



ALERT

IT IS TIME TO REVIEW YOUR BUSINESS SUCCESSION PLAN

In *Connelly v. United States* (602 U.S. ___2024), the United States Supreme Court (*Supreme Court*) addressed the issue of whether life-insurance proceeds used to redeem a decedent's shares in a corporation must be included when calculating the value of those shares for purposes of determining the decedent's federal estate tax.

Michael Connelly and Thomas Connelly, two brothers, were the sole shareholders of a closely held corporation (*Corporation*). Michael owned 77.18% of the shares and Thomas owned the remaining 22.82%. Michael and Thomas entered into an agreement to ensure that the Corporation would stay in the family if either brother died. This agreement provided the surviving brother with the option to purchase the deceased brother's shares. If the surviving brother declined to purchase the shares from the decedent's estate, then the Corporation would be required to redeem the shares. In order to ensure that the Corporation had sufficient cash to redeem the shares, the Corporation obtained a \$3.5 million life insurance policy on each brother.

Michael Connelly died in 2013. Thomas Connelly declined his option to purchase Michael's shares from Michael's estate, thereby forcing the Corporation to redeem Michael's shares. Michael's beneficiaries and the Corporation reached an agreement, valuing Michael's shares at \$3.0 million. Thomas, as Executor of Michael's estate, filed Michael's estate tax return reporting the value of Michael's shares as \$3.0 million, based on the agreement between Michael's beneficiaries and the Corporation. The Internal Revenue Service audited Michael's estate tax return. Thomas, as Executor, paid the estate tax deficiency (approx. \$890,000) and filed suit against the United States Treasury for a refund. The District Court granted summary judgment in favor of the federal government. The U.S. Court of Appeals for the Eighth Circuit affirmed. Certiorari was granted. In a unanimous opinion delivered by Justice Thomas, the Supreme Court affirmed the lower court's holding 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.

The Supreme Court explained that a share redemption at fair market value cannot reduce the



value of the shares because the redemption does not affect a shareholder's economic interest. To illustrate this point, the Supreme Court provides the following example:

Consider a corporation with one asset—\$10 million in cash—and two shareholders, A and B, who own 80 and 20 shares respectively. Each individual share is worth \$100,000 (\$10 million ÷ 100 shares). So, A's shares are worth \$8 million (80 shares × \$100,000) and B's shares are worth \$2 million (20 shares × \$100,000). To redeem B's shares at fair market value, the corporation would thus have to pay B \$2 million. After the redemption, A would be the sole shareholder in a corporation worth \$8 million and with 80 outstanding shares. A's shares would still be worth \$100,000 each (\$8 million ÷ 80 shares). Economically, the redemption would have no impact on either shareholder. The value of the shareholders' interests after the redemption—A's 80 shares and B's \$2 million in cash—would be equal to the value of their respective interests in the corporation before the redemption. *See, Connelly, Supra, 602 U.S. at _____* .

The Supreme Court further explained that the estate tax is calculated at the moment of Michael's death—before the redemption is effectuated. On Michael's death, the Corporation held a life insurance policy that required the proceeds to be paid to the Corporation. Accordingly, any prospective buyer would consider the life insurance policy to be an *asset* to the Corporation—not a *liability* reducing the value of the Corporation.

Following *Connelly*, financial advisors and attorneys should meet with clients in order to review current business succession plans. A buy-sell agreement funded with life insurance purchased by the company may no longer be the proper solution, depending on the value of the policy, the value of the company and the estate values of the owners. As the Supreme Court suggests, there are other planning options available to achieve succession planning goals. For example, the owners of the Corporation can purchase life insurance policies on each other instead of the Corporation purchasing the policies. This practice removes the policy from the Corporation's asset base, while providing the surviving owners with liquidity to purchase the decedent's shares. Another option may be establishing a separate entity, such as an LLC, to purchase and manage a life insurance policy for the sole purpose of executing a buy-sell agreement. Following the death of the first LLC Member, the life insurance proceeds would be paid out to all the Members. The LLC would then be terminated. The surviving LLC Members could use their proceeds to purchase the Corporation's shares from the deceased Member's estate, providing the surviving Members with a new basis in the Corporation shares.

Connelly is not the end of buy-sell agreements funded with life insurance. With the proper guidance, life insurance can still be an important tool used to facilitate a business succession plan. Please contact our office in order to discuss your business succession plan and its effectiveness following *Connelly*.

Author

[Brandon Lee Spivack](#)

T 925.944.9700

bspivack@brotherssmithlaw.com

BROTHERS SMITH LLP provides its clients, professional advisors and its friends with up-



to-date reports on recent developments in business, real estate, employment, estate planning and taxation.

[Learn More](#)

[Practice Areas](#)

[Professionals](#)

[Publications](#)

[About](#)

[Contact Us](#)

Stay Connected



[Email Us](#)

2033 North Main Street, Suite 720
Walnut Creek, California 94596
T 925.944.9700 F 925.944.9701

www.brothersmithlaw.com

CIRCULAR 230 DISCLOSURE – Pursuant to rules and regulations imposed by the Internal Revenue Service, any tax advice contained in this communication, including any attachments, is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another person any transaction or matter addressed herein.

The summary which appears above is reprinted for information purposes only. It is not intended to be and should not be considered legal advice nor substitute for obtaining legal advice from competent, independent, legal counsel. If you would like to discuss these matters in more detail, please feel free to contact us so that we can provide the clarification and resources you need to make effective decisions.

Brothers Smith LLP | 2033 N. Main Street, Suite 720 | Walnut Creek, CA 94596 US

[Unsubscribe](#) | [Update Profile](#) | [Constant Contact Data Notice](#)



Try email marketing for free today!