SUPREME COURT
OF THE UNITED STATES

IN THE SUPREME COURT OF THE UNITED STATES

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THOMAS A. CONNELLY,)
AS EXECUTOR OF THE ESTATE OF)
MICHAEL P. CONNELLY, SR.,)
Petitioner,)
v.) No. 23-146
UNITED STATES,)
Respondent.)

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1 IN THE SUPREME COURT OF THE UNITED STATES
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3 THOMAS A. CONNELLY,)
4 AS EXECUTOR OF THE ESTATE OF)
5 MICHAEL P. CONNELLY, SR.,)
6 Petitioner,)
7 v.) No. 23-146
8 UNITED STATES,)
9 Respondent.)
10 -
11
12 Washington, D.C.
13 Wednesday, March 27, 2024
14
15 The above-entitled matter came on for
16 oral argument before the Supreme Court of the
17 United States at 11:41 a.m.
18
19 APPEARANCES:
20 KANNON K. SHANMUGAM, ESQUIRE, Washington, D.C.; on
21 behalf of the Petitioner.
22 YAIRA DUBIN, Assistant to the Solicitor General,
23 Department of Justice, Washington, D.C.; on behalf
24 of the Respondent.
25

1 C O N T E N T S

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1 P R O C E E D I N G S
2 (11:41 a.m.)
3 CHIEF JUSTICE ROBERTS: We will hear
4 argument next in Case 23-146, Connelly versus
5 United States.
6 Mr. Shanmugam.
7 ORAL ARGUMENT OF KANNON K. SHANMUGAM
8 ON BEHALF OF THE PETITIONER
9 MR. SHANMUGAM: Thank you, Mr. Chief
10 Justice, and may it please the Court:
11 To ensure continuity in their
12 operations, closely held corporations will often
13 agree to redeem the stock of a shareholder upon
14 his death and then obtain a life insurance
15 policy on the shareholder in order to fund the
16 redemption obligation.
17 This case presents the question of how
18 the federal estate tax treats such arrangements.
19 Because the proceeds from a life insurance
20 policy to fulfill a contractual redemption
21 obligation do not increase the corporation's net
22 worth, they do not increase the estate tax owed
23 on the decedent's stock. The court of appeals'
24 contrary conclusion was erroneous.
25 The legal framework governing this

1 case is relatively straightforward. The
2 Internal Revenue Code and Treasury regulations
3 provide that where the parties agree on the
4 price to redeem a shareholder's stock, that
5 price will establish the value of the stock for
6 purposes of the estate tax in certain
7 circumstances.
8 But where, as here, those
9 circumstances have not been met, the value of
10 the stock is determined by the price at which
11 such stock would change hands between a
12 hypothetical willing buyer and willing seller.
13 Here, a hypothetical buyer would not
14 treat the life insurance proceeds as increasing
15 the value of the stock because that asset is
16 offset by the contractual obligation to redeem
17 shares, a preexisting corporate liability.
18 Now the government argues that a court
19 should attach no weight to the redemption
20 obligation when assessing the value of the
21 company. But the government fails to
22 distinguish between a contractual obligation to
23 redeem stock on the one hand and a voluntary
24 stock redemption on the other.
25 A hypothetical buyer would treat the

1 contractual redemption obligation like any other
2 debt that reduces the net worth and therefore
3 the value of the company. The government's
4 approach would lead to a grossly inflated
5 valuation of the decedent's shares, and it would
6 effectively lead to double taxation. It would
7 defy common sense to take one side of the
8 transaction into account but to ignore the other
9 for purposes of the estate tax. And it would
10 destroy a valuable succession planning tool that
11 the nation's small businesses have openly used
12 for decades. The judgment of the court of
13 appeals should be reversed.
14 I welcome the Court's questions.
15 JUSTICE THOMAS: Mr. Shanmugam, the --
16 if a very interested buyer showed up the day
17 after Michael died, would Thomas sell the
18 business to him for 3.86 million?
19 MR. SHANMUGAM: So, if Thomas were the
20 person we were thinking about and not Michael, I
21 think it is quite possible that a hypothetical
22 willing buyer would pay $3.68 million --
23 JUSTICE THOMAS: No, I'm -- I'm -- I'm
24 -- I'm more focused on the asking price. If a
25 buyer showed up the day after Michael died and

1 offered to buy it at any price, what would he
2 sell it for?
3 MR. SHANMUGAM: So I think it's
4 important here to distinguish between Michael
5 and Thomas.
6 JUSTICE THOMAS: Who's -- which one
7 died?
8 MR. SHANMUGAM: Michael is the one who
9 died.
10 JUSTICE THOMAS: Okay.
11 MR. SHANMUGAM: And -- and Michael, of
12 course, is the one whose shares would be subject
13 to the $3 million --
14 JUSTICE THOMAS: But -- but Thomas --
15 -- is the -- he is actually in charge of the
16 estate and the company, so he's on both, so he
17 can actually sell the property, right?
18 MR. SHANMUGAM: Yes, except for the
19 fact that, under the buy-sell agreement, Thomas
20 is actually disabled from selling the property.
21 JUSTICE THOMAS: Well, he has the
22 first option.
23 MR. SHANMUGAM: He has the first
24 option. That is correct. But, under the terms
25 of the buy-sell agreement, the estate cannot

1 sell the stock.

2 JUSTICE THOMAS: Okay. Let's --

3 MR. SHANMUGAM: So the way --

4 JUSTICE THOMAS: Well, let me just

5 blink that for a minute, okay? What would he

6 ask for it, assuming he could sell it? Would he

7 ask 3.86 million or 6.86 million, assuming that

8 the insurance was in -- was included in the

9 assets or liabilities of the company?

10 MR. SHANMUGAM: Sure, Justice Thomas.

11 So the first question is what is the net worth

12 of the company, because we're in agreement with

13 the government that that is the first question.

14 Our view is that the net worth of the

15 company throughout all of this is $3.86 million.

16 The government's view is that the net worth of

17 the company is $6.86 million because, in the

18 government's view, you take into account the

19 life insurance proceeds but not the offsetting

20 redemption obligation.

21 JUSTICE THOMAS: So, if a willing

22 buyer shows up -- and who owns the life

23 insurance policy?

24 MR. SHANMUGAM: So the company is

25 entitled to the proceeds of the life insurance.

1 And that is hugely important when you're
2 applying this test because the fundamental
3 problem with the government's view -- our view
4 is that 77 percent of $3.86 million is $3
5 million. The government's view is that
6 77 percent of $6.86 million is $5.3 million.
7 A willing buyer would never, at that
8 moment, if buying Michael, the decedent's,
9 shares, pay $5.3 million. Why? Because a
10 willing buyer would not be able to capture those
11 life insurance proceeds by swooping in before
12 the redemption. Those life insurance proceeds
13 belong to the company.
14 JUSTICE THOMAS: Well, the value has
15 to go someplace. The 3 million goes someplace.
16 Does it go into the value of the remaining
17 stocks? And if it is there, why isn't the
18 appropriate valuation 6.86 million?
19 MR. SHANMUGAM: The $3 million of the
20 life insurance proceeds are used to redeem
21 Michael's shares under the terms of the parties'
22 agreement.
23 Now, as a practical matter, the
24 problem here and the fundamental issue that all
25 of us are wrestling with is that what we know is

1 that you can't use the $3 million as simply the
2 valuation. Why? Because, as I noted at the
3 outset, we didn't satisfy the requirements of
4 Section 2703.
5 And, therefore, you have to engage in
6 this counterfactual inquiry, and the problem
7 with the counterfactual inquiry that the
8 government wants this Court to engage in is,
9 again, that it requires you to disregard the
10 redemption obligation.
11 Now it is true that one consequence of
12 our interpretation is that, as to Thomas, the
13 surviving stockholder, Thomas in some very real
14 sense benefits from the increase in value by
15 virtue of this transaction. Why? Because
16 Thomas goes from having 22 percent of the
17 company to a hundred percent of the company.
18 But, under our approach, as under the
19 government's approach, that is taken care of by
20 the eventual application of the capital gains
21 tax.
22 What the government wants you to do is
23 to effectively take those life insurance
24 proceeds into account twice, once when
25 calculating the estate tax because the

1 government wants you to tax this higher amount,
2 $5.3 million -- and, again, no hypothetical
3 willing buyer would ever have paid that. Crown
4 would never have redeemed the shares for $5.3
5 million. And I'm happy to explain why.
6 But then the government also will
7 subject Thomas eventually to the capital gains
8 tax on the increase in the value of his shares.
9 And that, in our view, is the fundamental
10 problem with the government's approach here, and
11 that is why this is effectively double taxation.
12 And to just spell out for another
13 sentence or two why the $5.3 million valuation
14 --
15 JUSTICE KAGAN: But, if I can just
16 stop you there because it seems that the
17 fundamental problem with your approach is that
18 Thomas's -- the -- you know, Thomas's asset has
19 quadrupled in value, and it's quadrupled in
20 value without him putting a single cent more
21 into the company.
22 And there might be some taxation
23 effect in the end of all that, but -- but not
24 sufficient to -- you know, to -- to make up for
25 the fact that your -- it's -- it's a -- it's a

1 tell that your way of -- of calculating the
2 thing is wrong that somebody can come away with
3 four times the value without putting a single
4 cent into the company.
5 MR. SHANMUGAM: So, with respect,
6 Justice Kagan, I completely disagree with that,
7 and let me explain why.
8 It is true that Thomas is in a very
9 real sense practically the beneficiary of the
10 life insurance proceeds. Why? Because those
11 proceeds extinguish the offsetting liability on
12 the books, the offsetting redemption obligation.
13 And so this is a context in which
14 Thomas does come away with the benefit of those
15 proceeds because he is the sole owner of a
16 company that is worth $3.86 million.
17 Now the government complains around
18 the edges about the fact that it's the capital
19 gains tax, the capital gains tax only operates
20 upon realization, there is a stepped-up basis
21 when someone dies and passes the stock along and
22 so forth.
23 But those are all features of the
24 capital gains tax system. That is not a bug
25 with our position. Again, our position is the

1 rational one precisely because the tax system
2 captures that increase.
3 And, of course, under our approach,
4 Michael's heir is still, of course, paying the
5 estate tax. Michael's heir is paying the estate
6 tax at -- on stock at around $3 million,
7 coincidentally roughly the amount that was
8 contained in the buy-sell agreement, which I
9 think confirms that that amount was a rational
10 amount here.
11 But the problem with the $5.3 million,
12 again, the government's view is -- let's take
13 Crown. The government's view is presumably that
14 if there had been a proper arm's-length
15 agreement here, Crown would have been willing to
16 pay $5.3 million to redeem this stock.
17 That would have required Crown to use
18 all of the life insurance proceeds here, the
19 entire $3.5 million, and also to dip into its
20 operating assets in order to redeem those
21 shares. That illustrates why the government's
22 position here is irrational.
23 Now, to be sure, I think there is a --
24 JUSTICE SOTOMAYOR: Why?
25 MR. SHANMUGAM: -- conceptual --

1 JUSTICE SOTOMAYOR: If -- if Thomas
2 had done what he needed to do, he would have --
3 both owners would have insured each other. They
4 would have paid the price and -- and gotten the
5 shares. What you did was to off that to the
6 corporation and give the corporation a benefit
7 that entitled Thomas to own the company a
8 hundred percent. I think that's where Justice
9 Thomas's question comes up.
10 MR. SHANMUGAM: Well, it just --
11 JUSTICE SOTOMAYOR: The value of the
12 company is the value at which someone's going to
13 own a hundred percent shares of the stock.
14 MR. SHANMUGAM: So, Justice Sotomayor,
15 I think that that hypothetical which the
16 government uses actually helps our position, and
17 let me explain why.
18 The government acknowledges that if
19 you had a situation in which the individuals
20 themselves took out the insurance policies and
21 entered into a cross-purchase agreement, that it
22 would be subject to tax treatment along the
23 lines of what we are suggesting here.
24 Why should this situation be treated
25 differently? And -- and one reason

1 parenthetically why that alternative is
2 impractical is that if you have a company with
3 multiple owners, that gets very complicated, but
4 it's also distinguishable because, in that
5 situation, the individuals have to pay the
6 premiums.
7 Here, the reason why the corporation
8 is paying the premiums is precisely because the
9 corporation derives a benefit from this
10 arrangement, and that benefit, as I said in my
11 very first words, is continuity of ownership.
12 That is an incredibly valuable benefit to
13 closely-held corporations in this context.
14 And -- and so this is not a situation
15 in which the corporation itself derives any sort
16 of windfall. The corporation is paying premiums
17 and it gets the life insurance proceeds in
18 return.
19 I think what the government is really
20 bridling against --
21 JUSTICE SOTOMAYOR: Thank you, Mr.
22 Shanmugam.
23 JUSTICE BARRETT: Mr. Shanmugam, what
24 is the right perspective? So, when Justice
25 Thomas asked you the question, you know, he said

1 how much would you buy the company for, I -- I
2 think, but regardless of how he asked it, I
3 think that would be one way to consider it, like
4 what was the whole value worth.
5 Or do we ask, if you had a stranger to
6 the situation, what would the price of one share
7 be? Is that the right way to think about it?
8 And then just kind of to build on to that, do
9 you assume the perspective of Thomas, you know,
10 someone who would buy one of Thomas's shares or
11 someone who would buy one of Michael's shares or
12 just someone who -- like you could even pretend
13 that you had a third brother named Ralph who
14 only had one share?
15 Like, what's the right way to think
16 about it?
17 MR. SHANMUGAM: So, Justice Barrett,
18 it is a hypothetical buyer of the same
19 proportion of shares in the company. So it's a
20 hypothetical buyer of 77.18 percent of Crown's
21 shares.
22 Now I think the reason why we talk
23 about the value of a company here is that I
24 think we are in agreement that under the
25 relevant regulations -- and this is 20.2031-2(f)

1 -- we are really focusing on the net worth of
2 the company and then multiplying the relevant
3 percentage here. I think we and the government
4 are in agreement that that is the correct
5 approach here.
6 Now that will not always be true.
7 There may be circumstances in which, for
8 instance, that block of shares gives you a
9 control premium that needs to be valued. And
10 when you look at the lower court case law in
11 this area, often the price will then be adjusted
12 up or down.
13 But we're all in agreement that
14 there's no such adjustment here. And so,
15 really, the fundamental question here is what
16 was the net worth of the company. And to make
17 just two additional points about that, the first
18 is the reason why we're talking about a
19 hypothetical block of 77.18 percent of the
20 shares is precisely because, if we were talking
21 about Michael's actual shares, those shares are
22 about to be extinguished.
23 They're subject to the redemption
24 obligation. So I think there's really no good
25 conceptual way to do that. And I think that the

1 regulations recognize that when they talk about
2 the fact in 20.2031-1(b) that you can look to an
3 equivalent asset, a comparable item in the words
4 of the regulation, when you're making this
5 determination.
6 And then I think the second thing that
7 I think is important to keep in mind here is,
8 that when you're talking about the net worth of
9 the company, I don't really hear the government
10 to dispute the fact that an obligation to redeem
11 shares would be treated ordinarily -- and common
12 sense bears this out -- as a liability like any
13 other.
14 It's a legally-binding obligation.
15 The accounting standards treat it as a
16 liability. In fact, the accounting standards go
17 so far as to specifically enumerate stock to be
18 redeemed upon the death of the holder as giving
19 rise to a liability.
20 JUSTICE GORSUCH: So -- so fair enough
21 on that, but it -- it just see if I've got this
22 right, and tell me where I'm wrong.
23 You agree that the -- the relevant
24 value is of the corporation as a whole. And,
25 really, the question is what do we do with the

1 $3 million in life insurance proceeds, how
2 should that be dealt with.
3 And I hear the government saying a
4 prospective buyer would consider that part of
5 the assets of the corporation, and, therefore,
6 it enhances the value of the company to five
7 point whatever it is. And I hear you saying no,
8 you really shouldn't count those insurance
9 proceeds because they're -- they're earmarked
10 for the redemption, and so no willing purchaser
11 would account for them in part of his assessment
12 of the value of the company.
13 Is that a fair assessment of the
14 difference between the two?
15 MR. SHANMUGAM: I would word the point
16 slightly differently, Justice Gorsuch, but I
17 think this difference is important. We're not
18 disputing that the life insurance proceeds are
19 an asset. What we're really debating here is
20 whether or not they are a net asset, whether --
21 JUSTICE GORSUCH: Whether a willing
22 buyer would consider them part of the value of
23 the company that he's going to obtain when
24 they're really earmarked for redemption.
25 MR. SHANMUGAM: And what a willing

1 buyer I -- would do, I think, is to look at this
2 and to say: Yes, there are $3 million in life
3 insurance proceeds that are going to come into
4 the company, but those proceeds are going to
5 immediately go out again. They're going to go
6 out in order to fund this offsetting liability
7 which is on the books.
8 And under our approach, which, again,
9 I think accords with a healthy dose of common
10 sense here, when the parties entered into the
11 initial buy-sell agreement, that had the effect
12 of putting an asset and a liability on the books
13 at the same time.
14 JUSTICE GORSUCH: It offset one
15 another.
16 MR. SHANMUGAM: They offset each other
17 at every point.
18 JUSTICE GORSUCH: Okay. Now --
19 MR. SHANMUGAM: And that is precisely
20 why, as I said, in response to one of the
21 earlier questions, under our approach, the net
22 worth of the company is the same throughout. In
23 other words, it's the same before death, it's
24 the same at the moment of death, and it's the
25 same after the redemption obligation.

1 JUSTICE GORSUCH: Now one wrinkle to
2 that, though, is I -- I don't think the life
3 insurance proceeds -- the only permitted use for
4 them was the redemption, and the government
5 makes something of that.
6 MR. SHANMUGAM: That is correct, and
7 that's why I didn't pick up on the word
8 "earmarked" in your question --
9 JUSTICE GORSUCH: Right. Right. And
10 -- and -- and -- yeah. And --
11 MR. SHANMUGAM: -- because money is
12 fungible.
13 JUSTICE GORSUCH: Yeah.
14 MR. SHANMUGAM: And so I think our
15 analysis would be the same if you were talking
16 about $3 million that happened to be some other
17 non-operating asset.
18 JUSTICE GORSUCH: It's still a $3
19 million liability.
20 MR. SHANMUGAM: It would still be
21 offset. And, indeed, in this case, the life
22 insurance policy was not for $3 million. It
23 turns out it was for $3.5 million. We're in all
24 -- we're all in agreement that the remaining
25 $500,000 is an asset, a non-operating asset that

1 should be on the company's books.
2 And so all we are doing here, I think,
3 is giving effect to the broader framework which
4 not just Congress but the Treasury and the IRS
5 has set up here, which is a framework that says
6 that when you are in the hypothetical world
7 conducting this analysis, you assume that the
8 hypothetical buyer and seller takes all relevant
9 facts into account.
10 JUSTICE KAVANAUGH: You -- you said --
11 MR. SHANMUGAM: And --
12 JUSTICE KAVANAUGH: Keep going, I'm
13 sorry.
14 MR. SHANMUGAM: And -- and -- and I
15 think that the problem with the government's
16 approach is that the government's approach
17 requires you to do one of two things: either to
18 disregard the offsetting liability or to assume
19 -- and I think, when you look at the
20 government's italicized hypotheticals, all of
21 them effectively do this -- to assume that your
22 hypothetical buyer is somehow going to be able
23 to capture the life insurance proceeds.
24 That was the flaw with the court of
25 appeals' reasoning because the court of appeals

1 posited a situation where you had a buyer not
2 just of the 77 percent of the shares but of the
3 entirety of the company. Of course, if a buyer
4 could get their hands on both Michael's shares
5 and Thomas's shares, presumably, the first thing
6 that buyer would do is to extinguish any
7 redemption obligation, not that that redemption
8 obligation would make any sense in that
9 hypothetical, and to have the benefit of the
10 $3.86 million in corporate value and the $3
11 million in life insurance proceeds.
12 JUSTICE KAVANAUGH: Something you said
13 that I think is critical to your position is
14 that the net worth before, on the day of, on the
15 day after, a month after, after the life
16 insurance and the -- and the redemption has
17 occurred or whenever after that, is -- is
18 constant.
19 MR. SHANMUGAM: Yes, and that is
20 different from a voluntary redemption. Much ink
21 is spilled both in the government's brief and --
22 and the briefs of the amicus law professors on
23 the fact that when you're dealing with a
24 voluntary redemption -- let's say a publicly
25 held company decides on the next day to redeem

1 shares, at that point, it is true that you are
2 going to have a diminution in the net worth,
3 which ensures that the remaining shareholders'
4 stock remains relatively constant.
5 That actually turns out not to be true
6 when you're dealing with publicly held companies
7 because often the stock will move up or down in
8 response to such an announcement, but I think
9 that basic principle is one that we don't
10 disagree with.
11 But everything in the government's
12 brief presupposes that a voluntary redemption
13 and a contractual obligation to redeem shares
14 are treated exactly the same way. And I think
15 the problem is that if you're a hypothetical
16 buyer looking at the company, a redemption
17 obligation is like any other debt. You see that
18 on the corporate books. And that is $3 million
19 that is going out the door.
20 Now, to be sure, this is a
21 hypothetical buyer, and so we are presupposing
22 that the buyer is not attempting to buy the
23 shares that are subject to the redemption
24 obligation. That would, again, be impossible
25 under the terms of the buy-sell agreement, and

1 even if they could, they would be entitled only
2 to $3 million, and we're disregarding that
3 figure.
4 JUSTICE KAVANAUGH: On -- on the
5 professors' -- the -- Professor Chodorow and
6 Professor Hellwig's amicus briefs, obviously,
7 they've spent a lot of time thinking about this
8 issue. They're against you. Do you want to --
9 maybe you just covered it in your view, but
10 where do they get it wrong? Maybe your point is
11 the voluntary redemption is where they -- where
12 they get it wrong, but I'd like some more
13 explanation because they -- they clearly have
14 studied this.
15 MR. SHANMUGAM: I -- I -- I think that
16 that is -- the fundamental flaw is that they
17 really presuppose a voluntary redemption, and so
18 many of the principles that they set out and,
19 indeed, the four principles that the government
20 sets out are principles that we have no
21 objection to in that context.
22 In this context, by contrast, again,
23 it's that a hypothetical buyer would not somehow
24 disregard this redemption obligation. The
25 hypothetical buyer would take it into account

1 and recognize that the funds that are coming in
2 are going out the door again.
3 And to be clear, this results in no
4 windfall whatsoever to anyone other than the
5 benefit to Thomas that's going to be taxed.
6 I think, when the government says that
7 the purposes here are not legitimate, there's
8 nothing in the case that we disagree with more.
9 The reason that closely-held corporations engage
10 in these transactions, as the Chamber's amicus
11 brief explains at some length, is precisely
12 because this is a way of ensuring continuity of
13 operations without engaging in disruption.
14 If you don't have the life insurance
15 proceeds here, most of these companies, which
16 are typically very small, are going to have to
17 dip into operating assets or otherwise engage in
18 some sort of transaction to ensure continuity.
19 If you have an heir who doesn't want to run the
20 company or if the heir is someone outside the
21 family, you have a very real risk that that
22 person will not be interested in running the
23 company or that you'll have a disruption of
24 operations.
25 JUSTICE JACKSON: Mr. Shanmugam, can I

1 just ask you -- because I'm trying to follow.
2 So you've said many times that the money is
3 going out, but I guess I'm trying to figure out
4 whether the proceeds of the life insurance are
5 really going out when they're being used to
6 redeem the shares.
7 So what -- what is the effect on the
8 value of the remaining shares once the
9 redemption occurs?
10 MR. SHANMUGAM: So the remaining
11 shares effectively have a larger share of
12 ownership in the company. In other words --
13 JUSTICE JACKSON: Their value
14 increases. Is that where the four times that
15 Justice -- Justice Kagan was talking about -- is
16 that where that comes from?
17 MR. SHANMUGAM: Yes, that's correct.
18 And this is the contrast, I think, with a
19 voluntary redemption because, in the context of
20 a voluntary redemption, rather than these life
21 insurance proceeds, something else has to go out
22 of the company and you are getting the shares
23 back into the company.
24 And -- and the reason why that is
25 different is that, here, you are extinguishing

1 an existing liability. That is what makes this
2 different, is that you have a --
3 JUSTICE KAGAN: But you're treating
4 this --
5 MR. SHANMUGAM: -- liability on the
6 books.
7 JUSTICE KAGAN: -- you're treating
8 this redemption obligation like any other
9 redemption obligation, and it's really not like
10 any other redemption obligation because this
11 obligation is benefiting the equity interests
12 that we're trying to value. And so it -- it --
13 it just doesn't seem to make a lot of sense in
14 that context to say that the redemption
15 obligation simultaneously serves to reduce the
16 value of that interest.
17 MR. SHANMUGAM: I think that that's a
18 fair factual statement, but let me explain to
19 you why that should make no difference.
20 In our view, the -- the redemption
21 obligation is like any other debt from the
22 perspective of the hypothetical buyer. And I
23 recognize that this is the artificiality of the
24 case, but I think it's an artificiality of the
25 case that is inherent in the way that the

1 regulations work, and I think it's a problem
2 that the government has to come to terms with as
3 well.
4 Our view is that from the perspective
5 of a hypothetical third party, the fact that
6 this redemption obligation runs to somebody else
7 is of no moment. The hypothetical buyer here is
8 not in the same position as Michael. It's a
9 hypothetical buyer.
10 And so that is why we think that when
11 you're applying a regulation that requires you
12 to take into account all relevant facts, you've
13 got to look at the economic reality from the
14 position of the company.
15 And, again, the best way I think to
16 understand that is to think about whether or not
17 the government's fair market valuation would be
18 one that the parties would use. We know that
19 our fair market valuation, in fact, pretty
20 closely tracks the price that was agreed. Five
21 point three million dollars would have destroyed
22 Crown if Crown had spent that amount of money to
23 redeem the shares because, again, the life
24 insurance proceeds would not have covered that
25 amount. And I think that that illustrates why

1 the government's position cannot be correct.
2 CHIEF JUSTICE ROBERTS: Thank you,
3 counsel.
4 Justice Thomas?
5 Justice Alito?
6 Justice Sotomayor?
7 Justice Gorsuch?
8 Justice Kavanaugh?
9 Justice Barrett?
10 JUSTICE JACKSON: Can I just ask one
11 more question? Assume that the company doesn't
12 take out life insurance to fund the redemption.
13 The agreement just says the company promises to
14 -- redeem the shares at fair market value upon
15 the shareholder's death.
16 What, if anything, about your
17 treatment of the redemption obligation changes
18 in that circumstance?
19 MR. SHANMUGAM: So I think the
20 analysis is somewhat different, Justice Jackson.
21 And I think that that is similar to the two
22 sisters hypothetical that the government uses in
23 its brief, and that is for the simple reason --
24 and we've kind of been talking to some extent
25 about this -- that in that hypothetical, the

1 obligation to redeem shares actually has a
2 depressive effect on the company's future
3 earning capacity. Why? Precisely because the
4 company has to use other assets and typically
5 operating assets in order to fund the redemption
6 obligation.
7 And in that circumstance, there could
8 well be a depressive effect on the valuation,
9 and that depressive effect could, in fact, be
10 substantial. One reason why this circumstance
11 is different is precisely because, where you
12 have an offsetting life insurance policy and
13 redemption obligation, it actually makes sense
14 to think about valuation in terms of the net
15 worth of the company.
16 I think, once you start to get away
17 from that, the valuation of the company is
18 affected by its remaining operating assets, how
19 the business is going to do on a going-forward
20 basis. But, here, precisely because there's no
21 effect on the remainder of the company, it makes
22 sense to engage in the valuation by multiplying
23 the percentage of shares by the net worth.
24 JUSTICE JACKSON: Thank you.
25 CHIEF JUSTICE ROBERTS: Thank you,

1 counsel.
2 MR. SHANMUGAM: Thank you.
3 CHIEF JUSTICE ROBERTS: Ms. Dubin.
4 ORAL ARGUMENT OF YAIRA DUBIN
5 ON BEHALF OF THE RESPONDENT
6 MS. DUBIN: Mr. Chief Justice, and may
7 it please the Court:
8 The estate's evaluation of Michael
9 Connelly's shares contradicts basic math and
10 valuation principles. According to the estate,
11 before we can value Michael's shares in Crown,
12 we must first subtract the price that Crown paid
13 for Michael's shares. In other words, the
14 estate's theory is that before you can value
15 something, you must first subtract the price
16 paid for the very thing you are trying to value.
17 That makes no sense. Using the item
18 you're trying to value as a line item in its own
19 valuation will never give you the correct
20 answer, and it doesn't give the estate the right
21 answer here either.
22 The estate's contrary view rests on a
23 fundamental misunderstanding of the nature of a
24 redemption obligation. A redemption obligation
25 is not a corporate debt that reduces the

1 corporation's net worth or the value of the
2 shares to be redeemed. A debt owed to creditors
3 reduces corporate and shareholder value. A
4 redemption obligation divides the corporate pie
5 among existing shareholders without changing the
6 value of their interests.
7 And, here, the corporate pie was worth
8 6.86 million, not 3.86 million. And that's true
9 even if you look only at the estate's own
10 numbers. Petitioner admits that Michael's
11 estate walked away from the redemption with
12 approximately $3 million in cash, but Petitioner
13 also admits that Thomas walked away from the
14 redemption with $3.86 million in value.
15 And the estate doesn't dispute the
16 black-letter valuation principle that the
17 interest of each equity shareholder added
18 together has to equal the -- company's total
19 value. That defeats their position because that
20 means that Crown's total net worth before the
21 family divided the company was 6.86 million, the
22 value of the two equity slices put back
23 together, and that means that the estate's
24 valuation of Michael's 77 percent stake in Crown
25 at $3 million came nowhere close to fair market

1 value.

2 I welcome the Court's questions.

3 JUSTICE THOMAS: I think what

4 Petitioner is arguing is that, yes, we took the

5 insurance policy, the receipts, 3.5 million, we

6 paid out 3, and we received the shares, so it's

7 a wash. The 3 million, up -- up to 3 million,

8 is a wash. So what do you do with that

9 argument?

10 MS. DUBIN: Sure. So that argument

11 depends on the idea that the $3 million

12 redemption obligation is a debt, a liability,

13 and that's just not correct.

14 What it is is a promise to cash out

15 one of the existing shareholders' shares. So,

16 for example, in the two sisters hypothetical, on

17 page 27 of our brief, if you own 80 percent of a

18 company worth $5 million, you have a $4 million

19 stake in the company, a redemption obligation at

20 fair market value would be a promise to cash you

21 out for your shares for your stake in the

22 company.

23 It is not the same thing as the

24 corporation, for example, owing a mortgage or

25 some other debt. A mortgage or some other debt

1 like that would reduce the value of the company
2 and the value of -- for its shareholders. That
3 is simply just not true of a redemption
4 obligation.
5 And I think that, you know, it's sort
6 of important that Petitioner concedes that a
7 voluntary redemption obligation wouldn't
8 decrease the value of the company because, on
9 the date of Michael's death, it doesn't matter
10 whether the redemption obligation is voluntary
11 or mandatory.
12 Three million dollars is being paid to
13 Michael's shares, so that's where that money is
14 going. But it is going either whether that's
15 voluntary or mandatory. The point is that that
16 was part of the corporate assets here and it was
17 paid to Michael on the date of his death.
18 JUSTICE BARRETT: Do you agree that
19 none of the money escapes taxation because more
20 value -- I mean, the -- the $3 million of the
21 life insurance proceeds didn't vanish. As you
22 say, it's -- it's retained by the company, and
23 Mr. Shanmugam was pointing out that Thomas will
24 be taxed on that as a capital gains tax when he
25 sells out his shares. So Mr. Shanmugam says

1 that means that the government is double
2 dipping.
3 What do you have to say to that?
4 MS. DUBIN: A couple responses to
5 that. First of all, any sort of double dipping
6 allegation comes from the Connelly family's
7 decisions to value the shares at below fair
8 market value. Had these shares been redeemed
9 for fair market value, which is $5.3 million,
10 there would be no risk of double taxation. The
11 risk of double taxation comes because $2.3
12 million stayed in Crown and inured to Thomas's
13 benefit, but that money was really part of the
14 fair market value of Michael's shares.
15 In a normal -- in a transaction that
16 was done at fair market value, you would have
17 had 5.3 million go to Michael's estate, be
18 subject to the estate tax, and never be subject
19 to any possibility of future taxation through
20 capital gains on Thomas. So that's the first
21 answer, which is this problem comes because the
22 estate valued these shares below fair market
23 value.
24 But the second answer is that we just
25 simply can't know what will happen to Thomas's

1 shares in the future. Maybe they will be
2 subject to capital gains. It depends if he
3 bequeaths them. It depends what they're worth
4 at that time. That's a separate inquiry that
5 goes to the value of Thomas. The estate tax
6 cares about the value of Michael's shares at the
7 time of Michael's death and Michael's estate,
8 not what went to any of the particular heirs or
9 beneficiaries.
10 JUSTICE SOTOMAYOR: I thought -- am I
11 wrong that on -- on capital gains you pay the
12 tax when you -- capital gain at the -- at the
13 price that it's -- you've gotten it?
14 MS. DUBIN: If -- if you get a
15 stepped-up basis.
16 JUSTICE SOTOMAYOR: And that's why he
17 won't pay on that.
18 MS. DUBIN: If he sells it during his
19 lifetime --
20 JUSTICE SOTOMAYOR: Right.
21 MS. DUBIN: -- he didn't get these
22 shares as a bequeathment, so he's not entitled
23 to stepped-up basis, but he could pass it on to
24 his heirs with a stepped-up basis.
25 JUSTICE SOTOMAYOR: Thank you.

1 JUSTICE KAVANAUGH: The net worth
2 question that Mr. Shanmugam said the net worth
3 stayed the same all the way through, A, do you
4 agree? B, why is that not relevant if it is
5 true?
6 MS. DUBIN: It's not true. The
7 corporation was worth 6.86 million on the date
8 of Michael's death. Our view is not that only
9 somehow Michael's shares had some value in them
10 that the corporation didn't have. Our view is
11 that the corporation's equity value is made up
12 by the equity stakeholder's value. Michael's
13 shares were entitled to a $5.3 million valuation
14 and Thomas's shares were a $1.5 million
15 valuation. That adds up to our $6.86 million
16 valuation.
17 JUSTICE KAVANAUGH: Why -- why is it
18 -- you said the redemption obligation is not a
19 debt. Just walk me through that if you can,
20 because I find this case extremely difficult.
21 So it seems like a key point and I'd like to
22 hear you explain it again.
23 MS. DUBIN: Sure. And I would just
24 start off with saying, I mean, I think the
25 Petitioner agrees that a voluntary redemption is

1 not the paying of the debt.
2 JUSTICE KAVANAUGH: Yeah.
3 MS. DUBIN: So I think that sort of to
4 the extent we're --
5 JUSTICE KAVANAUGH: But he's saying
6 that's the key point in the case. I think
7 that's what he said. So I'd like to hear you
8 address that.
9 MS. DUBIN: Yeah. And I think that --
10 I think -- we've been talking a little bit about
11 the amicus briefs and they are very helpful in
12 explaining just the nature of a redemption
13 generally, but the nature of a redemption, what
14 a company is agreeing to do in a redemption is
15 to exchange one of the existing shareholders'
16 shares, so their stake in the company, their
17 equity stake in the company, in exchange for
18 cash.
19 So that's -- that's the promise. It's
20 we will get back your equity shares and we will
21 give you cash in exchange for it. If that were
22 done at fair market value, it would mean that if
23 you had an 80 percent stake in a $5 million
24 company, you would be entitled to $4 million in
25 cash.

1 What happens on the other side, your
2 shares are extinguished, so they no longer
3 exist. So the remaining shareholder, who was a
4 20 percent stakeholder in our $5 million
5 company, he had originally, to start, he had a
6 20 percent stake in a $5 million company, which
7 is a $1 million stake. Now, after this
8 redemption which is paid out at $4 million, he
9 would be left with sole ownership of a $1
10 million company.
11 So, in a redemption, both of the
12 corporate shareholders, if the redemption is
13 done at fair market value, they both walk away
14 with the same value they had before. By
15 contrast, in a debt situation where you're
16 paying a debt, the corporation pays money out of
17 its coffers to someone outside the corporation
18 and that will reduce both the corporate and the
19 shareholder value, and if this had been that
20 sort of $3 million debt, then Petitioner's
21 analysis would be right, but, here, the $3
22 million went into Michael's pocket, it went to
23 one of the equity shareholders. So that does
24 not -- decrease the value of the corporation or,
25 of course, the value of the shares to be

1 redeemed.

2 And I think just to pause on that for

3 a second, you know, Petitioner says what we're

4 really valuing here is some theoretical stake in

5 the corporation, not Michael's shares. That's

6 not correct as a matter of the statute. The

7 statute tells us in 26 U.S.C. 2031, 2033, and

8 2036 that the relevant shares to be valued here

9 are the decedent's shares. That's, of course,

10 what we're valuing. So that's not correct.

11 But, even if you were going to value

12 some hypothetical 77 percent stake in the

13 company, some 70 percent seven -- 77 percent

14 stake in the company with a redemption

15 obligation or anything like that, you would

16 always get $5.3 million because $5.3 million is

17 what that stake is equivalent to.

18 The only way you get Petitioner's

19 numbers is if you treat it as if there's a

20 separate $3 million debt that you first take out

21 of the company and then you try to value

22 Michael's shares. But that just doesn't make

23 sense because that $3 million runs to the holder

24 of Michael's shares. It is not some

25 free-floating debt out there in the universe.

1 JUSTICE BARRETT: But it would work if
2 -- Petitioner's would work if it was a
3 free-floating debt somewhere outside in the
4 universe?
5 MS. DUBIN: Yes. If it were a debt
6 owed to creditors just generally when you're
7 doing a very simplistic valuation of a
8 corporation, you would subtract the liabilities
9 owed to creditors before you determine what is
10 the equity value remaining.
11 But, here, we're looking at an equity
12 stake and money paid to an equity stake, and you
13 can't say that that reduces the value of that
14 equity stake or the value of the corporation as
15 a whole.
16 JUSTICE GORSUCH: Would your answer
17 differ if the life insurance proceeds had been
18 earmarked for the redemption of Michael's
19 shares?
20 MS. DUBIN: No. The parties' intent
21 doesn't govern here. I think both we and
22 Petitioner agree that the $3 million is actually
23 an asset to the corporation. It does count.
24 And we both agree on that. The only question is
25 whether it's offset by a debt, offset by a

1 liability, and for that -- and for that purpose,
2 I think it doesn't matter.
3 JUSTICE GORSUCH: Well, help -- help
4 me on that because I understand a hypothetical
5 purchaser of the company of -- as a whole would
6 say: Ah, that $3 million is going to inure to
7 my benefit because I'm just going to extinguish
8 the redemption obligation and off we go.
9 But, if somebody's purchasing
10 Michael's shares at the time of his death, why
11 -- why isn't it different then and -- and --
12 because we're assessing his estate value, and
13 there you have an obligation to pay him out and
14 the insurance proceeds coming in to do that.
15 MS. DUBIN: Absolutely. And the
16 answer is that for all of the illustrations that
17 we've suggested, whether it's a buyer of Crown
18 as a whole, whether it's a buyer of just
19 Michael's shares, you will always be able to
20 capture the value of the insurance proceeds.
21 JUSTICE GORSUCH: Okay. But you agree
22 the relevant measure is the buyer of Michael's
23 shares?
24 MS. DUBIN: Yes, although, as
25 Petitioner mentioned, we agree that it's a pro

1 rata share of Crown as a whole, so you will get
2 the same number whether you value a buyer of
3 Crown as a whole and then take Michael's pro
4 rata share of that or value just Michael's
5 shares. Either way, a buyer who just buys
6 Michael's shares is going to get a 77 percent
7 stake in a company with total assets of $6.86
8 million. So, if that redemption obligation now
9 runs to him, he will get cash in exchange for
10 the 77 percent obligation. If the redemption
11 obligation is for some reason not honored or
12 whatever it is, then he has a 77 percent stake
13 in a company worth $6.86 million.
14 But what -- the problem with
15 Petitioner's case is that he tries to take $3
16 million out of that pot. But the problem is
17 that that $3 million goes to the holder of
18 Michael's shares.
19 JUSTICE KAVANAUGH: Feel free to tell
20 me this is the wrong question, but what's the
21 net worth of the company after the shares are
22 redeemed?
23 MS. DUBIN: On Petitioner's view, it's
24 $3.86 million, and you see this in the pie
25 charts that they have on their reply brief on

1 page 6.
2 JUSTICE KAVANAUGH: Well, how about on
3 your view?
4 MS. DUBIN: On our view, had the
5 redemption been done at fair market value, which
6 it was not, had the redemption been done at fair
7 market value, it would be 1.53 million.
8 But I think that that picks up on a
9 critical point, which is our -- our view, the
10 government's view, here about how the estate tax
11 works doesn't change how the parties had to
12 structure their transactions. They are free to
13 redeem shares at below fair market value for
14 whatever business or idiosyncratic reasons they
15 want to. But the estate tax looks at what was
16 the fair market value of those shares.
17 JUSTICE KAVANAUGH: So, after they get
18 the life insurance proceeds and redeem the
19 shares, the net worth of the company's dropped
20 dramatically in your estimation?
21 MS. DUBIN: Yes. And that's the
22 fundamental way when you're --
23 JUSTICE KAVANAUGH: Doesn't that
24 seem that -- just explain that to me.
25 MS. DUBIN: Sure, and I think this

1 goes a little bit to your questions earlier
2 about how a redemption is supposed to work.
3 A redemption is a -- essentially, it's
4 sort of like a spinoff, right? You're dividing
5 the corporate assets among existing
6 shareholders. One is getting cash in exchange
7 for their share, and one gets sole ownership of
8 a company worth less.
9 It is a problem for Petitioner that
10 notwithstanding that that's how a redemption is
11 supposed to work in his view, the corporation
12 maintains the same amount before and after. And
13 the reason that the problem comes from is
14 because he's saying the corporation is worth
15 $3.86 million before, but it's actually worth
16 6.86 million.
17 JUSTICE KAVANAUGH: I think it's odd
18 that you have a net worth of the company --
19 what's the net worth of the company in your view
20 -- the day before he dies?
21 MS. DUBIN: So just -- I don't -- I
22 don't mean to pause, but the trickiness of it is
23 trying to value the life insurance policies the
24 day before he dies. There's a cash surrender
25 value of the life insurance policies, which is

1 approximately $500,000 the day before Michael
2 dies. So that's a little bit tricky.
3 But putting aside any interest in the
4 life insurance policies whatsoever, it's around
5 $3 million.
6 JUSTICE KAVANAUGH: Okay. And then,
7 after he dies, even though they've bought the
8 life insurance for exactly this purpose, the net
9 worth of the company has dipped in half, right?
10 MS. DUBIN: So two --
11 JUSTICE KAVANAUGH: That seems a
12 little -- I mean, maybe you say they just messed
13 up, but that -- the whole purpose of the life
14 insurance policy was to make sure that didn't
15 happen, right?
16 MS. DUBIN: So two responses to that.
17 On the first point, if you're only looking at
18 Crown, it is correct that after the redemption,
19 Crown becomes a smaller company. That's how
20 redemptions work. But, if you're looking at the
21 total value that the Connelly family walked away
22 with, they are going to walk away with a total
23 of $6.86 million. Some of it was used to buy
24 out Crown -- buy out Michael, and some of it was
25 used to Crown.

1 To your point about what the parties
2 want --
3 JUSTICE KAVANAUGH: The whole family
4 mean -- and Thomas got out of this -- well, I
5 think, but I'm not sure why the company's net
6 worth should dip in half when the whole purpose
7 of getting the life insurance policy, I think, I
8 -- you've probably already answered this, but
9 the life insurance policy was meant to prevent
10 that, I thought.
11 MS. DUBIN: I think that -- my
12 understanding is that is what the parties
13 intended. Intent doesn't govern here.
14 JUSTICE KAVANAUGH: I -- I got it, but
15 it's weird to walk away the day after his death
16 with a company that's suddenly worth 50 percent
17 of what it had been worth the day before his
18 death, even though you bought a life insurance
19 policy to cover the redemption.
20 MS. DUBIN: Yeah. So two -- two
21 responses to that. One is it's really not
22 strange in the concept of what a redemption is.
23 That is what a redemption is supposed to do. A
24 redemption is supposed to give one shareholder
25 cash in exchange for their assets, and the other

1 one is supposed to maintain control of the
2 smaller company.
3 But, to your point about doesn't seem
4 like that's what the parties wanted to do here,
5 you're right, what the parties wanted to do here
6 was maintain Crown as a $3.86 million enterprise
7 and give Michael $3 million. That's what the
8 parties wanted. That means that there's $6.86
9 million of value in the estate tax because
10 Michael owned that $6.86 million of value. His
11 percentage stake of it says that was the fair
12 value -- market value of Michael's shares.
13 I think that sort of pulls up, you
14 know, Petitioner's points about -- continuity of
15 ownership. There are many ways in which to
16 arrange for continuity of ownership of a
17 closely-held corporation, but what you can't do
18 is have $6.86 million of corporate assets by
19 virtue of a life insurance proceed, take $3
20 million out and give it to one shareholder,
21 maintain the company at its $3.86 million size,
22 and then maintain for purposes of the estate tax
23 that the company wasn't worth $6.86 million.
24 JUSTICE GORSUCH: What do we --
25 CHIEF JUSTICE ROBERTS: Do you --

1 JUSTICE GORSUCH: I'm sorry, Chief.
2 CHIEF JUSTICE ROBERTS: Do you dispute
3 your friend's statements that this is been a
4 common way for family corporations to maintain
5 continuity of operations? And is -- if -- if
6 that's the case, how -- how long has the
7 government overlooked the fact that there was
8 this great pool of money out there waiting for
9 them to take?
10 MS. DUBIN: Sure. So our
11 understanding is not Petitioner's understanding.
12 This is what we know, and I'll -- I'll tell you
13 what we know, which is there have only been
14 these three reported cases that we know of. So
15 it's Blount and Cartwright from 1999 and 2005
16 and then this case. That's it. So, in terms of
17 the litigated cases, not very many.
18 We did ask at the cert stage the IRS
19 examiners who are charged with looking at estate
20 tax returns if they're seeing a lot of these in
21 the pipeline, and they are not. They couldn't
22 find any. So they didn't see any sort of
23 maneuvers like this in the fact patterns in what
24 they are looking at.
25 I understand that that's not, you

1 know, sort of a conclusive view of whether
2 people are doing it or not. My guess is that --
3 or my view is what should have been happening is
4 that tax advisors are looking at what you have
5 on the one hand is the Ninth and Eleventh
6 Circuit extremely thinly reasoned decisions on
7 this, and on the other hand, what you have is
8 the Tax Court's decision in Blount I, and the
9 Tax Court's decision in Blount I explains
10 extremely clearly that this doesn't make sense
11 because you are, you know, subtracting the value
12 of the very thing you're trying to price in
13 determining the value of that thing.
14 JUSTICE KAGAN: And so what do most --
15 CHIEF JUSTICE ROBERTS: So the -- I'm
16 sorry. I just was going to say, so the Ninth
17 and the Eleventh Circuits were on your friend's
18 side?
19 MS. DUBIN: That's right.
20 CHIEF JUSTICE ROBERTS: Which might
21 suggest that it is a common way of -- for family
22 corporations to maintain continuity of
23 operations.
24 MS. DUBIN: Right. So I would say is
25 my best guess is that if -- if -- if this is

1 happening often, it was probably happening in
2 the Ninth and Eleventh Circuits, which, of
3 course, this case doesn't arise from. This
4 comes from the Eighth Circuit. And that -- that
5 might be one way that advisors are saying they
6 can do it in those circuits.
7 Tax advisors tend to be risk averse.
8 I think they would be very well aware of the
9 fact that there are other ways to structure
10 this, like the cross-insurance agreement or held
11 by a trust or various ways in which the critical
12 piece is that the life insurance proceeds do not
13 go into the corporation, because the premise of
14 Blount and Cartwright, the court of appeals
15 decisions, is that somehow you can have money
16 come into a corporation and have it not count
17 when you're valuing shares in the corporation.
18 And there's no reasoning whatsoever to
19 explain why they think it's appropriate to treat
20 the redemption --
21 CHIEF JUSTICE ROBERTS: Well --
22 MS. DUBIN: -- obligation as a
23 liability.
24 CHIEF JUSTICE ROBERTS: Well, they
25 might think it's appropriate because the money

1 that comes in goes out fairly quickly.
2 MS. DUBIN: I agree that's definitely
3 the sort of initial appeal of what Petitioner is
4 saying and what the courts must have thought was
5 true in Blount and Cartwright. It's simply just
6 not correct, though, because the going out
7 matters. If it's going out to a creditor, it
8 reduces the corporation's net worth, and it
9 would reduce the shareholders' values. We
10 absolutely agree with that.
11 But, here, when it went out, it went
12 out to the holder of Michael's equity stake.
13 Michael has a stake, and we are cashing out his
14 shares. That's what's happening there. So it's
15 not something that reduces the value of the
16 shareholders' shares. It would not reduce the
17 value of Michael's shares, and it wouldn't
18 reduce Crown's net worth when we're looking at
19 it. It's not a debt owed to creditors. It is a
20 promise to exchange a shareholder's shares for
21 cash.
22 JUSTICE KAGAN: So, if the IRS doesn't
23 see many people doing this, what are they
24 seeing? What do families do instead?
25 MS. DUBIN: Our understanding is it is

1 much more common to do the cross-purchase
2 arrangement so you keep -- right. The two
3 brothers would cross-insure each other. The
4 life insurance proceeds would never come into
5 the corporation. And so you have a situation
6 where, if Thomas wanted to, he could buy Michael
7 out, and that would be a much simpler way of
8 accomplishing that, and you wouldn't have this
9 problem that we're dealing with here where you
10 have corporate assets that Petitioner has to
11 argue shouldn't be counted as corporate assets.
12 CHIEF JUSTICE ROBERTS: And the reason
13 that's not as attractive is because, in this
14 situation, it's the corporation that is paying
15 the premiums or --
16 MS. DUBIN: They're a different --
17 they're not economically exactly the same
18 transactions, of course. It's not us saying
19 that this is, you know, sort of just a
20 form-over-substance distinction. That's not
21 what's happening here. They're different.
22 In the situation that happened here,
23 you had Crown paying the premiums, Crown had the
24 benefits and burdens of ownership, and that's
25 why, in the end, when Crown then gets the

1 proceeds, it's treated as a corporate asset.
2 In the cross-insurance arrangement, it
3 would be the brothers personally responsible for
4 maintaining those life insurance policies. And,
5 no, there would not be the same confidence from
6 one brother to another that you will maintain
7 those policies.
8 So these -- these different tactics do
9 have different economic consequences, but those
10 are the choices taxpayers can make as they're
11 navigating how can we minimize the estate tax
12 consequences of a large estate.
13 JUSTICE KAVANAUGH: Your position
14 doesn't depend on this, but I think it's little
15 rough to tell a tax advisor, oh, figure out
16 whether the Ninth and Eleventh Circuit opinions
17 are thinly reasoned and don't follow them when
18 they're --
19 MS. DUBIN: So I don't -- I don't mean
20 to disparage those decisions in any way, but I
21 think that if Your Honor would look at them, I
22 don't think you would need to be a tax
23 specialist to think that they are not a fulsome
24 analysis of this issue. There's a few
25 sentences, and they don't engage at all with the

1 arguments that --

2 JUSTICE KAVANAUGH: Right, but the --

3 MS. DUBIN: -- the IRS had been

4 making.

5 JUSTICE KAVANAUGH: Right. That's

6 fair. But, normally, you'd rely on the bottom

7 line, I think, if you were in that business of

8 two -- two courts of appeals, but --

9 MS. DUBIN: Well, just to clarify that

10 --

11 JUSTICE SOTOMAYOR: But you have a

12 whole bunch of academics who for years have been

13 writing about this.

14 MS. DUBIN: There are many academics

15 writing about it, including one of the amicus

16 here, Professor Chodorow. There's also many,

17 many other articles that have come out since

18 those cases explaining why they're wrong,

19 including those by Delaney, Burke, and

20 Bogdanski, and other professors.

21 But I think just to go to sort of the

22 heart of your question, the Tax Court, you know,

23 is -- is free -- it doesn't have to follow the

24 Ninth and Eleventh Circuit decisions. So, if

25 you are coming up in a circuit that is not the

1 Ninth or Eleventh, there is no reason for you to
2 think that those Ninth and Eleventh Circuit
3 precedents are governing. And I do expect that
4 tax advisors would know that.
5 JUSTICE KAVANAUGH: Mm-hmm.
6 JUSTICE KAGAN: But if I could just
7 sort of put this in most simple -- you know,
8 it's a little bit hard for me to get this
9 through my head, but your basic pitch is this is
10 not any old liability. This is a redemption
11 obligation. A redemption obligation is supposed
12 to split the pie, so you come away with a
13 smaller pie. That's because that's what
14 redemption obligations do.
15 MS. DUBIN: Yes, that's correct.
16 That's our basic pitch about a redemption
17 obligation. I would just add that the other
18 part of our pitch is that the hole in their case
19 is that they are trying to value Michael's
20 shares after Crown already redeemed them.
21 You can't do that. The price paid out
22 for Michael's shares is value that goes to
23 Michael's shares. If you subtract that as a $3
24 million liability before trying to value
25 Michael's shares, you will never get the correct

1 answer.
2 CHIEF JUSTICE ROBERTS: Thank you,
3 counsel.
4 Anyone, anything further? Anything
5 further? No?
6 Thank you.
7 Rebuttal, Mr. Shanmugam.
8 REBUTTAL ARGUMENT OF KANNON K. SHANMUGAM
9 ON BEHALF OF THE PETITIONER
10 MR. SHANMUGAM: So the gist of the
11 government's position is that it is not any old
12 obligation. But that's the fundamental problem
13 with the government's position.
14 You see, the government doesn't
15 dispute the fact that it is a liability in
16 common sense or accounting terms. They say:
17 Well, it's a liability that runs to an equity
18 holder. It's a liability that runs to the
19 Michael -- to Michael. But the problem here is
20 that we're analyzing this from the perspective
21 of a hypothetical buyer, not Michael.
22 And from the perspective of a
23 hypothetical buyer, this is, therefore, like any
24 other debt. The fact that the debt runs to one
25 of the other shareholders rather than to the

1 bank that holds the mortgage is of no moment.
2 It is a liability that does not inure to the
3 benefit of the hypothetical buyer.
4 And so, when valuing the company and
5 determining its net worth, you have to look at
6 it from the perspective of somebody who is
7 examining the entirety of the company and try to
8 figure out what he or she would -- pay for that
9 share.
10 And while it is true that we're trying
11 to value Michael's shares, we're not trying to
12 value Michael's actual shares because, after
13 all, those are the precise shares that are
14 subject to the $3 million redemption obligation
15 and are going to be extinguished. That's why
16 you have to make the move to a hypothetical
17 block of shares in the same proportion.
18 Now let's drill down a little bit
19 about the basic flaw in the government's
20 position. I think this flaw was illustrated in
21 the colloquy between my friend, Ms. Dubin, and
22 Justice Kavanaugh, and that is because the
23 government's position is not just that Michael's
24 shares are worth $5.13 million. It's that after
25 the redemption, the remaining shares, Thomas's

1 shares, would be worth $1.53 million.
2 What does that tell you? It tells you
3 that in order to engage in a redemption at fair
4 market value, the company would have to do
5 something that it would never do. This is a
6 $3.86 million company that would have to use
7 some of that corporate value and some of its
8 operating assets in order to redeem the shares
9 and thereby diminish the remainder of the
10 company and be left with a stub of a company.
11 And particularly for a company like
12 Crown in an industry like the construction
13 industry, where most of the assets are literally
14 bricks and mortar inventory, that is something
15 that is completely counterfactual and would
16 never take place in the real world.
17 And, parenthetically, to the extent
18 that the government comes back to the fact that
19 supposedly under our approach the two sets of
20 shares would add up to $6.86 million because
21 Thomas's shares would be valued at $3.86
22 million, the problem with that is that $3.86
23 million is the post-redemption value of Thomas's
24 shares.
25 Under our approach, as the pie charts

1 in our reply brief bear out, if you are valuing
2 Thomas's shares, those shares would be worth
3 only $880,000 at the time of Michael's death
4 precisely because what you're trying to do is to
5 value the entire company from the perspective of
6 a hypothetical buyer.
7 Now, to the extent that the government
8 says, well, you're getting a benefit here,
9 you're getting a $3 million redemption of shares
10 and Thomas is walking away with the same company
11 that existed beforehand, that is a feature of
12 the fact that the company is getting, through
13 awards of the life insurance, it is getting $3
14 million and that $3 million is being put to use.
15 But that is being accounted for by the
16 operation of the tax system and, in particular,
17 the operation of the capital gains tax. And to
18 the extent that Ms. Dubin today in response to
19 Justice Sotomayor said: Well, you may not get
20 that money right away, you only get it upon
21 realization, you only get the difference between
22 the value at the time of realization and the
23 value at the time that Thomas acquired the
24 shares, all of those are features of the capital
25 gains system.

1 In terms of whether or not this is a
2 common practice, that's obviously a hard thing
3 to quantify. I would respectfully submit that
4 the number of client alerts and -- and the
5 amount of froth in the industry in response to
6 the Court's grant of cert suggests that this is
7 a pretty common practice.
8 But, if we look at the reported cases,
9 I think the two critical facts are, first, that
10 the government, in fact, took the contrary
11 position in Estate of Cartwright, a case where
12 the contrary position benefitted the government
13 because we were dealing with income tax rather
14 than the estate tax; second, that the government
15 never indicated its non-acquiescence in those
16 decisions as the IRS sometimes does when it
17 disagrees with them; and, third, that I think
18 it's a little bit unfair to disparage the Ninth
19 and the Eleventh Circuits here because it isn't
20 as if the Eighth Circuit offered more extended
21 reasoning.
22 The sum total of the Eighth Circuit's
23 reasoning was that if you posited a buyer of the
24 entirety of the company, that buyer could
25 capture the value of the life insurance

1 proceeds. And, ultimately, that analysis is
2 fundamentally flawed.
3 And none of the alternative ways of
4 attempting to achieve the same result that the
5 government posits, in fact, are successful. I
6 think Ms. Dubin actually herself illustrated the
7 flaws with individuals cross-purchasing
8 insurance in order to conduct this arrangement
9 off the corporate books. Individuals could, of
10 course, charge their minds. There would be the
11 lack of certainty. But, fundamentally, the
12 corporation would not be paying the premiums,
13 and the corporation is the one who benefits from
14 continuity of ownership.
15 Thank you.
16 CHIEF JUSTICE ROBERTS: Thank you,
17 counsel -- counsel.
18 The case is submitted.
19 (Whereupon, at 12:35 p.m., the case
20 was submitted.)
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