No. 23-146

IN THE

Supreme Court of the United States

THOMAS A. CONNELLY, PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND NATIONAL FEDERATION OF INDEPENDENT BUSINESS SMALL BUSINESS LEGAL CENTER, INC. AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Closely held companies often enter into agreements requiring them to redeem a shareholder's stock after the shareholder's death in order to preserve the closely held nature of the business. Companies that enter such agreements commonly purchase life insurance on the shareholder to fund the transaction. The question presented is as follows:

Whether the proceeds of a life-insurance policy taken out by a closely held company on a shareholder, to facilitate the redemption of the shareholder's stock under a redemption agreement, constitute a net asset of the company when calculating the value of the shareholder's shares for purposes of the federal estate tax.

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INTEREST OF AMICI CURIAE*

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than

* Pursuant to this Court's Rule 37.6, amici curiae state that no counsel for any party authored this brief in whole or in part and that no entity or person, aside from amici curiae, their members, or their counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases, like this one, that raise issues of concern to the Nation's business community.

NFIB Small Business Legal Center, Inc. (NFIB Legal Center) is a nonprofit, public-interest law firm established to provide legal resources and to be the voice for small businesses in the Nation's courts through representation on issues of public interest affecting small businesses. It is an affiliate of the National Federation of Independent Business, Inc., which is the Nation's leading small-business association and represents member businesses in all 50 States and the District of Columbia. To fulfill its role as their voice, NFIB Legal Center frequently files amicus briefs in cases that will impact small businesses.

Amici's interests in this case derive from the fact that the position advanced by the Internal Revenue Service (IRS), and adopted by the court of appeals below, would deter the common practice of buying life insurance on the owners of closely held businesses to fulfill redemption agreements. Not only is the practice legitimate, but it is, in many instances, critical to assure the continuity in management and ownership of those companies. Amici and their members also have an interest in a workable and stable tax regime that allows taxpayers, including small businesses, to plan for and facilitate the succession of ownership within private companies and safeguard the millions of jobs that these companies create.

SUMMARY OF ARGUMENT

I. Closely held companies play a vital role in the American economy. They make up the vast majority of businesses and employ approximately half of American workers, generating trillions of dollars in GDP every year. By combining management and ownership in a single set of individuals, closely held companies can minimize the agency problems that publicly traded companies confront. At the same time, closely held companies face particular challenges that they must solve with contracts and other legal arrangements. A prime example of those challenges is preserving continuity of ownership and management when an owner dies.

II. A redemption agreement financed by a life-insurance policy is a commonplace, prudent solution to that recurring problem. The decision below improperly threatens that legitimate, long-established tool.

A. The settled, common-sense solution of redemption agreements coupled with life insurance benefits both the surviving owners of the business and the decedent's estate. A redemption agreement benefits the business and its remaining owners by ensuring that the company remains closely held and that, for example, an outsider will not interfere with the business. And life insurance ensures that the business can afford to redeem the decedent's stake without liquidating key assets or assuming substantial debt. These arrangements also benefit the decedent's estate by providing cash—which the estate may need to cover estate taxes that come due mere months after the decedent's death. Closely held companies' employees and communities also benefit from the businesses' continued existence and continuity of ownership.

B. The decision below threatens this valuable tool based on a fundamental misconception. The IRS and the Eighth Circuit mistakenly treated proceeds of a life-insurance policy as inflating the company's net worth *without* accounting for the company's corresponding obligation to redeem the deceased owner's stock—artificially inflating the estate's tax liability. But the insurance proceeds used to satisfy that redemption obligation did not nearly double the company's net worth overnight; they merely *maintained* its existing value. The company's obligation to redeem the shares should not be ignored in determining its net worth.

The IRS and the court of appeals distorted the Department of the Treasury's relevant regulations, which call for a holistic assessment of value that accounts for the full factual context, including such offsetting liabilities. The decision below embodies a caricature of that practical approach by basing the estate's tax liability on a fictional valuation of the company completely divorced from economic reality.

C. The IRS's position, which treats life-insurance proceeds as artificially increasing the company's value (and the decedent's estate-tax bill) without regard to the redemption obligation, will deter closely held companies from relying on this long-established tool for prudent succession planning. Obtaining life insurance would guarantee that the estate receives *less* (net of estate taxes) than if no insurance were acquired. And securing enough additional insurance coverage to pay the added tax could be cost-prohibitive.

III. In resolving this dispute over the correct interpretation of Treasury regulations, the Court should not accord the IRS's litigating position any deference. The principles articulated in *Kisor* v. *Wilkie*, 139 S. Ct.

2400 (2019), counsel strongly against deferring to the IRS's self-serving views here. Its position has shifted repeatedly over decades. The only apparent constant is that the IRS will pursue whichever position maximizes tax liability. That inconsistency undermines the plausibility of the agency's position and has deprived taxpayers of fair notice, as this case illustrates. Closely held businesses should not be discouraged from making long-term succession plans by the IRS's unpredictable, shifting position.

Deference is especially inappropriate because the agency advanced its inconsistent positions largely in litigation rather than rulemaking, compounding fair-notice problems. Rulemaking provides prospective notice, enables public input, and facilitates judicial review by requiring the agency to put its reasoning on the record. The IRS's approach here is emblematic of its self-perceived immunity from administrative-law norms, a fiction this Court and others have repudiated. All of these considerations counsel strongly against according the IRS's position deference. If anything, its latest swerve should be met with skepticism.

ARGUMENT

Closely held companies are exceptionally important to the American economy and the communities they serve. Redemption agreements funded through life-insurance policies that the companies take out on their owners help these businesses survive across generations. Such insurance policies do not transform the economic fundamentals of companies. They *preserve* the companies' value and viability by ensuring continuity in ownership while avoiding potentially business-altering liquidation of capital assets or the assumption of massive debt at short notice.

The IRS's contrary position blinks reality and does not merit any deference. The agency's characterization of the life-insurance proceeds as an asset unencumbered by any corresponding liability ignores the basic economic facts of these arrangements and is contrary to federal tax law's model, which assumes a willing buyer and willing seller fully informed of the relevant circumstances. By taking inconsistent positions, apparently in service of litigation expediency, the IRS has forfeited any claim to deference in interpreting the Treasury regulations at issue. Amici urge this Court to reverse the decision below.

I. CLOSELY HELD COMPANIES PLAY A VITAL ROLE IN THE ECONOMY

Michael and Thomas Connelly's business, Crown C Supply Company (Crown), is just one example of millions of closely held companies that play a vital role in the American economy. Closely held companies—business entities with a small number of owners who typically manage and direct operations—are ubiquitous and are a key pillar of American commerce.

Indeed, the overwhelming majority of American businesses are closely held. Being closely held "typi[cally]" means simply that there is "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the [company]." *Donahue* v. *Rodd Electrotype Co. of New England*, 367 Mass. 578, 586 (1975). That structure is commonplace. By one recent measure, there are only approximately 4000 publicly traded companies in the United States, compared to 25 million companies that are private. Asaf Eckstein & Gideon Parchomovsky, *Where the*

Wild Things Are? The Governance of Private Companies 3 (University of Pennsylvania Institute for Law and Economics, Research Paper No. 23-15, 2023). And private companies are typically closely held.

Closely held companies "are also vitally important to the economy." Venky Nagar et al., *Governance Problems in Closely Held Corporations*, 46 J. Fin. & Quantitative Analysis 943, 944 (2011). They are present in every key sector of the economy, and consumers encounter them every day. Closely held companies are common, for example, in industries including real estate, restaurants, and construction. They also provide many Americans with their livelihood, employing approximately half of the country's labor force. *Ibid.*

Some closely held companies are very large and have an outsized impact on the national economy. See Eckstein & Parchomovsky 3. But the lion's share are small—yet no less significant to the daily lives of those they employ and serve. See, *e.g.*, Office of Advocacy, U.S. Small Business Administration, *2023 Small Business Profile* (2023), http://tinyurl.com/yc6kpv2z (88% of small businesses with employees had fewer than 20 employees); Office of Advocacy, U.S. Small Business Administration, *Frequently Asked Questions* (Mar. 7, 2023), http://tinyurl.com/mr29t52k (99.9% of American businesses are small businesses). Many closely held companies are family-owned businesses critical to their local communities. U.S. Small Business Administration, *Frequently Asked Questions*.

The prevalence of closely held ownership reflects in part the valuable governance and structural benefits it offers. One key advantage is that the same individuals typically both own and manage the firm.

This structure directly aligns the interests of managers and owners—thereby reducing the well-documented agency problems that can plague publicly traded firms and eliminating the associated need for complex mechanisms like stock-option plans and performance-pay arrangements. See, *e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 Stan. L. Rev. 271, 274, 278 (1985) (Easterbrook & Fischel).

Owners of closely held companies may also value the stability and predictability of their co-owners. Unlike public companies, whose ownership can change day-to-day, closely held businesses may experience ownership transitions relatively rarely. But when transitions do occur, they have the potential to be more disruptive. That is why prudent owners of closely held companies undertake thoughtful succession planning, enabling their businesses to continue serving their customers, employees, and communities.

Closely held businesses often plan for these events through various legal arrangements, such as limitations on the sale of an owner's stake. 3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 14:9 (3d ed. 2011). For example, "[b]uy-out arrangements on contingencies such as retirement [or death]" have long been "common in closely held corporations." Easterbrook & Fischel 294. "Such agreements provide some liquidity and ensure that the identity of the managers and the investors remains the same, reducing agency problems." *Ibid.* Those and other arrangements provide assurance to owners that a co-owner will not be replaced without warning by one or more strangers and the company's character and priorities abruptly and irreparably altered.

Clear, predictable rules are critical for such arrangements to be effective and reliable.

The IRS and the Eighth Circuit have undermined that predictability. And their position effectively punishes an activity—deliberate succession planning—that benefits these companies, their owners, their employees, and their communities.

II. REDEMPTION AGREEMENTS AND LIFE INSURANCE ARE CRITICAL, PRUDENT PLANNING TOOLS THAT THE DECISION BELOW IMPROPERLY THREATENS

This case concerns one particular arrangement common among closely held companies to address a foreseeable yet uncertain risk: death of an owner. Every closely held company with individual owners must anticipate the eventuality that those owners will someday pass away and that both the business and the decedent's estate will need to confront the fallout. In particular, the estate may be faced with a substantial, time-sensitive estate-tax liability based on the decedent's stake in the company—which may be difficult to liquidate in the open market. If the estate is able to sell part or all of the decedent's interest, and chooses to transfer it to an individual or entity that is a stranger to the company, the company will then face the conundrum of changed or splintered ownership. The company can avoid that outcome by buying out the decedent's shares, but without other arrangements, that approach may simply trade one problem for another: To raise the funds needed to pay for the decedent's shares, the company might need either to sell off capital assets—which could be the backbone of the company and critical to its operability—or to assume substantial debt, which could be impracticable

to service. Either way, an owner's death can present an existential threat to a closely held company.

Redemption agreements financed by life insurance are well tailored to solve this problem. That arrangement combines the certainty of a share-repurchase obligation—assuring the estate that its stake will be liquidated, and assuring the company that the stake will not fall into unfamiliar hands—with a guarantee that liquidity will be available to cover the company's liability to the decedent's estate. In short, everyone wins. Even the IRS may benefit, and it is at least no worse off than if the company paid for the redeemed shares out of pocket.

The IRS and the Eighth Circuit fundamentally misunderstood these well-established arrangements. Both mistakenly concluded that redemption funded by life insurance causes the company's value to skyrocket due to the ephemeral insurance proceeds, disregarding the company's redemption obligation. That view makes no sense and has no basis in the relevant Treasury regulations. Redemption agreements are a prudent way to prepare for ownership transition. And the insurance facilitates redemption by furnishing the company with the funds to fulfill its contractual duty right when they are needed. The insurance proceeds are provision for a foreseeable liability, not a winning lottery ticket that gives the company a windfall. If adopted, the IRS's and the Eighth Circuit's view would chill closely held companies' reliance on this familiar strategy for confronting the inevitable, yet unpredictable, eventuality of an owner's death.

A. Redemption Agreements Paired With Life Insurance Are A Prudent Solution To A Pressing Problem Frequently Faced By Closely Held Companies

The death of a significant owner poses many challenges for a closely held company. Beyond grief and disruption of operations, the estate tax, 26 U.S.C. § 2001, can put the company and the deceased owner's estate in a bind.

The estate tax can thrust on estates of business owners a difficult and time-sensitive decision. The tax rate ranges up to 40% of the amount subject to the tax, 26 U.S.C. § 2001(c), foisting a potentially massive cash obligation onto the estate. And, absent extension, the estate's tax payment and return are due within nine months of the death. 26 C.F.R. § 20.6075-1. A decedent's ownership interest in a closely held company is often a substantial and illiquid portion of the estate. And if the heirs have no interest or ability to assume the deceased owner's role in the business, the shares might even seem an albatross. Unless the estate has adequate liquid assets, that looming tax liability thus can intensify the often already-strong incentives for the estate to sell its stake in the company, potentially to an outsider—if a buyer can be found at all.

Selling an estate's interest in a closely held company to satisfy the estate-tax obligations, however, is often undesirable from the company's perspective. A stranger's acquisition of that stake can destroy continuity of management. And if a competitor acquires the decedent's interest, the difficulties can multiply.

A closely held company can address this problem in advance through a redemption agreement—a contract in which the company agrees to buy the decedent's ownership interest from the estate upon his death. Howard Zaritsky, *Tax Planning for Family Wealth Transfers: Analysis with Forms*, § 9.10 Corporate Buy-Sell Agreements, 2002 WL 1970949, at *1 (Oct. 2022) (Zaritsky). These agreements address the most acute concern of the company and its remaining owners by preventing the sale of the decedent's interest to an outsider. They also benefit the estate, which can be assured of finding a buyer willing to pay a fair price for an asset that might otherwise be unmarketable.

Fulfilling a redemption obligation, however, can itself be challenging for a closely held company because accessing liquid funds quickly to purchase the decedent's stake poses its own practical difficulties. Unless the company happens to have large reserves of excess cash on hand, it will need to raise funds. That might necessitate selling off major capital assets that are crucial to the company's value. A manufacturing firm, for example, that needs to buy out a 75% owner's interest might have to sell its production equipment. And the need to act quickly may depress the prices that those assets can command. Alternatively, the company might try to borrow to finance the buyout, but that could result in substantial debt. A loan for an amount equivalent to a large portion of the company's value, if obtainable at all, might prove unsustainable for the company to service. Either way, raising funds to fulfill a redemption obligation might save the operation at the expense of the patient: It might

preserve continuity of ownership of a company no longer worth owning.

One common way to ensure that a closely held company can meet its redemption obligations without sacrificing its own value and viability is the simple solution Crown adopted here: insurance, the age-old method for managing risks that are foreseeable in the abstract but unpredictable in their particulars. By purchasing a life-insurance policy on the owner whose interest the company has agreed to redeem, the company can ensure a source of funds will be available to pay for that stake when that debt comes due. In other words, the company "couple[s] the purchase of reciprocal life insurance policies on the lives of the business associates with a binding agreement among them" that their estates will sell each of their interests back to the company upon their deaths. Samuel M. Fahr, *The Business Purchase Agreement and Life Insurance*, 15 Law & Contemp. Probs. 319, 321 (1950). This arrangement is no novelty; it was "not new" in 1950 and has been traced back more than a century. *Ibid.* (noting that these arrangements were "in vogue" by 1905 (citation omitted)). And it is commonplace today. See, *e.g.*, 1 Hodge O'Neal & Robert B. Thompson, *Close Corporations and LLCs: Law and Practice* § 7:45 (rev. 3d ed. 2023) ("When the option or obligation to purchase is conditioned on death of the holder, business insurance is frequently used to insure the ready availability of sufficient cash to buy the holder's interest.").

Redemption-plus-life-insurance arrangements are thus a prudent and effective tool that can protect the interests of all concerned. The company "almost immediately" has cash to pay the estate for its interest in the business. Fahr 322. The estate faces neither

the incentive to find an outside purchaser nor the risk of having no takers. And the company can continue to function smoothly for the surviving owners without having to make any changes to the business to purchase the decedent's stake. *Ibid.* The company thus ensures continuity and prevents fracturing in the future, and it avoids facing a business-altering liability without adequate liquid resources. Moreover, where, as here, the redemption agreement and life-insurance policies are executed within a family business, the agreement prevents the sale of an ownership interest outside the family unit, which may further simplify matters. Intra-family transactions often can be executed with few formalities under state law. Zaritsky *1-*2. And "[l]ife insurance is often the preferred means of funding the testamentary purchases under a buy-sell agreement," *id.* at *4, because it can be secured by premium payments made over years, enabling the company to spread this expense over time.

The IRS is also no worse off, and may even benefit, when a closely held company finances a redemption agreement with life insurance. The estate facing an estate-tax liability will have liquid assets to pay it, reducing the risk that the tax debt is uncollectible. At a minimum, the IRS is not prejudiced by the arrangement. The IRS receives the same share of the estate's stake in the company, worth exactly what it was on the date of the owner's death, as the IRS would have if the company had instead paid for that stake with cash, by liquidating assets, or by borrowing.

Put simply, redemption agreements combined with life insurance are a perfectly legitimate, and often highly prudent, approach for closely held companies to

prepare for a contingency that is certain to occur yet impossible to forecast with precision.

B. The Court Of Appeals And IRS Distort The Operation And Object Of Redemption-Plus-Life-Insurance Arrangements

The decision below threatens this time-tested, commonplace succession-management tool based on a misconception of the effects of a redemption agreement and life insurance on a closely held company and its net worth.

1. "Setting aside for the moment the life insurance proceeds used to redeem Michael's shares," the Eighth Circuit and the IRS valued Crown—based on its "operations, revenue streams, and capital"—to be worth "about $3.86 million." Pet. App. 11a; see *id.* at 3a-4a & n.2. That valuation included the portion of the life-insurance proceeds (about $500,000) that was *not* used to redeem Michael's shares under the redemption agreement, which all agree is a net asset of the company and is not at issue. Br. in Opp. 5 n.1; see Pet. Br. 26 n.3; Pet. App. 12a. The valuation should have ended there. The "stuff" that constituted Crown—its capital, business, expertise, and goodwill—was worth just under $4 million. So too, then, was the company itself. The IRS's regulation permitting "proceeds of life insurance" (among other nonoperating assets) to be considered in a valuation "to the extent such nonoperating assets have *not* been taken into account in the determination of net worth" changes nothing. Pet. App. 11a (quoting 26 C.F.R. § 20.2031-2(f)(2)) (emphasis added). The insurance proceeds *were* "[t]ak[en] * * * into account" in determining Crown's net worth. *Id.* at 3a-4a. As petitioner explains (Br. 22-27), how-

ever, the redemption obligation should *also* have been taken into account in the net-worth calculation, where it should have canceled out the effect of the vast majority of the insurance proceeds.

The IRS and court of appeals, however, skewed Crown's net worth by treating the life-insurance proceeds used to buy back Michael's shares as a company asset *without* treating the company's contractual obligation to buy them as an offsetting liability. Pet. App. 12a-15a. Petitioner demonstrates (Br. 20-28) why that perplexing proposition is wrong as a doctrinal matter. At an even more basic level, it makes no sense.

The essence of the IRS's theory, which the Eighth Circuit embraced, is that the life-insurance proceeds transformed Crown and nearly doubled its net worth in an instant. But insurance proceeds that are used to satisfy a redemption obligation do not alter the company or its value. As with insurance proceeds to cover liabilities in other familiar contexts, the resources to satisfy an anticipated liability (insurance proceeds) come into being at the same time, and because of the same triggering event, as the liability itself (the redemption obligation). Consider a construction company that buys liability insurance to cover damage its workers accidentally cause to properties they remodel. If a worker causes $10,000 in damage, and the insurer pays the construction company $10,000 that it in turn remits to the property's owner, no one would say the construction company is worth $10,000 more because it briefly held those funds. The same is true of a family business that collects an insurance check to rebuild a $1 million burned-down restaurant; the business is not worth $1 million more as a result. Insurance proceeds that are used to satisfy an obli-

gation of the insured arising from the same insured event do not *increase* the net worth of the insured. They merely *maintain* its value, by saving the insured from having to divert other resources to cover the liability.

In this case, Crown was never a $6.86 million company. It was a $3.86 million company that took the prudent step of making provision for its redemption obligations through insurance. The insurance payout was never designed, and did not operate, as a windfall for the company. It was a means for ensuring continuity of ownership and management within the firm. The insurance proceeds thus cannot be viewed in isolation as a detached, unencumbered asset but only in conjunction with Crown's redemption obligation.

2. The court of appeals nevertheless disregarded that obligation based on its view that "[a]n obligation to redeem shares is not a liability in the ordinary business sense," and it therefore need not be offset against the life-insurance proceeds. Pet. App. 14a. As petitioner explains, that proposition flouts settled valuation principles. Pet. Br. 22-24. It also cannot be reconciled with the realistic, common-sense approach to valuation that the regulations require.

The regulations contemplate a pragmatic, holistic approach to fair market value that entails examining a wide array of factors to achieve a valuation that reflects the real world. The key regulation, 26 C.F.R. § 20.2031-2(f), requires that, where selling prices are unavailable, as with shares of closely held companies, "the fair market value is to be determined" based on "the company's net worth, prospective earning power and dividend-paying capacity, and other relevant fac-

tors." *Ibid.* Longstanding IRS guidance confirms that the valuation "depend[s] upon the circumstances in each case" and calls for "common sense, informed judgment and reasonableness" in "weighing th[e] facts and determining their aggregate significance." Rev. Rul. 59-60, § 3.01, 1959-1 C.B. 237. That same guidance recognizes that "valuations cannot be made on the basis of a prescribed formula" and directs an appraiser to "maintain a reasonable attitude in recognition of the fact that valuation is not an exact science." *Id.* §§ 3.01, 7. In short, a valuation should reflect a realistic assessment of the company's net worth taking account of all relevant circumstances.

Any sensible appraiser applying that holistic, "common sense" approach (Rev. Rul. 59-60, § 3.01) would take account of a company's contractual obligation to repurchase shares in assessing its net worth. Even if that obligation were not technically classified as a liability under accounting principles, but see Pet. Br. 23-24, a rational, fully informed prospective purchaser of a stake in a company would not ignore the company's contractual duty to pay millions of dollars to a former owner in determining a fair price. A blinkered valuation that disregards a binding payment obligation does not reflect fair market value.

The Eighth Circuit also departed from the regulations by positing the price a willing buyer would pay for a different asset than the estate property at issue and reasoning backwards from that hypothetical to erase the redemption obligation. Pet. App. 14a. The regulations define "fair market value" as "the price at which *the property* would change hands between a willing buyer and a willing seller." 26 C.F.R. § 20.2031-1(b) (emphasis added). "[T]he property" in

that passage refers to an "item of property includible in a decedent's gross estate." *Ibid.* The proper analysis thus must focus on what a buyer would pay for *Michael's 77.18% stake* in Crown; that, after all, is "the property" (*ibid.*) Michael's estate owned.

The court of appeals, however, undertook a misguided thought experiment in which it imagined a hypothetical purchaser who acquired *100%* ownership of Crown. Pet. App. 14a. Upon acquiring complete ownership, the court speculated, the hypothetical buyer could then capture the insurance proceeds, either by canceling the redemption agreement or repurchasing the shares from himself. *Ibid.* But that counterfactual scenario proves nothing about the value of the actual property the estate held and only distorts the analysis. The value of a stake in a company necessarily depends on the particular rights and abilities that stake entails. See Pet. Br. 28-31. Here, a 100% stake in Crown was worth more than the sum of its parts precisely because a sole owner would have (*inter alia*) the additional rights that the Eighth Circuit identified—rights that a holder of only Michael's partial interest did not. The IRS's and Eighth Circuit's contrary approach has troubling consequences. It risks systematically inflating the worth of partial interests in closely held companies by imputing to them the value of rights only a complete owner could wield.

C. The IRS's And Eighth Circuit's Position Would Imperil A Vital Planning Tool

Upholding the Eighth Circuit's erroneous ruling would seriously impede many closely held companies' ability to rely on the redemption-plus-life-insurance approach as a practical matter. The court's conclusion

that only the life-insurance proceeds, but not the offsetting redemption obligation, are to be included in the company's value—and thus in the estate's taxable stake—threatens to discourage closely held companies from entering redemption-plus-insurance arrangements or to make them cost-prohibitive.

By inflating a closely held company's net worth to include life-insurance proceeds without an offset for the company's binding redemption liability, the Eighth Circuit's and IRS's approach artificially (and significantly) increases the value of the decedent's interest. If that inflated interest is subject to the estate tax, financing the redemption obligation with insurance will significantly increase the estate's tax liability. Instead of achieving its purpose of ensuring that the closely held company can meet its redemption obligation when it arises, an insurance policy would simply take a larger tax bite out of the estate. This case vividly illustrates that effect: The IRS's valuation more than tripled the tax owed. Pet. App. 3a-4a.

If the Eighth Circuit's rule stands, closely held companies would have little incentive to obtain life-insurance policies on their owners to fund their redemption agreements, as insurance would counterproductively reduce what the owners' heirs receive. And without insurance, redemption agreements present all the practical problems for closely held companies discussed above. The estate-tax effects of the court of appeals' approach could render those beneficial arrangements useless for many businesses.

Companies might try to work around the estate-tax increase that insurance triggers by obtaining even more insurance to cover the estate's additional tax ob-

ligations. But increasing the amount of insurance coverage will increase the cost of premiums. And because (under the Eighth Circuit's test) every additional dollar of insurance proceeds itself increases the company's net worth, the amount of additional insurance coverage needed to offset the increased estate tax could be substantial and potentially cost-prohibitive.

For example, to take a slightly simplified version of the facts here, consider a decedent who owned a 75% stake in a $3 million company that had entered a redemption agreement to repurchase his shares and obtained a life-insurance policy to pay for them. (Assume, for simplicity, that the decedent's entire stake is subject to the top estate-tax rate of 40%.) Under the rule that prevailed until the decision below, the company would need a policy for $2,250,000 (75% of $3 million). But under the Eighth Circuit's rule, if the company sought additional insurance to offset the estate's additional tax attributable to the insurance proceeds themselves, it would need nearly a million dollars more in insurance coverage (roughly $3.2 million). And that is just for the 75% owner. For many closely held companies, that much insurance coverage—far above the amount of each owner's interest—to offset the increase in estate taxes may well be out of reach.

The IRS's and Eighth Circuit's approach is thus not only unfounded, but it risks making a well-settled tool for prudent corporate-succession planning unworkable. This Court should reject that misguided approach.

III. THE IRS'S INCONSISTENT POSITIONS AND LACK OF REASONED EXPLANATION DISENTITLE ITS CURRENT INTERPRETATION TO DEFERENCE

For the reasons explained above and in petitioner's brief, the correct answer to the question presented is that proceeds of a life-insurance policy purchased by a closely held company that are used to fulfill a binding contractual redemption obligation are not company assets and so should not inflate the decedent's estate-tax liability. At a minimum, that is the better view. That should end the analysis because, although the question concerns the interpretation of an agency regulation, the IRS's current litigating position is not entitled to any deference. The agency has repeatedly changed its position on this basic issue over decades. Its inconsistent stances have deprived business owners of fair notice. Moreover, the IRS compounded that problem by changing positions mostly through litigation rather than engaging in rulemaking. No thumb on the scale in the IRS's favor is warranted here. If anything, its actions call for skepticism.

As this Court made clear in *Kisor* v. *Wilkie*, 139 S. Ct. 2400 (2019), courts should not reflexively defer to agencies' readings of their own regulations. See *id.* at 2414-2418. Several key preconditions must be met before deference is even a possibility. The regulation must contain a "genuine ambiguity," and the agency's reading "must come within th[at] zone." *Id.* at 2415-2416; cf. *United States* v. *Home Concrete & Supply, LLC*, 566 U.S. 478, 493 n.1 (2012) (Scalia, J., concurring in part and concurring in the judgment) ("It does not matter whether the word 'yellow' is ambiguous when the agency has interpreted it to mean 'purple.'"). The "character and context of the agency in-

terpretation" also count. *Kisor*, 139 S. Ct. at 2416. The interpretation must embody the agency's "fair and considered judgment," not a "convenient litigating position." *Id.* at 2417 (citation omitted). And, of particular relevance here, courts should not defer to interpretations that work "unfair surprise" by contradicting the agency's prior position or otherwise "upen[d] * * * reliance" interests. *Id.* at 2418 (citation omitted). Those considerations cut decisively against deference here.

The IRS's interpretation of its regulations exceeds any arguable ambiguity. The regulations require valuing the property *of the estate*, 26 C.F.R. § 20.2031-1(b) ("item of property includible in a decedent's gross estate")—here, a 77.18% share of Crown. But the IRS's view is based on valuing different property that neither the estate nor anyone possessed—a *100%* stake—and then working backwards from that fictional, inflated figure. See, *e.g.*, Br. in Opp. 10. And even if a company's "net worth" can exclude some commitments it has made, 26 C.F.R. § 20.2031-2(f), a contractual duty to repurchase a deceased owner's interest is not one of them.

Moreover, the IRS and its precursors have advanced inconsistent and opportunistic positions on this issue over many years, in the face of contrary judicial decisions, and the agency adopted its latest change in position without notice or reasoned explanation. At first, the agency unsuccessfully advanced a position similar to its argument here. In *Newell* v. *Commissioner*, 66 F.2d 102 (7th Cir. 1933), the Commissioner determined, and the Board of Tax Appeals upheld, an estate-tax deficiency against an owner's estate premised on including the full proceeds of a life-

insurance policy in the net worth of the company he owned. *Id.* at 103. The estate challenged the inclusion of the full amount of the life-insurance payout, urging an offset for "the amount of the loss which the company sustained due to the death of its founder and guiding spirit." *Ibid.* The Seventh Circuit adopted the estate's position, which it deemed "eminently sound and fair." *Id.* at 104.

In 1974, Treasury amended its regulation governing the valuation of stock held by an estate to add the sentence calling for consideration of "proceeds of life insurance policies" if and "to the extent" those proceeds "have not been taken into account in the determination of net worth." T.D. 7312, 1974-1 C.B. 277 (26 C.F.R. § 20.2031-2(f)). The IRS quickly advanced a categorical interpretation of that added language, urging that "the value of the stock is ascertained by first finding the value of such stock without the life insurance proceeds and by then adding such proceeds to such value." *Estate of Huntsman* v. *Commissioner*, 66 T.C. 861, 872 (1976). But that attempt failed in court just as quickly. *Id.* at 874. The Tax Court in *Huntsman* acknowledged that "life insurance proceeds must be given 'consideration'" but found it "equally obvious that the price paid by a willing buyer would not necessarily be increased by the amount of the life insurance proceeds." *Ibid.* The court explained that "[a] buyer would take into consideration such proceeds in the same manner as he would consider other liquid assets of the corporation" and thus would account for offsetting "liabilities." *Id.* at 874-875. The regulation itself "call[ed] for life insurance proceeds to be treated in the same manner as other nonoperating assets." *Id.* at 875. *Huntsman*

thus held that the IRS's position "[wa]s contrary to the regulations and contrary to well-established principles of valuation." *Ibid.*

Two decades later, the IRS reversed course and adopted the opposite view—ostensibly either recognizing the flaw in its prior position or acquiescing in judicial decisions rejecting that view. In *Estate of Cartwright* v. *Commissioner*, 183 F.3d 1034 (9th Cir. 1999), a company entered a redemption agreement and procured life insurance to be used for both repurchasing a deceased owner's shares and paying compensation for work in progress at his death. *Id.* at 1035-1036. The estate there urged including the full proceeds in the company's valuation, which reduced the estate's taxable income. *Ibid.* The IRS, flipping its position from *Huntsman*, argued the opposite, contending that "an offsetting liability * * * would offset the value of such proceeds." IRS Br. at 40-41, *Cartwright*, *supra*, No. 97-70032 (Apr. 29, 1998). Citing *Huntsman*, the Ninth Circuit agreed with the IRS's new interpretation, holding that the "insurance policy would not necessarily affect what a willing buyer would pay for the firm's stock because it was offset dollar-for-dollar by [the company's] obligation to pay out the entirety of the policy benefits to [the shareholder's] estate." 183 F.3d at 1038.

Just six years later, however, the IRS flopped back to its earlier position, where that view was again rebuffed. *Estate of Blount* v. *Commissioner*, 428 F.3d 1338, 1345 (11th Cir. 2005). In *Blount*, the IRS argued that the company's "contractual obligation" to redeem the decedent's shares did "not serve to reduce the value of" those shares. IRS Br. at 45-46, *Blount*, *supra*, No. 04-15013 (Mar. 21, 2005); see *id.* at 44-49.

The IRS tried to cabin its victory in *Cartwright* and purported to distinguish *Blount* on its facts. *Id.* at 47-49. It argued that, because the Tax Court in *Blount* (unlike in *Cartwright*) had declined to treat the parties' redemption agreement as conclusively determining the fair market value of the company as a whole, *id.* at 47-48, the company's redemption obligation under that agreement was somehow no longer a liability that offset the life-insurance proceeds the company received, see *id.* at 16, 49.

That proffered distinction is perplexing. Whether or not the repurchase price prescribed in a redemption agreement controls the fair market value of the redeemed shares for tax purposes, the company's contractual duty under the agreement to repurchase the shares remains. The IRS's argument in *Blount* also appears to be in tension with its own longstanding guidance providing that, even when such an agreement is not "determinative of fair market value," it is still "a factor to be considered." Rev. Rul. 59-60, § 8.

In all events, the Eleventh Circuit in *Blount* roundly rejected the IRS's new argument and reached the same conclusion as *Cartwright*, holding that the redemption liability did offset the insurance-proceeds asset. 428 F.3d at 1345. *Blount* expressly disapproved the IRS's invented distinction, holding that, "[e]ven when a stock-purchase agreement is inoperative for purposes of establishing the value of the company for tax purposes, the agreement remains an enforceable liability against the valued company, if state law fixes such an obligation." *Ibid.*

Despite those decisions repudiating the position the IRS advanced in *Huntsman* and *Blount*, the agency

tried it again in this case. See, *e.g.*, Br. in Opp. 9-16. And it continues to try to narrow its win in *Cartwright* based on the same empty distinction *Blount* rejected. See *id.* at 18. If there is any through line across these cases, it is that the IRS apparently follows whatever interpretation will maximize the taxes it can collect.

Whatever the motivation behind the IRS's hopscotching between positions, its inconsistency undercuts any claim to deference. *Kisor* precludes deference "to a merely convenient litigating position" that "creates unfair surprise." 139 S. Ct. at 2417-2418 (internal quotation marks omitted). Deference is even more inappropriate where the agency's current, changed position contradicts a judicial consensus, to which the agency previously appeared to yield.

Deference is particularly unwarranted because the agency has shifted positions principally through litigation rather than rulemaking, further exacerbating the lack of fair notice and transparency. If the IRS had buyer's remorse over its win in *Cartwright* and disagreed with courts' reading of the regulations, the agency should have amended them. Rulemaking would have provided prospective notice of the agency's position. It also would have subjected the agency's changed views to the crucible of public comment. And it would have facilitated judicial review by requiring the agency to articulate its rationale for a new position on the record. Instead, for five decades the agency has changed course through court filings. Deference is improper where the agency did not publicly explain its switches contemporaneously and instead attempts to reconcile its past stances after the fact in footnotes of appellate briefs. *E.g.*, Br. in Opp. 18 n.3; see *Kisor*, 139 S. Ct. at 2417.

The IRS's decision to bypass rulemaking is reminiscent of its troubling track record of noncompliance with administrative-law safeguards. "For decades," the myth of "'tax exceptionalism'"—"the perception that tax law is so different from the rest of the regulatory state that general administrative law doctrines and principles do not apply"—was widespread. Stephanie Hoffer & Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 Minn. L. Rev. 221, 222 (2014); see, *e.g.*, Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1729 (2007). But the days of tax exceptionalism are over, and this Court and others have increasingly called the IRS to account. It is now settled that the same standards of review that govern other agencies apply to Treasury regulations, see *Mayo Foundation for Medical Education & Research* v. *United States*, 562 U.S. 44, 55 (2011); that tax rules are not exempt from the Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*, 701 *et seq.*, see *Mann Construction, Inc.* v. *United States*, 27 F.4th 1138, 1142-1148 (6th Cir. 2022); and that the Anti-Injunction Act, 26 U.S.C. § 7421(a), does not insulate every rule with some attenuated link to taxes from judicial review, see *CIC Services, LLC* v. *IRS*, 141 S. Ct. 1582, 1588-1594 (2021).

So too here, just as any other agency's unexplained shift in positions and failure to provide fair notice would take deference off the table, see *Kisor*, 139 S. Ct. at 2417-2418, the IRS's reading of the regulations in this case must pay its own way. Treasury would not tolerate such a lack of transparency from taxpayers. And "[i]f men must turn square corners

when they deal with the government," an adage that arose in the tax context, "it cannot be too much to expect the government to turn square corners when it deals with them." *Niz-Chavez* v. *Garland*, 593 U.S. 155, 172 (2021); see *Rock Island, Arkansas & Louisiana Railroad Co.* v. *United States*, 254 U.S. 141, 143 (1920). Because the IRS's position is unpersuasive, this Court should reject it.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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