Financial, Legal & Tax Advisory

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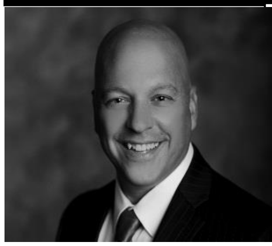
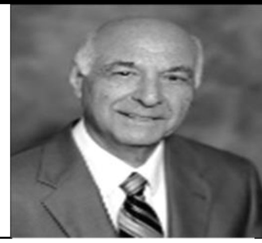


Roman A. Basi, President of The Center, is an Attorney, CPA, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning, and Real Estate.



Dr. Bart A. Basi, Senior Advisor of the Center for Financial, Legal & Tax Planning, Inc., is an expert on closely-held companies, an attorney, and CPA. He is a member of the American Bar Association's Tax Committees on Closely-Held Businesses and Business Planning.

Connelly vs. United States: Impact on Company-Owned Life Insurance Proceeds and Buy-Sell Agreements

On June 6, 2024, the Supreme Court released its much-anticipated decision in Connelly v. United States. The court sided with the IRS and held that life insurance proceeds a corporation received to fund a share redemption agreement increased the corporation's estate tax value, and the corporation's obligation to redeem the shares was not a liability that decreased the corporation's value. With the statement above being held, the value of a deceased shareholder's shares must reflect the corporation's fair value, including insurance proceeds meant to fund a redemption of shares.

The Connelly's, Michael, and Thomas, were two brothers who were sole shareholders in Crown. They established a buy-sell agreement funded by a company-owned life insurance policy. The buy-sell is intended to keep the corporation in the family. When either brother died, the surviving brother would have an option to purchase the deceased brother's shares. If that option was declined, Crown would be obligated to purchase the shares, which Thomas Connelly did when his brother died in 2013.

The corporation used the life insurance proceeds to redeem the shares per the buy-sell agreement. Michael's estate filed a federal tax return that listed the value of his estate at $3 million, the amount that Crown paid to redeem the shares. The IRS disagreed by saying that Crown's redemption obligation did not include the life insurance proceeds. This went on to set Crown's total value at $6.86 million based on the $3 million and a $3.86 valuation of Crown based on the redemption amount paid and Michael's ownership percentage (77%) in Crown. This made Michael's value in the crown $5.3 million, resulting in an additional estate tax liability of $889,914.

The Connelly decision impacts shareholders who use corporate-owned life insurance to fund equity purchase and buy-sell agreements. This ruling by the Supreme Court resolved a split that was between the Tax Court and some Courts of Appeals. Business owners are going to have to consider:

- Reviewing buy-sell agreements
- Make sure agreements are structured in the most tax-efficient manner
- Planning for Future Tax Obligations
- Have a strategy to cover potential tax liabilities arising from corporate obligations or share redemptions
- Cross-Purchase Agreements
- These agreements can avoid complications by ensuring insurance proceeds go directly to purchasing shares without inflating estate tax values
- Evaluating Life Insurance Policies
- Review your life insurance policies to make sure they are structured to avoid unexpected tax liabilities
- Seeking Professional Valuations
- Obtaining professional valuations enables compliance with current market values as well as tax regulations
- Consulting Legal and Tax Experts
- Obtain estate planning attorneys as well as tax advisors to review and update corporate structures and agreements to ensure they align with current regulations

At The Center for Financial, Legal & Tax Planning, Inc., (The Center) our M&A team is equipped with attorneys and CPAs to guarantee you are properly prepared for the exit of a business partner. If you need a buy/sell agreement prepared or would like your current buy/sell agreement reviewed, please feel free to reach out at our website, www.taxplanning.com, or by phone at (618) 997-3436.

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4501 W DEYOUNG ST., SUITE 200 | MARION, IL 62959

618-997-3436

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