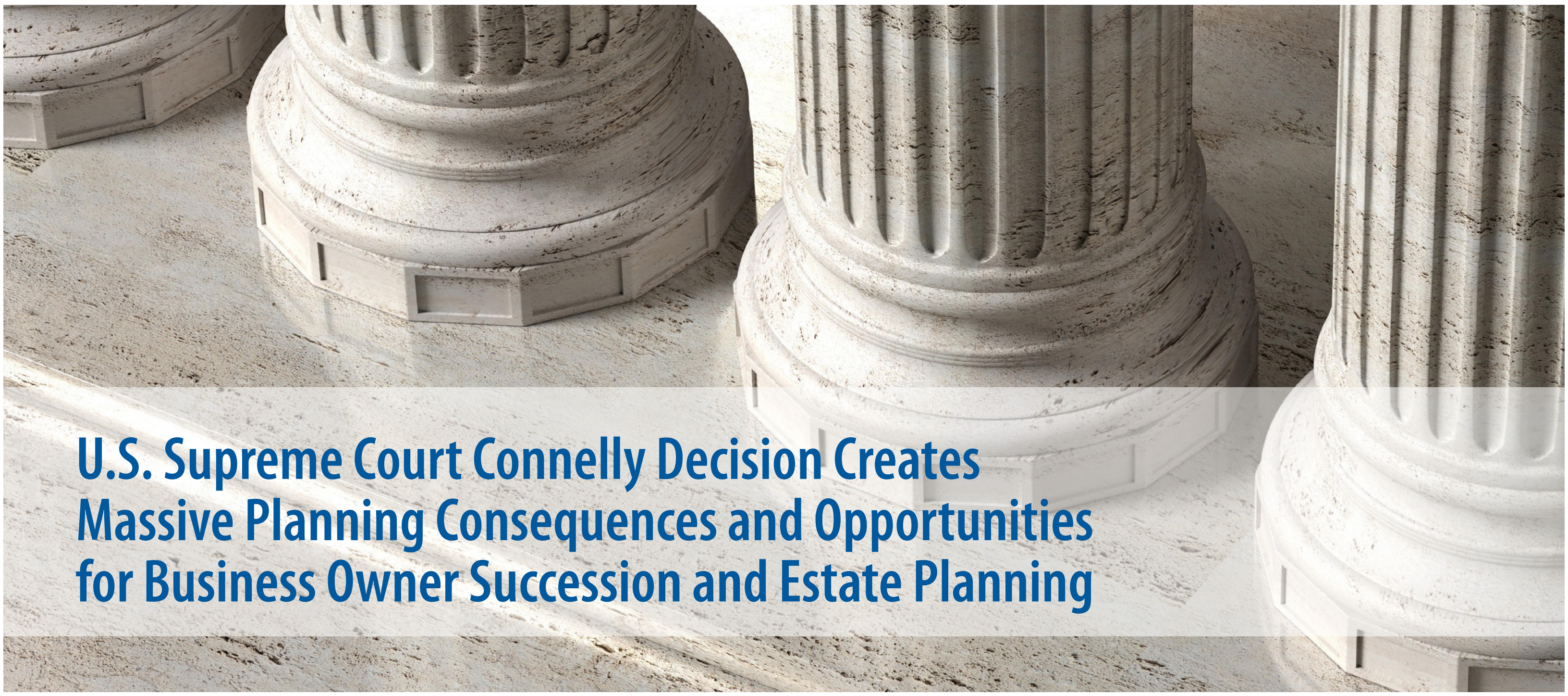

U.S. Supreme Court Connelly Decision Creates Massive Planning Consequences and Opportunities for Business Owner Succession and Estate Planning

For those of us in the business owner planning space, this was a MAJOR decision that can impact anyone who has done entity buy/sell planning and estate planning for business owners.

Please note that I am not an attorney or legal expert in the areas of business succession planning and agreement drafting. Consult with your advanced sales teams at your preferred insurance companies as well as your client's business legal counsel regarding making changes to existing buy/sell agreements.

What happened? A brief timeline of events:

The Connelly brothers, (Thomas and Michael) owned Crown C Supply in St. Louis, MO. In 2001, the brothers entered into an agreement to give the surviving brother the right to buy the deceased brother's shares of the business. If the surviving brother declined, the business entity (Crown C) would be required to regain those shares. This is a common "wait and see" buy/sell agreement.

The entity (Crown) bought $3.5 million in life insurance policies on each brother. The brothers were not 50/50 owners. When Michael passed in 2013, he owned 77% of the company stock while Thomas owned 23%.

Who was to inherit Michael's ownership? After negotiating with Thomas (23% owner) and Michael's son (next in line to inherit the 77% majority ownership, yet seemed to decline that opportunity), **Crown C Supply purchased Michael's shares for $3 million and used $500,000 for operating expenses.**

Now the estate tax planning comes into play. Thomas Connelly filed an estate tax return on behalf of Michael's estate, valuing Michael's ownership shares at $3 million. The IRS audited the estate and while they determined that Michael's shares were worth $2,982,000, they concluded that the additional $3 million in life insurance proceeds should have been included as a non-operating asset and therefore increased the value of Crown C's shares.

Thomas filed a lawsuit against the IRS on behalf of the estate in the Eastern District of Missouri. The District Court ruled in the IRS's favor and the US Court of Appeals for the Eighth Circuit affirmed the decision. The U.S. Supreme Court upheld the decision on June 6, 2024 unanimously (9-0).

What triggered it?

Crown C's "wait and see" buy/sell planning did not redistribute the life insurance proceeds or shares to a new majority shareholder, they retained the proceeds. When the entity had its valuation ($2,982,000) and retained the life insurance proceeds ($3 million), it grew the value of the business for estate planning valuation purposes.

Until this decision, the obligation to pay out the proceeds was considered a liability retained on the books that would 'net out' the value of the business for federal estate tax purposes. That is no longer the case.

According to Tools and Techniques of Life Insurance Planning, 9th Edition, it says: "*There should be no direct estate tax inclusion of the life insurance proceeds if the business (in the case of an entity redemption) is the owner and beneficiary of the policies. However, planners should check the terms of the buy/sell agreement to determine the degree to which policy proceeds are excluded from the price paid to the deceased owner's estate. This is a major decision in drafting a buy-sell plan: if the value of insurance proceeds received under an entity redemption plan is ignored, it can be argued that the surviving owners receive a windfall at the expense of the decedent owner's family.*"

As a result of this Supreme Court decision, a business entity can no longer be the beneficiary of life insurance proceeds for succession planning purposes.

What about our existing business owner clients with similar entity succession agreements? What should be done with existing life insurance where a corporation changes from a stock redemption to a cross-purchase agreement? What about NEW planning for new business owner clients?

Per The Tools and Techniques of Life Insurance Planning, 9th Edition: "*In the case of a corporation that switches to a cross purchase from a stock* *redemption, planners should consider leaving currently owned corporate insurance on a reduced paid-up basis (the cash values in the policies pay future premiums but the death benefit is reduced) and using that corporate coverage as key employee insurance. Parties to the agreement can then purchase new coverage without fear of violating the transfer for value rule." [emphasis added]*

Of course, the ability to purchase new coverage will be based on the new attained age and insurability. Repurposing existing coverage may be an option but be sure to check on the transfer for value rules and any tax consequences for doing so.

This was a judicial risk which can happen with various kinds of planning. You may need to consider changing the buy/sell design. Check with the insurance company's advanced sales department that the client already has their policies with and find out if the policies can be re-implemented with a new agreement.

This is another reason to reach out to the business owners in your community and to ask your current business owner clients who else needs to know about this decision and the ripple effects that will come from it if it isn't addressed. Since these are private agreements, everyone who is a business owner should know and determine if and how this decision affects their current planning (or lack of planning).

As far as I can tell, there is no 'waiting period', 'grace period', or 'effective date'. This is the decision, and the implications are immediate.

One insurance company I'm appointed with discussed opportunities for using an Insurance LLC with a cross-purchase design to simplify the purchase of life insurance on multiple owners.

Entity stock redemptions may still be an option for smaller businesses with no estate tax issue. However, this would need to be coordinated with the sunset of the Tax Cuts and Jobs Act Tax Policy that will be sunsetting on December 31, 2025. Before the TCJA, the estate tax exemption was $5.49 million for a married couple, which is much smaller than today's possible $27 million.

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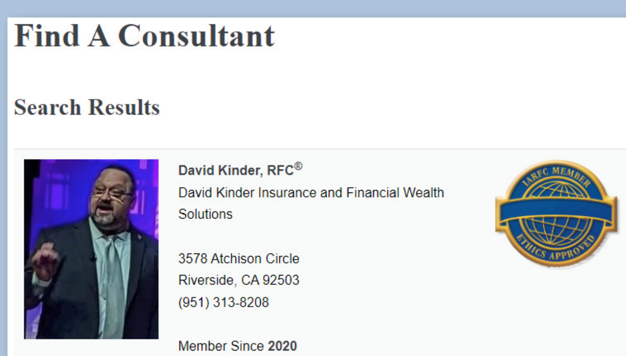

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