No. 07-1582

In the Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF FRAZIER JELKE, III, DECEASED, ET AL.

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

REPLY BRIEF FOR THE PETITIONER

GREGORY G. GARRE
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

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The court of appeals incorrectly held that it could decide *de novo*, as a matter of law, the appropriate method for valuing property for estate tax purposes. The court then compounded that error by mandating that a closely-held company must be valued based on the "arbitrary assumption" (Pet. App. 3a) that it is liquidated on the valuation date, even if the facts conclusively establish otherwise. The court's decision conflicts with *CSX Transportation, Inc.* v. *Georgia State Board of Equalization*, 128 S. Ct. 467 (2007), which held that determination of the fair market value of property, including selection of the appropriate valuation method, is generally a question of fact. The decision below also conflicts with governing Treasury regulations, which establish that selection of the valuation method for estate tax purposes, in particular, is a fact-based inquiry that must take into account "[a]ll relevant facts." 26 C.F.R. 20.2031-1(b). And the decision below conflicts

with decisions of other circuit courts holding that choice of valuation method in tax cases is a question of fact.

Despite respondent's efforts, it cannot make those conflicts disappear. And respondent does not even try to refute petitioner's demonstration (Pet. 22-24) that the questions presented are important. Accordingly, this Court should vacate the decision below and remand for reconsideration in light of *CSX*. Alternatively, the Court should grant plenary review.

1. Respondent argues (Opp. 8-13) that the decision below cannot conflict with *CSX* because *CSX* merely interpreted the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), 45 U.S.C. 801 *et seq*. That argument ignores the reasoning of *CSX*, which cannot be reconciled with the decision below.

The issue in *CSX* was whether railroads challenging their property taxes as discriminatory in violation of the 4-R Act can challenge state property valuation methods. The Eleventh Circuit had held that they cannot because the 4-R Act restricts them to challenging factual determinations and selection of valuation methodology is a legal question, distinct from the ultimate factual question of value. *CSX Transp., Inc.* v. *Georgia State Bd. of Equalization*, 472 F.3d 1281, 1291 (2006). The State defended the Eleventh Circuit's decision in this Court based on the same purported "distinction between valuation methodologies and their application," and this Court rejected that distinction. 128 S. Ct. at 472. The Court held that the distinction "is untenable given the way market value is calculated." *Ibid*. "Valuation of property," the Court stated, "is at bottom just 'an issue of fact.'" *Id*. at 473 (citation omitted). And choice of valuation methodology is so intertwined with that factual determination that a district court could not make the de-

termination accurately if its "factfinding" were limited by the inability to choose the valuation method. *Id.* at 472-473. *CSX* thus rests on the determination that choice of valuation method is an integral part of valuing property and the unitary inquiry is a factual one. The decision below cannot be reconciled with that determination.

While acknowledging *CSX*'s holding that valuation of property is an issue of fact, respondent asserts that this case presents a different question—whether the "choice of *methodologies* to be used in deciding value" is "likewise an issue of fact." Opp. 11. Respondent further asserts that "*CSX* simply does not address that issue." *Ibid.* Respondent cannot, however, successfully distinguish *CSX* by relying on the very distinction between valuation and choice of valuation methodology that this Court held "untenable" in *CSX* itself.

Respondent also argues that *CSX* supports the decision below because *CSX* aims "to ensure searching review" of valuation methodologies. Opp. 12-13. But that is not what *CSX* aims to ensure. *CSX* aims to ensure that the trial court, as fact-finder, has the freedom to select valuation methods that it needs to make an accurate determination of value, "based on careful scrutiny of all the data available." 128 S. Ct. at 472. The decision below conflicts with that aim because it imposes, as a matter of law, a valuation method based on an "arbitrary assumption," and it requires the trial court to ignore relevant facts. Pet. App. 29a.

Respondent further errs in contending (Opp. 8-9, 12 & n.1) that *Powers* v. *Commissioner*, 312 U.S. 259 (1941), establishes that choice of valuation method is a question of law. Respondent relies on a single sentence in *Powers* without any analysis of its context. As the

petition explains (at 17-18), *Powers*, taken as a whole, holds only that the question whether a valuation method is consistent with the underlying statute is a legal one. When valuation methods *are* consistent with the underlying statute and regulations, however, the choice among them is a question of fact, and the court of appeals erred in holding otherwise.

Even if it were unclear whether *Powers* or *CSX* governed this case, that uncertainty would not be a reason to deny the petition. Instead, it would be a reason to grant the petition, vacate the decision below, and remand for further consideration of *CSX*, so that the court of appeals could carefully consider whether that case governs here.

Respondent argues (Opp. 13-14) that a remand would serve no purpose because the government called *CSX* to the court of appeals' attention in a petition for rehearing en banc. This Court, however, remands for reconsideration in light of intervening cases even when litigants have raised those cases in rehearing petitions in the courts of appeals. See, *e.g.*, *Keisler* v. *Hong Yen Gao*, 128 S. Ct. 345 (2007); *Johnson* v. *Potter*, 127 S. Ct. 3003 (2007); *Klinger* v. *Director, Dep't of Revenue*, 545 U.S. 1111 (2005). That practice reflects the reality that courts of appeals are likely to pay closer attention to an intervening decision in response to a remand order from this Court than in response to a rehearing petition filed by a losing litigant. The alternative practice that respondent proposes would create a perverse incentive for litigants to bypass the rehearing process and proceed immediately to this Court whenever they believe that an intervening development has undermined the reasoning of an appellate panel. This Court should reject respon-

dent's invitation to make this Court a first, rather than a last, resort.

2. a. If the Court chooses not to grant, vacate, and remand, it should grant plenary review, particularly in light of the conflict between the decision below and the decisions of other courts of appeals. Notwithstanding respondent's protestations (Opp. 15-20), the holding below that choice of valuation methodology is a question of law conflicts with decisions of at least three other circuits. See Pet. 19 (citing *Sammons* v. *Commissioner*, 838 F.2d 330 (9th Cir. 1988); *Gross* v. *Commissioner*, 272 F.3d 333 (6th Cir. 2001), cert. denied, 537 U.S. 827 (2002); and *Estate of Godley* v. *Commissioner*, 286 F.3d 210 (4th Cir. 2002)).

Although respondent asserts (Opp. 17-18) that *Sammons* held that choice of valuation methodology is an issue of law, *Sammons* actually held the opposite. After noting that the taxpayers argued that "the method of valuation used by the trial court is a question of law reviewed de novo," the Ninth Circuit stated "[w]e disagree." *Sammons*, 838 F.2d at 334. It then upheld the Tax Court's judgment because it was "not left with 'a definite and firm conviction' that the Tax Court made a mistake in finding that the [taxpayers'] cost was the best indicator of the value" of the property. *Ibid.* In reaching that conclusion, the Ninth Circuit stated, in direct conflict with the decision below, that the "Tax Court's selection of [the] * * * method of valuation [is a] question[] of fact reviewed for clear error." *Ibid.*

Contrary to respondent's contention (Opp. 19-20), the decision below also conflicts with *Gross*. In *Gross*, the Sixth Circuit held that "[t]he choice of the appropriate valuation methodology for a particular stock is, in itself, a question of fact." 272 F.3d at 343 (citation omitted).

Moreover, the Sixth Circuit applied clear-error review to the Tax Court's decision not to discount for possible future corporate income taxes. That decision is precisely analogous to the Tax Court's decision in this case about whether and how to discount for possible future capital gains taxes, a decision that the court below reviewed *de novo*. The fact that the opinions in *Gross* carefully analyzed whether the facts justified a discount (Opp. 19-20) only highlights the conflict with the decision below, which held that facts indicating that Commercial Chemical Co. (CCC) would not actually be liquidated on Jelke's death were "of no moment" because the Tax Court must proceed on "the arbitrary assumption that a liquidation takes place" on that date. Pet. App. 29a.

The decision below also conflicts with *Estate of Godley*. Respondent asserts (Opp. 18) that the question in that case—whether to apply a discount to reflect the decedent's "minority" interest—did not involve a choice of valuation methodology. The decision whether or how to apply a minority discount is, however, just as much a choice of valuation method as the decision whether or how to discount for possible capital gains tax. Both decisions likewise involve determinations of fact. As the Fourth Circuit explained, in terms that anticipated this Court's reasoning in *CSX*, "[t]he question whether a taxpayer is entitled to a discount is intertwined in the larger question of valuation and valuation determinations are clearly questions of fact." *Godley*, 286 F.3d at 214.

Respondent also contends (Opp. 20) that there is no conflict because the cases on which petitioner relies have arisen in various contexts—estate tax, gift tax, and income-tax charitable deductions. Contrary to that con-

tention, whether choice of valuation method is a question of law or fact does not vary depending on the tax involved. There are no relevant differences in the language of the applicable regulations, see 26 C.F.R. 1.170A-1(c), 20.2031-1(b), 25.2512-1, and "[d]ecisions and rulings on valuation issues are ordinarily used interchangeably, regardless of the type of tax" or "the context in which the dispute arises." Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 135.1.1, at 135-4 (2d ed. 1992). Respondent acknowledges as much when it asserts that "decisions of this Court and the courts of appeals" have "uniformly h[eld] that choice of valuation methodology *for purposes of calculating taxes* is a question of law." Opp. 8 (emphasis added). In support, respondent cites cases involving the same three contexts involved in the conflicting cases identified by petitioner—estate taxes (this case), income-tax charitable donations (*Krapf* v. *United States*, 977 F.2d 1454 (Fed. Cir. 1992)), and gift taxes (*Powers*, *supra*). Thus, even if resolution of the issue is context-specific, there is a conflict within each context.

b. Respondent also fails (Opp. 22) to refute petitioner's demonstration (Pet. 19-20) that the decision below is inconsistent with the reasoning of decisions from the Seventh and Tenth Circuits. In *Van Zelst* v. *Commissioner*, 100 F.3d 1259, 1261-1262 (1996), cert. denied, 522 U.S. 807 (1997), the Seventh Circuit applied the "clearly erroneous" standard in upholding the Tax Court's decision to rely on an appraisal using the comparable-sales method rather than one using the capitalization-of-income method. In *Estate of Holl* v. *Commissioner*, 54 F.3d 648, 650-651 (1995), the Tenth Circuit held that the clear-error standard applied to its review of the Tax Court's choice between two competing

valuation methods because such a decision "primarily involves a factual inquiry." And, in upholding a jury's valuation of stock in *Heyen* v. *United States*, 945 F.2d 359, 364 (1991), the Tenth Circuit held that the jury could properly choose to rely on book value rather than the government's proposed valuation method. The reasoning of all three decisions depends on the premise that choice of valuation method is a question of fact—a premise expressly rejected by the decision below.

Respondent is likewise unable (Opp. 16-17, 20-22) to reconcile the internally inconsistent precedents within the First, Eighth, and Federal Circuits. See Pet. 20-21. Respondent notes (Opp. 17 n.4) that *McMurray* v. *Commissioner*, 985 F.2d 36, 40-42 (1st Cir. 1993)—which, like *Van Zelst*, reviewed for clear error the Tax Court's decision to rely on an appraisal using the comparable-sales method rather than one using the capitalization-of-income method—"does not cite, much less purport to overrule" *Collins* v. *Commissioner*, 216 F.2d 519, 522 (1st Cir. 1954), which states that "the proper criterion" for valuing property "is a question of law." But petitioner has never contended that *McMurray* overruled *Collins*, just that the two cases are inconsistent. Respondent also asserts that the choice between valuation methodologies in *McMurray* was a "factual determination" (Opp. 17 n.4), but respondent does not explain why that choice was any more "factual" than other decisions about valuation methodology, including the decision in this case about how to calculate the capital gains tax discount.

Similarly, respondent contends that *Becker* v. *United States*, 968 F.2d 691 (8th Cir. 1992), does not "obscure" (Opp. 17 n.4) the holding of *Palmer* v. *Commissioner*, 523 F.2d 1308, 1310 (8th Cir. 1975), that choice of valua-

tion methodology is a question of law. But respondent does not explain how *Palmer*'s holding can be reconciled with *Becker*'s statement that a jury, acting as fact-finder, can choose among valuation methods. 968 F.2d at 694-695. Nor does respondent attempt to reconcile the Federal Circuit's conflicting statements in *Krapf*. Compare 977 F.2d at 1458 ("The criteria by which a court determines the value of a charitable donation is an issue of law.") with *id.* at 1463 (The trial court "has discretion in choosing a method of evaluation.").

3. Respondent also argues (Opp. 15, 22-23) that plenary review would be premature because the courts of appeals have not had the opportunity to consider the import of *CSX*. But respondent cannot have it both ways. If, as respondent asserts (Opp. 11 n.1), *CSX* "has no bearing" on the question whether choice of valuation methodology is an issue of law or fact, then *CSX* provides no reason to defer resolution of the conflict among the courts of appeals on that question.

Respondent further contends (Opp. 23-24) that this case is not an appropriate vehicle for addressing the question. According to respondent, even if the court of appeals resolved the issue incorrectly, its judgment is still supportable because the Tax Court committed clear error when it refused to assume that CCC's stock portfolio would appreciate significantly after Jelke's death. That argument is flawed on multiple levels.

First, when an issue resolved by a court of appeals warrants review, the existence of a potential alternative ground to defend the judgment is not a barrier to review—particularly where, as here, that ground was rejected by the trial court and was not addressed by the court of appeals. Second, it is far from clear that the Tax Court committed error by declining to assume that

CCC's portfolio would appreciate significantly. Contrary to respondent's contention (Opp. 23-24), the Tax Court's decision not to assume capital appreciation does not conflict with its conclusion that CCC offered an attractive return, because CCC's portfolio generated substantial cash dividends. Pet. App. 51a. Moreover, the portfolio had historically performed at just under the S&P 500 Index. *Id.* at 4a n.6. When Jelke died on March 4, 1999, that index stood at 1246.64. When the Tax Court issued its decision more than six years later, on May 31, 2005, the index had *declined* to 1191.50. Even today, it is only slightly above its level at Jelke's death. See *S&P 500 Index* (visited Sept. 2, 2008) <http://money.cnn.com/quote/quote.html?symb=SPX>. Finally, even if the Tax Court had erred as respondent contends, that error would not justify the judgment of the court of appeals. That court did not simply vacate the Tax Court's decision but remanded with instructions to recalculate the value of Jelke's interest in CCC "using a dollar-for-dollar reduction of the entire $51 million in built-in capital gains tax liability, under the assumption that CCC is liquidated on the date of death and all assets sold." Pet. App. 33a. That judgment can be sustained only if respondent prevails on the questions presented by the petition.

Respondent's final argument is that certiorari is not warranted because petitioner could resolve the questions presented by regulation. See Opp. 26-27. Petitioner could indeed issue a regulation prescribing a specific methodology for calculating a capital gains tax discount. The central question raised by the petition, however, is whether selection of valuation methodology is a question of fact, subject to appellate review by a court

for clear error, or a question of law, subject to *de novo* review.

Moreover, it would be extremely burdensome, if not impossible, for petitioner to prescribe regulations addressing every valuation issue that could arise in every tax case. For that reason, petitioner has chosen to rely primarily on general regulations that require valuation of property based on "[a]ll relevant facts." 26 C.F.R. 20.2031-1(b). As explained in the petition (at 14-16), the decision below conflicts with those regulations because it requires property to be valued based on an "arbitrary assumption" (Pet. App. 29a) rather than the actual facts. Respondent argues that the valuation method mandated by the court of appeals complies with the regulations because, according to respondent, facts indicating "the future rate at which built-in capital gains will be realized" are not "relevant." Opp. 27 n.7. On the contrary, those facts are obviously relevant to "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), as Judge Carnes explained in his dissent, Pet. App. 38a-41a. Moreover, if there were any doubt on that score, it would have to be resolved by deference to petitioner's interpretation. See *Auer* v. *Robbins*, 519 U.S. 452, 461 (1997).

* * * * *

For the foregoing reasons, and those stated in the petition for a writ of certiorari, the petition should be granted, the judgment of the court of appeals should be vacated, and the case should be remanded for further consideration in light of *CSX*. Alternatively, the petition should be granted and the case set for briefing and oral argument.

Respectfully submitted.

GREGORY G. GARRE
Acting Solicitor General

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