CUMMINGS & LOCKWOOD LLC

CONNELLY V. UNITED STATES: SUPREME COURT WEIGHED IN ON THE VALUATION OF CLOSELY-HELD COMPANIES FOR ESTATE TAX PURPOSES

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Succession planning for many closely-held and family businesses will be impacted by the Supreme Court's June 6, 2024 ruling in *Connelly* v. *United States*. In the case, the Court unanimously upheld the IRS's position that life insurance proceeds payable to a company to fund its obligation to redeem shares from a deceased shareholder are an asset that increases the company's fair market value.

In *Connelly*, two brothers were the sole owners of a company and entered into a buy-sell agreement to ensure that their family owned and controlled the shares at their deaths. The company was required to redeem a deceased brother's shares if the surviving brother declined to buy the shares. To fund its redemption obligation, the company purchased life insurance policies on the brothers. At the death of the first brother, the surviving brother chose not to purchase the shares. The company used a portion of the life insurance proceeds it received to fulfill its obligation to redeem the deceased brother's shares at an agreed upon price. The IRS audited the decedent's estate and valued his shares as the value of the company plus a portion of the life insurance proceeds received by the company. This additional value significantly increased the estate tax liability for the decedent's estate by $889,914.

When calculating the federal estate tax, the value of a decedent's shares in a closely held company must reflect the company's fair market value. The Court in *Connelly* stated that the decedent's shares should be valued at the time of death, before the redemption occurs. Therefore, the Court held that the value of the company included the value of the life insurance proceeds the company received, and the company's contractual obligation to redeem the deceased shareholder's shares did not necessarily offset the value of the life insurance proceeds funding that redemption.

In light of the Court's decision, we recommend that owners of closely-held businesses consult with their estate planning attorneys and tax advisors to review and potentially update their buy-sell arrangements to ensure that they are structured with estate tax implications in mind.

If you have any questions about the *Connelly* case or your existing buy sell agreement, please contact your Cummings and Lockwood LLC attorney.