No.

In the Supreme Court of the United States

THOMAS A. CONNELLY, PETITIONER

v.

INTERNAL REVENUE SERVICE

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Closely held corporations often enter into agreements requiring the redemption of a shareholder's stock after the shareholder's death in order to preserve the closely held nature of the business. Corporations that enter such agreements often purchase life insurance on the shareholder in order to fund the transaction. The question presented is:

Whether the proceeds of a life-insurance policy taken out by a closely held corporation on a shareholder in order to facilitate the redemption of the shareholder's stock should be considered a corporate asset when calculating the value of the shareholder's shares for purposes of the federal estate tax.

RELATED PROCEEDINGS

United States District Court (E.D. Mo.):

Connelly v. *Internal Revenue Service*, Civ. No. 19-1410 (Sept. 21, 2021)

United States Court of Appeals (8th Cir.):

Connelly v. *Internal Revenue Service*, No. 21-3683 (June 2, 2023)

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Thomas A. Connelly respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-15a) is reported at 70 F.4th 412. The opinion of the district court (App., *infra*, 16a-55a) is not reported but is available at 2021 WL 4281288.

JURISDICTION

The judgment of the court of appeals was entered on June 2, 2023. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 2031(a) of the Internal Revenue Code, 26 U.S.C. 2031(a), provides:

> 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.

Treasury Regulation 20.2031-2, 26 C.F.R. 20.2031-2, provides in relevant part:

> (a) *In general.* The value of stocks and bonds is the fair market value per share or bond on the applicable valuation date.
>
> * * *
>
> (f) *Where selling prices or bid and asked prices are unavailable.* [Where] 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: * * * the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors. * * * [C]onsideration 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.

STATEMENT

This case presents an important question of federal tax law on which there is a clear and acknowledged conflict among the courts of appeals. Under the Internal Revenue Code, a decedent's estate is subject to federal estate tax based on the fair market value of the estate's property at the moment of death. In many cases, fair market value can be determined through a straightforward analysis of public markets. But when a particular type of asset is not freely traded, fair market value must be determined on the basis of assessment and evaluation.

Under applicable Treasury regulations, life-insurance proceeds payable to a corporation may be relevant to determining the value of a decedent's stock in the corporation in some circumstances but not others. The question presented is whether the proceeds of a life-insurance policy taken out by a closely held corporation on a shareholder in order to facilitate the redemption of the shareholder's stock should be considered a corporate asset when calculating the value of the shareholder's shares for purposes of the federal estate tax.

Petitioner Thomas Connelly is the executor of the estate of his brother, Michael Connelly. Thomas and Michael were the sole owners of a closely held building-materials company. Like the owners of many closely held corporations, the brothers wished to preserve the closely held nature of their company. To do so, the brothers and the company entered into an agreement providing that the company would redeem the shares of whichever brother died first. To ensure adequate liquidity for the eventual stock purchase, the brothers' company purchased \$3.5 million in life insurance on each brother.

After Michael died, Michael's son and Thomas negotiated an agreed-upon redemption price of \$3 million for

Michael's stock. As contemplated by the brothers' agreement, the company used the bulk of the life-insurance proceeds ($3 million of $3.5 million) to fund that redemption.

When the estate filed its tax return, it reported the value of Michael's stock at the time of his death at $3 million. But the Internal Revenue Service (IRS) rejected that valuation, asserting (among other things) that the valuation failed to account for the increase in the company's value resulting from the payout of the life-insurance proceeds. Litigation ensued, with the estate taking the position that the bulk of the life-insurance proceeds were not properly considered a corporate asset because they were offset by a corresponding liability—namely, the redemption obligation. The estate noted that two courts of appeals had reached that conclusion and urged the district court to follow suit. The estate further argued that it would be perverse to tax the estate based on an artificial price inflated by insurance proceeds when the estate had in fact sold the stock without regard to the value attributed to those proceeds.

The district court acknowledged that two courts of appeals had adopted the estate's position, but it nevertheless granted summary judgment to the IRS. The Eighth Circuit affirmed, concluding that "an obligation to redeem shares is not a liability in the ordinary business sense." Acknowledging that it was departing from the decisions of the two other courts of appeals, the Eighth Circuit concluded that insurance proceeds such as those here must be added to the value of a corporation for purposes of assessing the estate tax on the decedent shareholder's stock.

The Eighth Circuit's decision was erroneous, and it created a circuit conflict on an important question of federal tax law. Both the Ninth Circuit and the Eleventh Cir-

cuit have held that corporate insurance proceeds designated for redemption of a shareholder's stock do not increase the value of the company for purposes of the estate tax. But in the decision below, the Eighth Circuit reached the opposite conclusion. Because this case is an ideal vehicle for resolving the resulting conflict on a discrete question of federal tax law, the petition for a writ of certiorari should be granted.

A. Background

1. After death, come taxes. When a citizen or resident of the United States dies, the transfer of the decedent's "taxable estate" is subject to federal taxation. 26 U.S.C. 2001(a). "A necessary first step in calculating the taxable estate for federal estate tax purposes is to determine the property included in the gross estate, and its value." *Commissioner* v. *Estate of Hubert*, 520 U.S. 93, 99-100 (1997); see 26 U.S.C. 2031, 2051. With respect to stock held by the estate, Treasury regulations provide that the stock's value is measured by "the fair market value per share * * * on the applicable valuation date." 26 C.F.R. 20.2031-2(a). The phrase "fair market value" is defined by regulation as "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). As this Court has explained, the "willing buyer-willing seller test of fair market value is nearly as old" as the federal estate tax itself. *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973).

The willing-buyer/willing-seller test is simple to apply for stock freely traded in a market: the fair market value is generally "the mean between the highest and lowest quoted selling prices on the valuation date." 26 C.F.R. 20.2031-2(b). But when an estate owns stock in a closely

held business for which no market exists, applying the test is more difficult. In that circumstance, fair market value is determined by considering several factors enumerated by regulation. See 26 C.F.R. 20.2031-2(f)(2). Those factors include "the company's net worth, prospective earning power and dividend-paying capacity," as well as "[the company's] nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent that such nonoperating assets have not been taken into account in the determination of net worth." *Ibid.*

2. The death of a major shareholder in a closely held corporation can "create a serious problem" for surviving shareholders that wish to retain control of the corporation. George Gleeson Bogert et al., *The Law of Trusts and Trustees* § 253, at 387 (3d ed. 2012); see 3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 14:9, at 32 (3d ed. 2011) (Cox & Hazen). Many closely held corporations thus enter into agreements that require the corporation to redeem a shareholder's outstanding shares upon his or her death. Samuel M. Fahr, *The Business Purchase Agreement and Life Insurance*, 15 Law & Contemp. Probs. 319, 321 (1950); see Cox & Hazen § 18:13, at 425. To ensure sufficient liquidity for such a redemption at the time of death, many closely held corporations also purchase life-insurance policies on their owners. See 1 F. Hodge O'Neal & Robert B. Thompson, *Close Corporations and LLCs: Law and Practice* § 7:45, at 7-220 (rev. 3d ed. 2020).

When the shareholder dies, the corporation uses the proceeds of the life-insurance policy to fulfill the terms of the agreement, thus maintaining the corporation's closely held nature. Because the proceeds of the life-insurance policy are payable to the corporation rather than the estate, and because the decedent did not otherwise possess

"any of the incidents of ownership" in the policy at the time of his death, the proceeds are not themselves subject to estate tax. 26 U.S.C. 2042; 26 C.F.R. 20.2042-1(c)(6).

B. Facts And Procedural History

1. Michael and Thomas Connelly were brothers and the sole shareholders in Crown C Supply, a closely held family business that sold roofing and siding materials in St. Louis, Missouri. In 2001, the brothers and Crown entered into an agreement to ensure continued family control in the event of the death of one of the brothers. The agreement granted the surviving brother the right to buy the decedent's shares and, if he declined, required Crown to redeem those same shares. To fund the redemption obligation, Crown purchased $3.5 million in life-insurance policies on each brother. It is undisputed that the brothers always intended for Crown to redeem the shares of the first brother to die. App., *infra*, 16a-18a.

Michael died in 2013. At the time, Michael owned approximately 77% of Crown's stock and Thomas owned approximately 23%. Upon Michael's death, Crown received approximately $3.5 million in life-insurance proceeds. Pursuant to the agreement, Crown then purchased all of the Crown shares in Michael's estate for $3 million, an agreed-upon figure arrived at through negotiations between Thomas and Michael's son. Crown used the remaining $500,000 from the insurance proceeds to fund its general operating expenses. App., *infra*, 2a-3a, 20a.

Consistent with the price the estate received from Crown in the redemption transaction, petitioner filed an estate-tax return on behalf of Michael's estate valuing the estate's Crown shares at $3 million. The IRS audited the estate and issued a notice of deficiency. Although the IRS "independently determined that Michael's shares were worth $2,982,000 exclusive of the proceeds," App., *infra*,

4a n.2, it took the position that the $3 million in life-insurance proceeds used for redemption should have been included as an additional non-operating asset that increased the value of Crown shares by nearly 80%. The IRS thus valued the estate's shares at approximately $5.3 million, rather than approximately $3 million. *Id.* at 3a-4a.

2. In 2019, petitioner filed suit under 28 U.S.C. 1346 (a)(1) on behalf of Michael's estate against the IRS in the United States District Court for the Eastern District of Missouri. Petitioner sought a refund of over $1 million in estate tax.

As is relevant here, the estate argued that the $3 million of insurance proceeds used for the stock purchase should not be considered an additional asset of Crown for purposes of calculating estate-tax liability. The estate contended that those insurance proceeds were already effectively taken into account as part of the valuation of the company's net worth, because any additional benefit from the $3 million in cash was offset by the contractual obligation to use that cash for a stock purchase. App., *infra*, 4a. In support of that contention, the estate cited the Eleventh Circuit's decision in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (2005), and the Ninth Circuit's decision in *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034 (1999), in which both courts held that life-insurance proceeds should not be considered under indistinguishable circumstances.

The parties entered into several stipulations during the district-court proceedings. Of particular relevance here, the parties stipulated that, under the agreement, the brothers always intended for Crown (rather than the surviving brother) to purchase the deceased brother's shares. The parties also stipulated that, if the life-insurance proceeds were not added to the total value of Crown, the fair

market value of the estate's shares would be $3.1 million. App., *infra*, 18a, 21a.

3. The district court granted summary judgment to the IRS. App., *infra*, 16a-55a. The district court rejected petitioner's argument that the life-insurance proceeds were not properly considered as one of Crown's assets for purposes of the estate tax. The court asserted that the redemption obligation did not offset the insurance proceeds because "a redemption obligation is not a value-depressing corporate liability when the very shares that are the subject of the redemption obligation are being valued." *Id.* at 48a (internal quotation marks and citation omitted).

The district court acknowledged that its decision directly conflicted with the Eleventh Circuit's decision in *Estate of Blount*, but it declined to follow that decision on the ground that it was "demonstrably erroneous." App., *infra*, 54a (citation omitted). The court likewise declined to follow the Ninth Circuit's decision in *Estate of Cartwright*, in part on the ground that it "contain[ed] the same analytical flaw as *Estate of Blount*." *Id.* at 53a. The district court thus concluded that the IRS was correct to add the insurance proceeds to Crown's value for purposes of determining the fair market value of the stock. *Id.* at 54a.

4. The court of appeals affirmed. App., *infra*, 1a-15a. It agreed with the district court that the IRS properly included the insurance proceeds when calculating the value of the estate's stock. In so holding, the court of appeals acknowledged that, in *Estate of Blount*, which "present[ed] the same fair-market-value issue," the Eleventh Circuit held that such proceeds "do not augment a company's value where they are offset by a redemption liability." *Id.* at 12a-13a. The court of appeals likewise acknowledged that *Estate of Blount* relied on the Ninth

Circuit's decision in *Estate of Cartwright*, which "employed similar reasoning." *Id.* at 13a n.5. But the court of appeals reasoned that *Estate of Blount* was flawed "in its premise," because "[a]n obligation to redeem shares is not a liability in the ordinary business sense." *Id.* at 14a. On that basis, the court of appeals concluded that the life-insurance proceeds were "simply an asset that increased shareholders' equity." *Id.* at 15a.[1]

REASONS FOR GRANTING THE PETITION

In the decision below, the court of appeals expressly departed from the decisions of two other courts of appeals on an important issue of federal tax law. Closely held corporations frequently enter into agreements to purchase the stock of a deceased owner, funded by an insurance policy on the owner's life, in order to preserve the closely held nature of the business. Two courts of appeals have recognized that proceeds from such an insurance policy, used for the redemption of a deceased owner's stock, do not increase the value of a corporation and thus should not be considered when calculating the value of the owner's stock for purposes of the estate tax.

In holding to the contrary, not only did the court of appeals create an expressly acknowledged circuit conflict; it departed from the plain meaning of the applicable regulations and from common-sense principles of valuation.

[1] In the briefing below, petitioner contended in the alternative that the agreed-upon redemption price itself established the value of the estate's stock even if that price was less than the fair market value. See 26 U.S.C. 2703(b); C.A. Br. 11-23. The court of appeals rejected that contention, reasoning that the agreement failed to satisfy the requirements of Section 2703(b) because the agreement lacked a fixed or determinable price. App., *infra*, 6a-9a. Petitioner does not renew that argument before this Court.

The decision below was incorrect, and it threatens to deprive closely held corporations of a critical tool to ensure continuity after an owner's death. Because the question presented was pressed and passed upon below on a set of stipulated facts, this case is an ideal vehicle for resolving the circuit conflict. The petition for a writ of certiorari should be granted.

A. The Decision Below Creates A Conflict Among The Courts Of Appeals

In the decision below, the court of appeals acknowledged that it was creating a conflict with two other courts of appeals on the question presented. Both the Ninth and Eleventh Circuits have held that the proceeds of a life-insurance policy taken out by a closely held corporation on one of its owners in order to fund the redemption of the owner's shares upon his death should not increase the estate tax paid by the decedent owner's estate. The resulting conflict, on an important and discrete question of federal tax law, warrants the Court's review.

1. The Ninth Circuit was the first court to consider the question presented in *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034 (1999). There, several lawyers established a law firm as a closely held corporation and entered into an agreement requiring the firm to purchase the shares of each partner upon his death. See *id.* at 1035-1036. The partners also purchased a pair of life-insurance policies on the firm's principal shareholder, totaling $5 million, to be used exclusively for the redemption of his stock and the payment of outstanding obligations to his estate. See *ibid.* When the principal shareholder died, the firm transferred the full $5 million to the decedent's estate as provided for in the parties' agreement. See *ibid.*

The payment resulted in a tax dispute between the decedent's estate and the IRS. The estate maintained that

the full $5 million was payment for the decedent's stock, such that no portion of the sum was for outstanding compensation. See 183 F.3d at 1036. The estate thereby sought to avoid subjecting any part of the $5 million to income tax. As is relevant here, the estate defended that characterization of the payment by arguing that the $5 million insurance payout should be considered a non-operating asset of the company, thus substantially increasing the company's fair market value. See *id.* at 1038.

The IRS disagreed, arguing that only $1 million of the payment was properly characterized as a stock purchase and that the remainder was payment for outstanding compensation and thus taxable as income. See 183 F.3d at 1036. In defending that comparatively low valuation of the company, the IRS adopted the opposite position to that it took in this case, rejecting the estate's argument that the insurance proceeds should be considered a non-operating asset that increased the company's value. See *id.* at 1038. The tax court agreed with the IRS. See *ibid.*

The Ninth Circuit affirmed in part and vacated in part. See 183 F.3d at 1038. The court held that the $5 million transfer constituted payment both for stock and for uncompensated work in progress, but it disagreed with the tax court's precise apportionment between those two purposes. See *ibid.* As is relevant here, however, the Ninth Circuit upheld the tax court's conclusion that the life-insurance proceeds were not "an asset of the firm for stock valuation purposes." *Ibid.* Because those proceeds were "offset dollar-for-dollar" by the company's obligation to "pay out the entirety of the policy benefits" to the decedent's estate, the Ninth Circuit concluded that those proceeds "would not necessarily affect what a willing buyer would pay for the firm's stock." *Ibid.* The Ninth Circuit thus concluded that the insurance proceeds did not increase the fair market value of the estate's stock—and

thus did not alter the portion of the $5 million payment attributable to the stock purchase. See *ibid.*

2. The Eleventh Circuit also addressed the question presented in *Estate of Blount* v. *Commissioner*, 428 F.3d 1338 (2005). There, a closely held construction company and its two owners entered into an agreement requiring the company to purchase the stock of either owner upon death. See *id.* at 1340. The company also purchased insurance policies of roughly $3 million on each owner, "solely for the purpose of ensuring that the business could continue operations, while fulfilling its commitments to purchase stock under the agreement." *Ibid.* A subsequent evaluation and amendment to the agreement established the purchase price for the stock of one of the owners as $4 million. See *id.* at 1340-1341. When that owner died, the company duly purchased the decedent's stock for $4 million, financed in part by the insurance policy. See *id.* at 1341.

The decedent's estate asserted that the value of the owner's shares for purposes of federal taxation was $4 million, and the IRS filed a notice of deficiency. See 428 F.3d at 1341. Reversing positions from *Estate of Cartwright*, the IRS argued that the company—and thus the decedent's stock—was worth substantially more than the previously agreed-upon amount because the $3 million life-insurance payout had increased the company's non-operating assets. See *ibid.*

The Tax Court agreed with the IRS, but the Eleventh Circuit reversed. See 428 F.3d at 1341-1346. As the Eleventh Circuit explained, the company had "acquired the insurance policy for the sole purpose of funding its obligation to purchase [the decedent's] shares in accordance with the stock-purchase agreement"—"an enforceable liability against the valued company." *Id.* at 1345. Because the insurance proceeds were "offset dollar-for-dollar by

[the company's] obligation to satisfy its contract with the decedent's estate," the court reasoned, it would "strain[] credulity" to suggest that "a reasonably competent business person, interested in acquiring a company, would ignore a $3 million liability." *Id.* at 1346. The court thus concluded that insurance proceeds designated for such a stock redemption should not be added to the company's assets for purposes of establishing the value of the estate's stock. See *ibid.*

In reaching that conclusion, the Eleventh Circuit relied on the plain text of Treasury Regulation 20.2031-2(f)(2). The court observed that, in assessing the value of an estate's stock under that regulation, a court may only consider "life insurance policies payable to or for the benefit of the company to the extent that such nonoperating assets have not been taken into account in the determination of net worth." 428 F.3d at 1345 (citation omitted). Where such proceeds are offset by an immediate "obligation to pay those proceeds to the estate in a stock buyout," the court reasoned, they have effectively already been "taken into account." *Ibid.*

3. In all relevant respects, the facts of the foregoing cases are identical to those here. All three cases involve a closely held company that entered into an agreement to redeem the shares of an owner's stock after the owner's death. In all three cases, the company purchased a life-insurance policy to fund the redemption. And in all three cases, the parties disputed whether the proceeds of the insurance policy should be characterized as a corporate asset for purposes of calculating the decedent's estate tax.

The Ninth and Eleventh Circuits held that the proceeds of such an insurance policy do not themselves increase the value of the decedent's shares because the redemption obligation offset the proceeds of the policy that funded it. But in the decision below, the court of appeals

reached the opposite conclusion. In so doing, the court of appeals expressly acknowledged that the decisions of the Ninth and Eleventh Circuits were on all fours, but it rejected those decisions on the ground that they were not "correctly decided." App., *infra*, 13a-14a; see *id.* at 13a n.5.

The resulting conflict on the question presented is substantial, and there is no realistic prospect that it will resolve itself absent the Court's intervention. Further review is thus warranted.

B. The Decision Below Is Incorrect

In this case, the court of appeals held that, despite an undisputed contractual obligation for a closely held corporation to use the proceeds of a life-insurance policy on one of its owners for the redemption of the owner's stock, those proceeds should be considered additional assets of the corporation for purposes of determining the fair market value of the stock. That decision was incorrect.

1. As this Court has explained, "a necessary first step in calculating the taxable estate for federal estate tax purposes is to determine the property included in the gross estate, and its value." *Commissioner* v. *Estate of Hubert*, 520 U.S. 93, 99-100 (1997). In order to determine the value of stock held as part of the gross estate, courts must apply the "willing buyer-willing seller test." *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973). Under that test, a court considers a hypothetical buyer who operates without compulsion and who possesses "reasonable knowledge of relevant facts." *Ibid.* (citing 26 C.F.R. 20.2031-1(b)).

In applying that test, a court considers not only a corporation's assets, but also its liabilities. See, *e.g.*, *Estate of Jelke* v. *Commissioner*, 507 F.3d 1317, 1331-1333 (11th Cir. 2007); *Eisenberg* v. *Commissioner*, 155 F.3d 50, 57 (2d Cir. 1998). Accordingly, as the relevant regulations

confirm, a company's non-operating assets must be considered only to the extent they are not yet accounted for as part of the company's "net worth." 26 C.F.R. 20.2031-2(f)(2). Indeed, even the court of appeals appeared to accept the premise that nominal assets that are "directly offset" by a corresponding liability should not be considered when establishing the value of a corporation for estate-tax purposes. App., *infra*, 13a-15a.

If the court of appeals had properly applied those principles, it would have rejected the IRS's attempt to categorize the insurance proceeds as an additional corporate asset relevant to the valuation of Michael Connelly's estate. The court acknowledged that Crown obtained life insurance on Michael for the purpose of ensuring that, when he died, "the corporation could use the proceeds to redeem his shares." App., *infra*, 1a. The court also acknowledged that the corporation in fact used $3 million in insurance proceeds to purchase the estate's shares. See *id.* at 3a. And it acknowledged that, excluding consideration of the insurance proceeds, the estate's shares were worth approximately $3 million. See *id.* at 4a n.2.

In light of those undisputed facts, the court of appeals should have concluded that $3 million of the insurance proceeds was offset by the contractual obligation to use those proceeds to redeem Michael's stock. Put differently, because $3 million of the insurance proceeds were spoken for, the court should have held that those funds constituted a funding vehicle, rather than a genuine asset.

2. Rather than applying the foregoing analysis, the court of appeals concluded that the $3 million in insurance proceeds increased Crown's value (and thus the value of the estate's shares) by nearly 80%, even though Crown's net assets remained unchanged. In reaching that counterintuitive conclusion, the court of appeals committed multiple errors.

a. The court of appeals first erred by applying a distorted version of the willing-buyer/willing-seller test based on a speculative transaction.

Rather than imagining an investor seeking to purchase some portion of the actual stock at issue (*i.e.*, that held by the estate), the court of appeals posited a buyer seeking to "own Crown outright" in order to reap the benefit of the insurance proceeds. App., *infra*, 14a. Such a prospective buyer, the court asserted, could capture the insurance proceeds by obtaining *both* Michael's and Thomas' shares before redemption. The buyer could then "extinguish the stock-purchase agreement or redeem the shares from himself," thus ending up with full ownership of Crown *and* the full amount of the life-insurance proceeds. In light of that potential windfall, the court of appeals concluded, a buyer would be willing to "pay up to $6.86 million" for the entire company. *Ibid.* (emphasis omitted).

That analysis badly distorts the willing-buyer/willing-seller test because it is predicated on the hypothetical purchase of the entire company, rather than the shares at issue. To be sure, a hypothetical buyer that successfully purchased all of Crown's shares could reap a windfall. But the fair market value of individual stock is not assessed based on the price an investor would be willing to pay for the company as a whole. To the contrary, bids that seek control of an entire company generally offer a substantial premium *above* the fair market value of individual stock. See, *e.g.*, *Katz* v. *Gerardi*, 655 F.3d 1212, 1215 (10th Cir. 2011). What is more, a hypothetical purchaser of the *estate's* stock would not pay an elevated price based on the hope of "own[ing] Crown outright" because such a purchaser could not be certain that Thomas would sell *his* shares. As a result, a hypothetical buyer would not count on obtaining the insurance proceeds before they exit the

company, and he would acquire the estate's stock for a price that disregards them.

b. The court of appeals also erred by misapprehending the financial significance of a contractual redemption obligation. Although the court appeared to acknowledge that a nominal asset directly offset by a liability should not be considered for purposes of estate valuation, it reasoned that a contractual obligation to redeem shares "is not a liability in the ordinary business sense." App., *infra*, 14a. In the court's view, the "redemption of stock is a reduction of surplus, not the satisfaction of a liability." *Ibid.* (citation omitted).

The court appears to have confused the redemption of stock *in general* with redemption of stock *pursuant to a contractual obligation.* It is true, of course, that a stock redemption is not in and of itself a "satisfaction of liability." But the question here is whether a redemption pursuant to a contractual obligation constitutes a "satisfaction of liability." The answer to that question is yes. Under traditional accounting principles, "[a] demand of any sort against a corporation, even though contingent, unliquidated, or disputed, such as a damage claim or a guaranty of another's obligation, is still characterized as a liability." Cox & Hazen § 19:5, at 463.

Nor does it matter that the redemption of an estate's stock produces a corresponding benefit for the surviving shareholders. App., *infra*, 14a-15a. The question for purposes of the estate tax is the fair market value of the estate's stock if it were sold to a third party, not the effect of such a sale on preexisting shareholders. In any event, when assessing the value of a company, it is the *corporation's* assets, not those of the shareholders, that drives the analysis. And from the perspective of the corporation, the reacquisition of stock is no benefit at all. A company's own

equity is "not an asset to the corporation," *Strougo* v. *Bassini*, 282 F.3d 162, 175 n.10 (2d Cir. 2002), which is why corporate redemptions result in a net loss to the corporation. See *T.J. Enterprises, Inc.* v. *Commissioner*, 101 T.C. 581, 591 (1993), aff'd, 76 F.3d 976 (9th Cir. 1995). Indeed, the court of appeals seemed to recognize as much when it generally described the redemption of stock as a "reduction of surplus." App., *infra*, 14a (citation omitted). Like a dividend, the redemption of stock benefits shareholders at the expense of the corporation.

c. The court of appeals compounded those errors through its interpretation of the applicable regulations. Those regulations provide that, when "actual sale prices and bona fide bid and asked prices are lacking," then the fair market value of shares of stock should "be determined by taking * * * into consideration * * * the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors," including the "good will of the business," "the economic outlook in the particular industry," and "the company's position in the industry and its management." 26 C.F.R. 20.2031-2(f). The regulations further provide that, in addition to those factors, "consideration shall also be given to nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such nonoperating assets have not been taken into account in the determination of net worth, prospective earning power and dividend-earning capacity." *Ibid.* At the same time, the regulations caution that "the weight to be accorded" to any particular factor "depends upon the facts of each case." *Ibid.*

The regulations thus limit consideration of life-insurance proceeds in valuing stock for estate-tax purposes in two distinct ways. *First*, the regulations specifically restrict consideration of insurance proceeds to the extent

they have already been taken into account elsewhere in the valuation. *Second,* the regulations require that, like all of the relevant regulatory factors, insurance proceeds should be assigned only the weight due to them under the facts of the particular case.

Although the court of appeals purported to acknowledge the first limitation, it seems to have entirely missed the second. Even if the court were correct that life-insurance proceeds designated for a stock redemption are not excludable on the ground that they have been "taken into account," the court should still have assigned minimal "weight" to those proceeds on the ground that they were simply passing through the company. Indeed, before reversing positions in *Estate of Blount* (and this case), the IRS acknowledged as much in its brief to the Ninth Circuit in *Estate of Cartwright,* explaining that, because "the regulation also states, 'the weight to be accorded * * * evidentiary factors considered in the determination of a value depends upon the facts of each case,'" contractual liabilities "would offset the value" of designated insurance proceeds. Br. at 40-41, *Estate of Cartwright, supra* (No. 97-70032).

d. Nor was the court of appeals correct that adopting petitioner's approach would result in a "windfall" for surviving shareholders. The proceeds of a life-insurance policy are not a "windfall," because the policy is purchased by insurance premiums (often over many years). Nor is there anything untoward about life-insurance proceeds being received tax-free. Indeed, life-insurance proceeds are not subject to estate tax as long as the decedent did not possess "any of the incidents of ownership" in those policies or as long as the proceeds are owned and "payable to the corporation." 26 U.S.C. 2042; 26 C.F.R. 20.2042-1(c)(6). The IRS has never disputed that those provisions

preclude subjecting the life-insurance proceeds to estate tax here.

The court of appeals' concern about a windfall also makes little sense on its own terms, because it would subject only Michael's estate to increased federal tax. If, as the court of appeals reasoned, the agreement resulted in a "windfall to Thomas," who retained his Crown stock after Michael's death, App., *infra*, 14a, one would expect Thomas to bear the accompanying tax consequences. But the court of appeals' rule does not affect Thomas at all, instead subjecting Michael's estate to tax consequences in his place. The court of appeals' rule thus amounts to a backdoor attempt to impose liability on one taxpayer for the gains of another. This Court should grant review and reverse the court of appeals' counterintuitive decision.

C. The Question Presented Is Important And Recurring And Warrants The Court's Review In This Case

The question presented is one of profound importance to closely held corporations. And because the parties have stipulated to all of the relevant facts, that question is presented unusually cleanly here. This case presents an ideal vehicle to resolve an acknowledged circuit conflict.

1. Closely held corporations account for over 90% of all American companies, produce 51% of all private sector output, and employ 52% of the national labor force. See Venky Nagar et al., *Governance Problems in Closely-Held Corporations*, 46 J. Fin. & Quantitative Analysis 943, 944, 948 (2011). And the closely held status of those corporations is a central feature of their structure. Closely held ownership provides substantial benefits to shareholders, allowing them to manage a corporation's affairs without burdensome formalities and through direct participation, rather than a board of directors. See Wil-

liam S. Hochstetler, *Statutory Needs of Close Corporations—An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law?*, 10 J. Corp. L. 849, 852-853 (1985). Shareholders of a closely held corporation are also generally "in a better position than shareholders in a publicly held corporation to protect their investment." *Id.* at 854. And as this Court has recognized, the closely held nature of a corporation allows its shareholders to shape the values and spirit of the corporation in ways not necessarily available to shareholders of a publicly held corporation. See, *e.g.*, *Burwell* v. *Hobby Lobby Stores, Inc.*, 573 U.S. 682, 717 (2014).

Stock-purchase agreements funded by life insurance, such as those at issue in this case, are a common and critical tool for preserving the closely held nature of such corporations. Courts across the country have noted such arrangements for decades. See, *e.g.*, *Talcott Resolution Life & Annuity Insurance Co.* v. *Phoenix Printing Group, Inc.*, Civ. No. 20-74, 2022 WL 1072915, at *1 (S.D. Ga. Mar. 24, 2022); *Concord Auto Auction, Inc.* v. *Rustin*, 627 F. Supp. 1526, 1527-1528 (D. Mass. 1986); *Gissentaner* v. *Buckeye Sauce Corp.*, Civ. No. 18-899474, 2022 WL 486964, at *1 (Ohio Ct. App. 2022); *Associated Bank National Association* v. *Leafblad*, 833 N.W.2d 873 (Wis. Ct. App. 2013) (unpublished table disposition); *Cormack* v. *Aspentech, Inc.*, Civ. No. 01-99-444, 2000 WL 330179, at *1 (Tex. App. 2000); *Lussier* v. *Christman*, Civ. No. 91-501181, 1994 WL 547719, at *2 (Conn. Super. Ct. 1994); *Southeast Asphalt & Concrete Co.* v. *American Defender Life Insurance Co.*, 316 S.E.2d 311, 312 (N.C. App. 1984). Observers have commented on the popularity of such arrangements for decades, too. See, *e.g.*, Joseph W. Blackburn, *Review of TRA '86 Changes in Corporate and Personal Taxes*, 48 Ala. Law. 332, 334 (1987); George D. Hornstein, *Stockholders' Agreements in the Closely Held*

Corporation, 59 Yale L.J. 1040, 1050 (1950). The court of appeals' novel ruling thus threatens to undermine a well-established and widespread corporate practice.

The court of appeals' creation of a circuit conflict also injects unacceptable uncertainty and geographic disparity in the enforcement of the federal tax laws. Absent resolution by this Court, the conflicting decisions will create a patchwork of federal law under which the same estate would be subject to vastly different tax assessments based on geographical happenstance. But this Court has repeatedly emphasized the importance of "uniformity in the federal tax laws." *United States* v. *Equitable Life Assurance Society*, 384 U.S. 323, 331 (1966); see *United States* v. *Speers*, 382 U.S. 266, 270 (1965). The Court thus regularly grants certiorari to resolve circuit conflicts on questions of federal tax law even when the conflict is shallow. See, *e.g.*, *Polselli* v. *IRS*, 143 S. Ct. 1231, 1236 (2023) (1-1 conflict); *Bittner* v. *United States*, 143 S. Ct. 713, 717 (2023) (1-1 conflict); *Rodriguez* v. *FDIC*, 140 S. Ct. 713, 716-717 (2020) (2-1 conflict); *PPL Corp.* v. *Commissioner*, 569 U.S. 329, 331, 334 (2013) (1-1 conflict); *Boeing Co.* v. *United States*, 537 U.S. 437, 440, 445-446 (2003) (1-1 conflict); *Chickasaw Nation* v. *United States*, 534 U.S. 84, 86-88 (2001) (1-1 conflict); *United Dominion Industries, Inc.* v. *United States*, 532 U.S. 822, 828-829 (2001) (1-1 conflict).

The need for uniformity in tax law is especially acute because, when courts apply differing legal rules concerning the applicability of federal taxes, taxpayers lose their ability to "rely with assurance on what appear to be established rules." *United States* v. *Byrum*, 408 U.S. 125, 135 (1972). That uncertainty has substantial economic consequences: "[w]hen businesses are uncertain about taxes," they "adopt a cautious stance." Scott R. Baker et al., *Policy Uncertainty Is Choking Recovery*, Bloomberg (Oct. 5, 2011) <tinyurl.com/bloombergpolicyuncertainty>; see

Seth H. Giertz & Jacob Feldman, Mercatus Center, *The Economic Costs of Tax Policy Uncertainty: Implications for Fundamental Tax Reform* 15 (2012). Review is warranted to prevent those harms.

2. This case presents an ideal vehicle to resolve the acknowledged circuit conflict. As noted above, see pp. 8-9, the parties have stipulated to all of the relevant facts. For example, they have stipulated to the existence and content of the stock-purchase agreement and the life-insurance policy. App., *infra*, 18a. They have stipulated to the fact that the agreement's signatories always intended for Crown to purchase the decedent's shares using the life-insurance proceeds. *Id.* at 18a. And crucially, they have stipulated that, if the life-insurance proceeds are not considered in determining the value of Crown, the fair market value of the estate's shares would be approximately $3 million. *Id.* at 21a. The only issue left to resolve is a pure question of law. That question is thus cleanly presented and outcome-determinative.

Finally, because the court of appeals directly addressed the earlier decisions of the Ninth Circuit and Eleventh Circuits, the arguments on both sides of the question presented have been fully aired. No further percolation is necessary, and any delay in resolving the conflict would only allow uncertainty to continue to disrupt the financial and structural planning of the Nation's closely held corporations. There is no valid reason to postpone further review and resolution of such an important and discrete question of federal tax law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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