchases. Today, there are "[a]t least three different methods, with a number of variations," to account for such transactions: contracting capital, reducing surplus, and reflecting the cost of the repurchased shares as "an unallocated deduction from equity." 3 Cox & Hazen § 21:11 (noting that the last option "is probably the most common and best method"). Missouri law, for example, allows share redemption or repurchase "out of surplus," restricts them

"out of stated capital," and describes circumstances under which "stated capital" will be reduced. Mo. Rev. Stat. § 351.200 (2023). Federal estate-tax treatment should not be thought to track those state-by-state variations.

c. In any event, even if the accounting standards that petitioner identifies would have required Crown to reflect its obligation to redeem Michael's shares as a kind of "liability" on its balance sheet, that would be an obligation that Crown owed *to* the owner of Michael's equity interest—not an obligation that reduced the value *of* his equity interest. It thus would not diminish the value of Michael's shares.

Petitioner conflates a corporation's liabilities to its *creditors*, which reduce the assets available for equity claims, with a corporation's obligation to redeem shares, which is an *equity claim* belonging to a shareholder that does not reduce the assets available to pay that equity claim. "A shareholder of course gets paid only after everyone else gets paid." 11 *Fletcher Cyclopedia of the Law of Corporations* § 5081 (Sept. 2023). Equity holders "have a residual interest in the company's assets" and "get the value that remains after all other contracts are settled." Robert W. Holthausen & Mark E. Zmijewski, *Corporate Valuation—Theory, Evidence & Practice* 6 (1st ed. 2014) (emphasis omitted). Because liabilities to creditors are paid before equity claims, liabilities *to creditors* must be considered in determining the value of equity. J.A. 81-82. But an obligation to cash out an equity interest is not a "liability" that reduces the value of that equity interest, and neither of the accounting standards petitioner cites treats it as such.

To the contrary, the example in Accounting Standard 480-10-55-64 on which petitioner relies (Br. 23) itself demonstrates that shares subject to mandatory redemption are not treated like ordinary corporate liabilities. In that example, "[s]hares subject to mandatory redemption" are recorded separately from, and are distinct from, ordinary corporate "Liabilities other than shares." Financial Accounting Standards Board, *Accounting Standards Codification* ¶ 480-10-55-64, https://asc.fasb.org/1943274/2147481620/480-10-55-64. Further, in the example, the "[s]hares subject to mandatory redemption" are valued in precisely the way that other equity shares would be—with a note identifying them as consisting of the par value of outstanding shares, along with the retained earnings attributable to those shares and the other corporate income attributable to those shares. *Ibid.*

That is consistent with the illustration provided by a leading corporate law scholar of a corporation's balance sheet, before and after it uses $10,000 to redeem some of its shares:

Before redemption	
Assets	*Liabilities/ Shareholder Equity*
Cash $100,000	Liabilities $50,000
	Capital $20,000
	Surplus $30,000
After redemption	
Assets	*Liabilities/ Shareholder Equity*
Cash $90,000	Liabilities $50,000
	Capital $20,000
	Surplus $20,000

Stephen M. Bainbridge, *Bainbridge's Corporate Law* § 13.4, at 507 (4th ed. 2020) (applying Delaware law). As the example illustrates, a $10,000 stock redemption reduces a corporation's "[a]ssets" (in the left-hand column) but does not affect its "[l]iabilities" (in the right-hand column). *Ibid.* (emphasis omitted).

In the end, even petitioner admits (Br. 24) that not "*every* stock redemption involves a liability." Although petitioner insists that *this* stock redemption was a "liability" that reduced the value of Michael's shares, he concedes that a company's "voluntar[y]" redemption would not create a similar liability. *Ibid.* But whether a stock redemption is required by contract or not, its effect on the corporate coffers is the same. To effectuate the redemption in either case, a corporation would use cash to redeem a shareholder's shares, while extinguishing the shareholder's equity interest in the corporation. And in either case, no willing buyer or seller would treat the redemption as a liability that diminishes the value of the very shares to be redeemed.

d. Indeed, it is petitioner's approach that distorts the basic mechanics of a stock redemption. As explained above, see pp. 25-27, *supra*, when stock is redeemed, "the shareholder is essentially 'cashing out' his share of ownership in the company and its assets." J.A. 156-157. When that occurs, "the purchase price [for the shares] is simply withdrawn from the issuer's business," which "necessarily reduces the [corporation's] net assets." 3 Cox & Hazen §§ 19:6, 21:1. The Supreme Court of Missouri, valuing a closely held business in a divorce case, explained that a stock repurchase "diminished" the corporation's value and left the remaining shareholder with "a larger ownership percentage of a corporation that was worth less." *Hoffmann* v. *Hoffmann*,

676 S.W.2d 817, 822 (Mo. 1984) (en banc); see, *e.g.*, *Gold* v. *Lippman (In re Flying Mailmen Serv., Inc.)*, 539 F.2d 866, 870 (2d Cir. 1976) (stock repurchase "depletes a corporation's assets"); *Stanley* v. *Brock (In re Kettle Fried Chicken of Am., Inc.)*, 513 F.2d 807, 811 (6th Cir. 1975) (stock repurchase, "of course," reduced corporation's assets) (citing *In re International Radiator Co.*, 92 A. 255, 256 (Del. Ch. 1914)).

Petitioner acknowledges (Br. 22) that a redemption requires the corporation "to spend cash from the company's coffers and thereby reduce the company's assets," while leaving the remaining shareholders with greater ownership stakes. Yet petitioner's calculations defy that principle, because (under petitioner's approach) Crown's redemption of Michael's shares left Thomas with a *larger* ownership stake in a company with exactly the *same* value before and after the redemption. According to petitioner, Crown was worth only $3.86 million before the redemption when it was jointly owned by Michael and Thomas, and thus Michael's shares were correctly valued at $3 million. Cert. Reply Br. 6. But petitioner simultaneously contends, as his analyst confirmed, Gov't C.A. App. 72, that Crown was worth $3.86 million *after* Michael's 77.18% equity interest was extinguished through the redemption. In other words, in petitioner's view, Crown's value was $3.86 million both before and after it redeemed Michael's shares and Thomas became Crown's sole owner. See Cert. Reply Br. 8 (conceding that it is "[t]rue," "under [his] approach," that "'Crown's value remained the same before and after the redemption'") (citation omitted). That result cannot be reconciled with the fundamental nature of a redemption, which reduces a corporation's net assets (while leaving the remaining share-

holders with larger proportional interests in the less-valuable company).[9]

If Michael's shares had been redeemed for fair market value, *i.e.*, for $5.3 million instead of the non-arms-length price of $3 million, then Thomas would have become the sole owner of a company worth significantly less ($1.56 million). That is exactly how a redemption at a fair market price should work, when the former owner of the redeemed shares walks away from the exchange with what used to be the corporation's cash. Someone is being bought out, and that result does not come for free.

C. Petitioner's Remaining Arguments Lack Merit

Petitioner's other arguments are meritless. The lower courts did not apply a "control premium" in valuing Michael's shares. Including life-insurance proceeds owed to a corporation in valuing a decedent's shares for estate-tax purposes will not preclude small businesses from engaging in succession planning. And any risk of double taxation is speculative and, in any event, caused

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[9] For estate-tax purposes, all that matters is the value of Michael's shares at the time of his death, not the value of Crown's *other* shares. A buyer purchasing those other shares *would* consider the expected effects of Crown's obligation to redeem Michael's shares, "but only in connection with a simultaneous accounting of the impact of the redemption of decedent's shares on the ownership interest inherent in the other shares not being redeemed." *Blount I*, 2004 WL 1059517, at *25. Here, for instance, a buyer of Thomas's shares might take into account the fact that, after the redemption, Thomas would become the sole owner of a company worth $1.56 million, rather than a 22.82% owner of a company worth $6.86 million. A real-world buyer of Thomas's shares might also reasonably account for any effects that the change in ownership and reduction in assets as a result of the redemption might have on the corporation's ongoing operations.

by the Connelly family's non-arms-length agreement to undervalue Michael's shares, not by any valuation error on the government's part.

1. The lower courts did not apply a "control premium" in valuing Michael's shares

Petitioner concedes (Br. 30) that a willing buyer of 100% of Crown's shares "would treat the life-insurance proceeds as a net corporate asset" because such a buyer could cancel the redemption obligation and "pocket the insurance proceeds." Petitioner posits, however, that "a buyer of some subset (or even a majority) of corporate shares" would not be in the same position, and that the lower courts improperly "incorporate[d] value available only to an owner of the entire company" by valuing Michael's shares to include his share of the life-insurance proceeds. Pet. Br. 29-31 (arguing that the lower courts applied a "control premium" in valuing Michael's shares). That argument is both forfeited and meritless.

Until his filings in this Court, petitioner never argued that including the life-insurance proceeds in valuing Michael's shares would improperly incorporate any sort of "control premium." Again, petitioner bears the burden of proof in this tax-refund suit, yet he failed to provide any evidence to support any premiums (or comparative discounts) that he now invokes. Petitioner forfeited these issues by failing to timely raise them. See p. 35, *supra*.

In any event, the lower courts applied no such premium here. To determine Crown's net worth, the lower courts accepted the estate's claimed valuation of Crown at $3.86 million, then added the $3 million in life-insurance proceeds that petitioner's analyst had excluded, for a total of $6.86 million. To determine the value of Michael's shares, both courts then multiplied that total

value by 77.18% (*i.e.*, Michael's ownership stake). As shown above, see pp. 30-31, *supra*, a buyer of Michael's shares would obtain the value of only Michael's proportional share of the life-insurance proceeds when the corporation redeemed his shares. Similarly, a 100% owner would have shares reflecting 100% of the value of the incoming proceeds, and a minority, 25% owner would have shares reflecting 25% of the proceeds' value. The lower courts referred to a third-party buyer of the entirety of Crown (see Pet. Br. 30-31) as one way to illustrate how the life-insurance proceeds would increase Crown's value to a willing buyer and a willing seller, and therefore increase the proportional value of Michael's shares, J.A. 117, 152; see p. 32, *supra*—not because they believed that the value of the life-insurance proceeds could be captured only by someone who acquired all of Crown and then prevented the stock redemption. Thus, both courts mentioned that the proceeds' value would also be captured by a new owner who allowed the redemption to proceed. *Ibid.*

Indeed, if the degree of control represented by Michael's 77.18% interest were taken into account, that would likely *increase*, not decrease, the fair market value of his shares. As petitioner admits (Br. 30), a premium is sometimes applied when valuing a controlling interest in a corporation, and a discount is sometimes applied when valuing a non-controlling interest. See 26 C.F.R. 20.2031-2(f) (noting that one factor in valuing closely held shares is "the degree of control of the business represented by the block of stock to be valued"); *Estate of Godley* v. *Commissioner*, 286 F.3d 210, 214-216 (4th Cir. 2002); David Laro & Shannon P. Pratt, *Business Valuation and Federal Taxes—Procedure, Law, and Perspective* 271-275 (2d ed. 2011); Bogdanski

¶ 4.03[1][a] and [b]. Michael's controlling 77.18% interest in Crown is thus arguably worth *more* than his proportional share of Crown's total value. But the lower courts did not consider that factually intensive issue because no party raised it, and the parties' stipulations limited the valuation dispute to whether, in valuing Michael's shares, Crown's value included the life-insurance proceeds. J.A. 157.

Contrary to petitioner's claim (Br. 31-32), the government's position here bears no resemblance to arguments that were rejected by the Fifth and Ninth Circuits. In *Bright*, the Fifth Circuit held that a decedent's shares should not be valued by combining the decedent's shares and other shares held by family members, and then applying a control premium. 658 F.2d at 1001-1002. Here, even though Michael himself owned a 77.18% controlling interest in Crown, no control premium was applied (which *reduced* the estate's potential tax liability). In *Propstra* v. *United States*, 680 F.2d 1248 (9th Cir. 1982), the court rejected the government's contention that a decedent's half-interest in a parcel of real estate should be valued based on the assumption that separate interests in that parcel would be combined before sale. *Id.* at 1250-1253. Here, by contrast, the lower courts did not price Michael's shares on the assumption that those shares would be sold with any other shares. Rather, the lower courts considered the value of Crown as a whole only because—as petitioner agrees (Br. 14)—that is the starting point for valuing the decedent's shares in that corporation.[10]

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[10] The IRS did not object to petitioner's use of a 15% discount for lack of marketability as part of its $3.86 million valuation of Crown. C.A. App. 106; C.A. Gov't App. 20. But no such discount is appropriate for the additional $3 million in life-insurance proceeds that

2. Small-business owners have a variety of options to plan for the future

Petitioner asserts (Br. 33-35) that, if this Court affirms the decision below, small businesses will be unable to make reasonable and affordable plans for the future. That concern is misplaced.

A variety of planning options are available for those shareholders in closely held corporations to whom the estate tax might be relevant—currently, only those shareholders whose estates exceed $13 million in value, see p. 2, *supra*. For instance, 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. Unlike a share redemption, that approach does not expend corporate assets and the beneficiaries also benefit from a stepped-up basis, which can provide significant future savings in capital-gains tax. 26 U.S.C. 1014(a); Bittker & Lokken ¶ 41.4. And if the goal is to ensure that family members instead receive cash, those members could directly take out life-insurance policies on the shareholder, such that life-insurance proceeds never flow to the decedent's estate or to the corporation —and are therefore never included in valuing the corporation's shares. Alternatively, a shareholder could arrange for life insurance to be held through a trust, escrow, partnership, or limited liability corporation created solely for that purpose. Brian T. Whitlock, *Untaxingly Yours: Buy-Sell Agreements and Life Insurance —A Primer*, TAXES The Tax Magazine 7-8 (Feb. 2023); Michelle Porter & Emily Berlin, *Supreme Court Tax*

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should have been included in the company's total valuation, as there are no marketability concerns for cash.

Case Reveals Two Issues in Estate Protection, Bloomberg Law News, Jan. 11, 2024.

Another option is a cross-purchase arrangement, in which shareholders buy life-insurance policies on each other and agree to purchase each other's shares at death. See, *e.g.*, Dennis C. Reardon, *Another Chapter on Corporate-Owned Life Insurance*, 77 J. Fin. Serv. Prof'ls. 25, 27-28 (2023); Whitlock 7; Michael Yuhas et al., *Corporate Buy-Sell Agreements—Taking Stock of the Issues: Income and Estate Tax, Attribution, Life Insurance, C and S Corporations*, 47 Est. Plan. 23, 24-25 (2020). A cross-purchase arrangement cashes out a decedent's equity interest and maintains ownership among the current shareholders, while avoiding the valuation complications at issue here.

Petitioner ignores those alternatives and complains (Br. 33-34 & n.5) that Crown would have had to purchase a much larger life-insurance policy in order to redeem Michael's shares at fair market value without depleting Crown's other assets. That complaint assumes that petitioner's ultimate objective—to redeem an equity holder's interest without diminishing the corporation's assets by treating millions of dollars that flow into the corporation as something other than a corporate asset—is legitimate. But that goal is in tension with the nature of a stock redemption, which is designed *to cash out* an equity interest, thereby leaving remaining shareholders with larger fractional interests in a smaller company. See pp. 22-23, 25-27, 39-41, *supra*. And it is in tension with longstanding estate-tax principles, whereby a decedent's share of corporate assets is included in the value of his gross estate. Shareholders who want to plan for the future without affecting the value of the decedent's shares could use any of the other

options outlined above—none of which contemplate the corporation's receipt of life-insurance proceeds.

To plan for Crown's future, the Connelly brothers—like other owners of closely held businesses—had a menu of options, each of which was accompanied by benefits, risks, and consequences, including tax consequences. Had the brothers instead cross-insured each other, for instance, they would have kept the life-insurance proceeds out of Crown's assets and Michael's estate. But then they would have had to pay the premiums from personal funds and accept the risk that their redemption plan could fail if the surviving brother had financial difficulties and failed to maintain the insurance policy. Alternatively, had Michael bequeathed his shares to one or more heirs directly, no cash would have been generated to pay the estate tax on those shares. His heirs would also have been forced to stay in the business, when perhaps they wanted out. Or, to have the life insurance held in trust, the brothers would have had to set up and pay for that trust, then navigate the additional complexities associated with that approach, including (among other things) the tax consequences of funding the policy premiums.

Ultimately, the Connelly brothers chose a different course: to have Crown purchase the life-insurance policies and receive the proceeds. By opting to have Crown purchase life-insurance policies to fund any redemption, the brothers could guarantee that the premiums would be paid so that cash would be available to fund the redemption. They were also able to use corporate funds to pay the premiums. But that option meant that the proceeds were paid to Crown, and became Crown's asset, and therefore increased the fair market value of Michael's equity interest in Crown at the time of his death.

The tax consequences of that choice are determined "in accord with what actually occurred and not in accord with what might have occurred" had the parties chosen a different path. *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148 (1974).

Nor is petitioner correct that affirming the decision below would upset "a settled understanding in corporate tax law." Pet. Br. 35; see *id.* at 35-36. The IRS has never suggested that it believed *Blount II* or *Estate of Cartwright* to be correctly decided, nor otherwise indicated that shareholders should follow those decisions in managing their affairs. That is particularly so for the Connelly brothers, who were based in St. Louis—not in the Ninth or Eleventh Circuits. The brothers took obvious risks in assuming that the IRS, the Eastern District of Missouri, and the Eighth Circuit would fall in line behind the contested analyses in *Blount II* and *Cartwright*. The brothers had numerous other options to plan for Crown's future, see pp. 45-47, *supra*; the choice they made came with the risks associated with unsettled law.[11]

And petitioner offers no reason to think that his approach—which requires a departure from well-settled and familiar valuation principles—leads to simplified succession planning. Indeed, advisors often recommend against the redemption structure that Crown

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[11] Petitioner also asserts that doubt about words in a tax statute "must be resolved against the government and in favor of the taxpayer." Pet. Br. 36 (quoting *United States* v. *Merriam*, 263 U.S. 179, 188 (1923)). He does not, however, identify any purportedly doubtful words in any statute relevant here. See *ibid.* Moreover, in a later tax case, this Court was "not impressed by the argument that * * * all doubts should be resolved in favor of the taxpayer" and declined to abdicate "the function and duty of courts to resolve doubts." *White* v. *United States*, 305 U.S. 281, 292 (1938).

used, in favor of a cross-purchase arrangement or similar structure. See Porter & Berlin, *supra*, 2 (estate-planning advisors recommending that "practitioners generally should encourage clients to avoid arrangements like the one that landed the Connellys in court" and identifying other options); Caleb Harshberger, *Supreme Court Stock Buyback Case Could Mean Big Estate Tax Bills*, Bloomberg Law News (Dec. 14, 2023) (quoting a wealth-planning advisor who recommends cross-purchase arrangements rather than corporation-owned life insurance because the latter relies on "a specific case in a particular jurisdiction," is "not best practice," and "never made sense").

3. Any risk of double taxation is speculative and, in any event, caused by the Connelly family's agreement to undervalue Michael's shares

Petitioner acknowledges (Br. 37) that his own shares "'skyrocketed in value' as a result of [Crown's] redemption" of Michael's shares for only $3 million, $2.3 million less than their $5.3 million fair market value. But he complains (Br. 38-39) that, if he realizes gain from that lopsided benefit in the future—for example, if he sells his Crown shares—then that $2.3 million could be subject to capital-gains tax, which would "tax the same value twice" if the estate must pay tax on that value now. But those potential tax consequences are wholly attributable to the Connelly family's private agreement to undervalue Michael's shares, such that the $2.3 million remained in Crown, to Thomas's disproportionate benefit as the sole remaining shareholder. Had Crown redeemed Michael's shares for fair market value, $5.3 million (including Michael's $2.3 million share of the proceeds) would have flowed to the estate, and could have been taxed only once, through the estate tax.

Whether Thomas could be exposed to capital-gains tax on the disproportionate increase in his Crown shares, moreover, depends on hypothetical future circumstances that are impossible to predict, such as whether (and at what price) he might sell his Crown shares. Thomas could also avoid the issue entirely by keeping his Crown shares and bequeathing them to an heir, who could claim a stepped-up basis. 26 U.S.C. 1014(a); Bittker & Lokken ¶ 41.4. Through that simple and well-known planning technique, no one would pay capital-gains tax on the $2.3 million windfall that boosted the value of Thomas's shares.

For similar reasons, petitioner's reliance on the brothers' "inten[t]"—here, to use the life-insurance proceeds to redeem the deceased brother's stock, Pet. Br. 9 (citation omitted)—is irrelevant. As already explained, see pp. 2, 24, *supra*, the estate tax is not an inheritance tax and thus is not concerned with who ultimately receives what value from a decedent's property, or why. Instead, Congress made a deliberate choice to tax a decedent's property at fair market value, regardless of any private agreements to transfer a decedent's property at a lower price. Congress recognized the risk of "option[s], agreement[s], or other right[s] to acquire or use [a decedent's] property at a price less than fair market value" and, to combat tax evasion, instructed the IRS to disregard such agreements in valuing a decedent's property for estate-tax purposes. 26 U.S.C. 2703(a)(1). Whatever tax consequence might result from the difference between the $5.3 million fair market value of Michael's shares and the $3 million that the estate received under its private agreement with Thomas is the result of that congressional choice.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

1. 26 U.S.C. 2001(a) provides:

Imposition and rate of tax

(a) Imposition

A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

2. 26 U.S.C. 2031(a) provides:

Definition of gross estate

(a) General

The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

3. 26 U.S.C. 2033 provides:

Property in which the decedent had an interest

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

4. 26 U.S.C. 2051 provides:

Definition of taxable estate

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the deductions provided for in this part.

5. 26 C.F.R. 20.2031-1(b) provides:

Definition of gross estate; valuation of property.

(b) *Valuation of property in general*. The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value 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. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at re-

tail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031-6 and 20.2031-8. The value is generally to be determined by ascertaining as a § 20.2031-1 basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case. The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 20.2031-3. See § 20.2031-2 and §§ 20.2031-4 through 20.2031-8 for further information concerning the valuation of other particular kinds of property. For certain circumstances under which the sale of an item of property at a price below its fair market value may result in a deduction for the estate, see paragraph (d)(2) of § 20.2053-3.

6. 26 C.F.R. 20.2031-2 provides in pertinent part:

Valuation of stocks and bonds.

(a) *In general.* The value of stocks and bonds is the fair market value per share or bond on the applicable valuation date.

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(f) *Where selling prices or bid and asked prices are unavailable.* If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(1) In the case of corporate or other bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors; and

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: The good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. In addition to the relevant factors described above, 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. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the applicable valuation date.

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