Advanced Sales

Buy-Sell Planning

The *Connelly* Decision: Summary and Impact

The Supreme Court released its much-anticipated decision in *Connelly v. United States* case on June 6, 2024. The Court ruled in favor of the IRS and held that in this case, a corporation's obligation to redeem a deceased shareholder under a stock redemption does not offset any includable corporate-owned life insurance proceeds when calculating the value of the corporation for estate tax purposes.

What was the case about?

Connelly involved two brothers who were the only shareholders of a closely held corporation. They established a wait-and-see buy-sell agreement funded with corporate-owned life insurance. When the majority shareholder died, the surviving brother did not exercise his purchase option so that the corporation was then obligated to redeem the decedent's shares, which the company did via the life insurance proceeds it received. When determining the company's value for federal estate tax purposes, all parties agreed that the valuation included the death benefit proceeds the company received. However, the estate argued that the corporation's obligation to redeem the shares offset the value of the life insurance when valuing the decedent's shares.

The Court disagreed by holding unanimously that **a corporation's contractual obligation to redeem shares is not necessarily a liability that reduces a corporation's value for purposes of the federal estate tax.** As a result, the death benefit that was included in the corporation's value in this case was not offset by the corporation's redemption obligation.

What does it mean for your clients?

The *Connelly* decision impacts C and S corporation shareholders who use corporate-owned life insurance to fund entity purchase and wait-and-see buy-sell agreements. It resolved a split in opinions among the Tax Court and some of the Courts of Appeal, and should be considered the law of the land.

Note that while the Court mentioned in a footnote that the holding was not that a redemption obligation can *never* decrease a corporation's value, the example it gave was where a corporation might have to liquidate assets to pay for the redemption. That is unlikely to be the case where the corporation owns life insurance, as the death benefit proceeds would be tapped to pay the redemption before any assets would be sold. As such, taxpayers should not read too much into this comment, and instead assume that corporate-owned life insurance cannot be offset by a redemption obligation when valuing the company in the insured's estate.

Alternative Structures to Consider

To avoid inflating the value of the corporation for estate tax purposes, buy-sell structures utilizing corporate-owned life insurance should be avoided. Alternatives include a cross-purchase buy-sell, a cross-purchase buy-sell with an Insurance LLC, and "cross-endorsement" buy-sell.

Contact your Crump sales representative to learn more about how properly designed and funded buy-sell arrangements can help protect your business clients.

Crump is here to help you tailor solutions designed to protect your clients' businesses and families. Contact us today!