No. 07-1509

In the Supreme Court of the United States

TINCY ANTHONY, ADMINISTRATRIX OF THE SUCCESSION OF JAMES LOUIS BANKSTON, SR., PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether, for purposes of calculating the applicable estate tax, the right of the estate to receive periodic payments from private annuities was properly valued under the tables prescribed by 26 U.S.C. 7520(a), even though the estate's right to receive the payments is non-transferable.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A21) is reported at 520 F.3d 374.[1] The opinion of the district court (Pet. App. B1-B39) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 4, 2008. The petition for a writ of certiorari was

[1] On April 10, 2008, the court of appeals granted the government's motion to amend the opinion, but an amended opinion has not yet been issued. The amendment makes the italicized change to the following sentence (see Pet. App. A20): "The district court held that use of the annuity tables did not create an 'unrealistic or unreasonable' result even though the table valuation was substantially *more* [~~less~~] than the Estate's purported free market valuation."

filed on May 29, 2008. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case concerns the proper method for valuing, for federal estate tax purposes, a non-transferable right to receive periodic annuity payments under a structured settlement agreement. The Internal Revenue Code imposes a tax on the "taxable estate of every decedent who is a citizen or resident of the United States." 26 U.S.C. 2001(a). The taxable estate is the value of the gross estate minus any applicable deductions. 26 U.S.C. 2051. The value of the gross estate includes "the value at the time of [the decedent's] death of all property, real or personal, tangible or intangible, wherever situated." 26 U.S.C. 2031(a); see 26 U.S.C. 2033, 2039 (specifically including annuities).

Annuities generally are to be valued in accordance with the tables prescribed by the Secretary of Treasury. 26 U.S.C. 7520(a) ("For purposes of this title, the value of any annuity * * * shall be determined * * * under tables prescribed by the Secretary."). Under Section 7520's methodology, the fair market value of an annuity is its "present value," determined by using the interest rate set forth in Section 7520(a)(2) and the applicable mortality component provided by actuarial tables set forth in the Treasury regulations. See 26 C.F.R. 20.7520-1(a)(1), (b), (c).

Section 7520 applies with limited statutory exceptions not relevant here and with additional exceptions that are "specified in regulations." 26 U.S.C. 7520(b). For estates of decedents who died on or before December 13, 1995, however, exceptions to use of the valuation tables also developed through case law and administra-

tive rulings. See, *e.g.*, *O'Reilly* v. *Commissioner*, 973 F.2d 1403, 1407 (8th Cir. 1992). Under that judge-made law, departures from the tables were ordered in certain instances where the table valuation produced a "substantially unrealistic and unreasonable" result. *Id.* at 1408. For the most part, courts ordered such departures only when the actual facts were inconsistent with the interest rate or mortality assumptions underlying the tables, *e.g.*, when the source of the payments could be depleted or when the individual holding the term interest was terminally ill. See, *e.g.*, *Cook* v. *Commissioner*, 349 F.3d 850, 855 (5th Cir. 2003) (collecting cases). The Second and Ninth Circuits, however, held that departure from the tables also was warranted when an annuity was subject to restrictions on transferability. See *Estate of Gribauskas* v. *Commissioner*, 342 F.3d 85, 87-89 (2d Cir. 2003); *Shackleford* v. *United States*, 262 F.3d 1028, 1031-1033 (9th Cir. 2001).

For estates of decedents who died after December 13, 1995, which is the case here, exceptions are recognized in 26 C.F.R. 20.7520-3(b). See 26 C.F.R. 20.7520-3(c). The regulation states that the Section 7520 valuation tables may not be used to value a "restricted beneficial interest," which is defined as "an annuity, income, remainder, or reversionary interest that is subject to any contingency, power, or other restriction, whether the restriction is provided for by the terms of the trust, will, or other governing instrument or is caused by other circumstances." 26 C.F.R. 20.7520-3(b)(1)(ii). The regulation further explains that the Section 7520 valuation tables should not be used where an annuity is expected to exhaust the fund before the end of its term; where the effect of the governing instrument is to deprive the beneficiary of beneficial enjoyment of the property; where

the trust corpus may be invaded without the beneficiary's consent; or where an individual who is a measuring life is terminally ill. See 26 C.F.R. 20.7520-3(b)(2)(i), (ii) & (3). The regulation states that if "the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of any annuity, * * * the actual fair market value (determined without regard to section 7520) is based on all of the facts and circumstances." 26 C.F.R. 20.7520-3(b)(1)(iii). The regulation does not contain any explicit exception for an annuity subject to a restriction on transferability.

2. The decedent, James Bankston, Sr. (Bankston), was severely injured in an automobile accident in 1990. The settlement of an ensuing lawsuit resulted in the funding of three annuities, with Bankston as the beneficiary. Under one of the annuities, Bankston would receive 15 annual guaranteed lump sum payments, ranging from $25,000 in 1992 to $150,000 in 2006. Under another annuity, Bankston would receive monthly payments, guaranteed for 15 years and for life thereafter, beginning with $9350 in July 1991 and increasing three percent annually. Under the third annuity, Bankston similarly would receive monthly payments, guaranteed for 15 years and for life thereafter, beginning with $7000 in July 1991 and increasing three percent annually. The payments under all three annuities were non-transferable. Pet. App. A2.

Bankston died on July 30, 1996. At the time of his death, Bankston stood to receive 10 more years of periodic payments (annual or monthly) from each annuity. On Bankston's death, those payments became payable to his estate (the succession). Pet. App. A2-A3.

In April 1997, petitioner (the administratrix) filed a federal estate-tax return, which included the value (as of

the date of his death) of Bankston's right to the annuity payments. Petitioner reported the present value of those payments, calculated based on the Section 7520 tables, to be $2,371,409. Petitioner eventually paid a tax bill totaling $610,683. Pet. App. A3 & n.2.

In September 2001, petitioner filed a refund claim with the IRS, alleging that the estate had overvalued the annuities and, as a result, had overpaid its estate tax by $427,620. Petitioner alleged that, due to the transferability restrictions on the annuity payments, the Section 7520 tables did not produce a result that reasonably approximated fair market value. The IRS denied the claim, stating that it "does not recognize any discounts or departures from the values prescribed by the Section 7520 tables based upon an alleged lack of marketability." Pet. App. A3, B5.

3. Petitioner filed suit in district court seeking a refund. The parties filed cross-motions for partial summary judgment regarding the proper method for valuing the annuities. Petitioner contended that the right to the annuity payments was a "restricted beneficial interest" within the meaning of 26 C.F.R. 20.7520-3(b) and was therefore excepted from the tables. The government responded that the regulation refers only to restrictions affecting the enjoyment of the trust corpus and future income stream. Pet. App. A4.

The district court ruled in favor of the government. Pet. App. B1-B39. It rejected petitioner's argument that the right to non-transferable annuity payments is a restricted beneficial interest, reasoning that the "language used in the regulation refers only to those limitations that would divest Mr. Bankston's estate of all of the periodic payments due under the Agreement, as of July 30, 1996, and not to limitations on the ability of

Bankston and his heirs to market their right to periodic payments." *Id.* at B30-B31. The district court further noted that, although the Fifth Circuit's decision in *Cook* did not involve the regulatory exception (because the decedent in that case had died before the regulation's effective date), the *Cook* court had held that the Section 7520 tables assume a lack of marketability and thus such a restriction does not justify departure from the tables. *Id.* at B34-B38.

4. The court of appeals affirmed. Pet. App. A1-A21.

The court first reviewed, and reaffirmed, its decision in *Cook*. Pet. App. A7-A10. It explained that, in *Cook,* it had "refused to depart from the 'longstanding trend' of requiring valuation under the tables unless a case involved facts that disproved assumptions underlying those tables." *Id.* at A10. The opinion in *Cook*, it noted, disagreed with the Second and Ninth Circuits' recognition of a "non-marketability exception to the annuity tables," stating that although "the right to alienate is necessary to value a capital asset," it is "unreasonable to apply a non-marketability discount when the asset to be valued is the right, independent of market forces, to receive a certain amount of money annually for a certain term." *Ibid.* The court of appeals characterized *Cook* as "[the Fifth] Circuit's definitive interpretation of the law governing departure from the annuity tables" in the case of estates not subject to 26 C.F.R. 20.7520-3(b). Pet. App. A9.

The court of appeals next queried whether it should "re-evaluate the issue discussed in *Cook* in light of the later regulation," and ultimately held that "the post-December 1995 regulation [is not] a basis on which to reject the *Cook* conclusion about non-marketability and the tables." Pet. App. A11, A16-A17. It reviewed the lan-

guage, structure, and context of the regulation (*id.* at A11-A14), and concluded that a "reading of the entirety of Section 20.7520-3(b) discloses an emphasis on the fundamental assumptions—the interest rate and mortality components—when determining whether departure from the tables is warranted" (*id.* at A13). The court also examined the Treasury Decision accompanying the regulation's issuance, and observed that it "makes no mention of marketability or transferability restrictions and provides no examples that would invoke such restrictions." *Id.* at A15. The court of appeals concluded that "[b]y promulgating Section 20.7520-3(b), the Treasury Department formalized existing case-law exceptions that applied to valuation under the annuity tables—exceptions that were only applicable in cases that presented 'facts that disproved the assumptions underlying the tables.'" *Id.* at A16 (quoting *Cook*, 349 F.3d at 856). It thus held that Bankston's right to receive periodic payments was not a "restricted beneficial interest" within the meaning of 26 C.F.R. 20.7520-3(b)(1)(ii) and therefore was not excepted from valuation under the tables. Pet. App. A19. The court also held that, under the pre-regulation analysis in *Cook*, application of the tables to the annuity payments at issue would not produce a result so "unreasonable and unrealistic" as to warrant a departure. *Id.* at A19-A21.

ARGUMENT

Petitioner seeks review (Pet. 3-6) of the decision below that non-transferable annuity payments are not exempt from valuation under the Section 7520 tables. The court of appeals correctly applied 26 C.F.R. 20.7520-3(b) and concluded that no exception to use of the tables was warranted. No other court of appeals has applied

the regulation to circumstances like this one. Petitioner correctly identifies a circuit conflict with respect to the proper valuation of non-transferable annuities bequeathed by a decedent who died on or before December 13, 1995 (the effective date of the regulation). The circuit conflict is of no substantial continuing importance, however, because that preexisting body of law has been effectively superseded by the regulation itself. Further review therefore is not warranted.

1. Petitioner is correct that a prior Fifth Circuit decision conflicted with decisions from the Second and Ninth Circuits on whether non-transferable annuity payments (all arising out of lottery prizes) must be valued under the Section 7520 tables, or whether the tables produced results so "unrealistic and unreasonable" that departure was warranted. Compare *Cook* v. *Commissioner*, 349 F.3d 850, 854-857 (5th Cir. 2003) (no exception), with *Estate of Gribauskas* v. *Commissioner*, 342 F.3d 85, 87-89 (2d Cir. 2003) (exception applies), and *Shackleford* v. *United States*, 262 F.3d 1028, 1031-1033 (9th Cir. 2001) (same). All three of those cases, however, involved decedents who died before December 13, 1995 (the effective date of 26 C.F.R. 20.7520-3(b)). The courts in those cases therefore had no occasion to construe the regulation that governs the valuation issue in the present case, but rather relied solely on the judicially-crafted exception from Section 7520 when the resulting valuation was "substantially unrealistic and unreasonable." *Cook*, 349 F.3d at 858. By contrast, in this case, the decedent died after December 13, 1995, thereby making 26 C.F.R. 20.7520-3(b) directly relevant to the valuation question presented here.

The court of appeals correctly concluded that the regulatory exception does not apply, because the non-

transferability of annuity payments does not affect either the mortality or interest rate assumptions underlying the tables. In 1994, the Treasury Department issued a notice of proposed rulemaking, stating that amendments to the regulations under Section 7520 "are necessary in order to provide guidance consistent with court decisions that call for deviation from the use of standard valuation tables in valuing [annuities]." 59 Fed. Reg. 30,180. The preamble to the final regulations states that "these regulations generally adopt principles established in case law and published IRS positions," citing cases involving an underproductive income interest, a terminally-ill measuring life, and an exhausting corpus. See 60 Fed. Reg. 63,914 (1995). And the regulation itself provides exceptions to use of the tables only where "the interest rate and mortality components prescribed under section 7520 are not applicable in determining the value of [the] annuity." 26 C.F.R. 20.7520-3(b)(1)(iii). As the court of appeals correctly observed, "[b]y promulgating Section 20.7520-3(b), the Treasury Department formalized existing case-law exceptions that applied to valuation under the annuity tables—exceptions that were only applicable in cases that presented 'facts that disproved assumptions underlying the tables.'" Pet. App. A16 (quoting *Cook*, 349 F.3d at 856); see *Gribauskas* v. *Commissioner*, 116 T.C. 142, 165 (2001) ("the intent of [Section 20.7520-3(b)] was to formalize the existing case law regarding the validity of the tabular assumption in situations where facts show a clear risk that the payee will not receive the anticipated return").[2]

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[2] The Second Circuit's reversal in *Gribauskas* was based solely on its expansion of the "unrealistic and unreasonable" standard. See 342 F.3d

In particular, the court of appeals correctly held (Pet. App. A19) that the annuities at issue in this case are not "restricted beneficial interests" within the meaning of 26 C.F.R. 20.7520-3(b)(1)(ii). Section 20.7520-3(b)(1)(ii) defines that term to mean an annuity that is "subject to any contingency, power, or other restriction." As the court of appeals recognized, "a restriction within the meaning of the regulation is one which jeopardizes receipt of the payment stream, not one which merely impacts on the ability of the payee to dispose of his or her rights thereto." Pet. App. A19 (quoting *Gribauskas*, 116 T.C. at 165). Here, the bar to transfer of the annuities creates no meaningful doubt that the estate will ultimately be paid the full amounts owed under their terms. In any event, because no other court of appeals has addressed the application of Section 20.7520-3(b)(1)(ii) to a non-transferable annuity, review by this Court would be premature.

2. The preexisting conflict, which did not implicate Section 20.7520-3(b) because the decedents in the relevant cases died before the regulation's effective date, is of no substantial continuing importance. Where it applies, the regulation is the sole source of exceptions from use of the tables. See 26 U.S.C. 7520(b) ("This section shall not apply * * * [when] specified in regulations."); 26 C.F.R. 20.7520-1(a)(1) ("Except as otherwise provided in this section and in § 20.7520-3 (relating to exceptions to the use of prescribed tables under certain circumstances), * * * the fair market value of annuities * * * is their present value determined under this section."). Indeed, petitioner's primary argument below

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at 88. It did not interpret Section 20.7520-3(b) and did not criticize the Tax Court's interpretation of that regulation.

was that *Cook* no longer applied in light of the regulation, and that departure from the tables was warranted here under the "restricted beneficial interest" exception of Section 20.7520-3(b)(1)(ii). Pet. C.A. Br. 7, 12-17; see pp. 9-10, *supra*.

Contrary to petitioner's contention that "the valuation of receivable rights for federal estate tax purposes * * * will be inconsistent, varying depending on geography and which circuit of the Court Of Appeals has jurisdiction" (Pet. 6), the regulation should lead to uniformity of result in future cases. The government is not aware of any pending cases involving estates of decedents dying before December 13, 1995. There is consequently no need to resolve the conflict—predating application of Section 20.7520-3(b)—that faced such estates.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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