



Do You Have An Exit Plan For Your Business?

Now May Be The Time To Review Your Buy-Sell Agreement

Business owners often create plans for business transitions to make sure their families are compensated in the most tax-efficient way possible. Once these plans are in place, periodically reviewing them is a good practice to ensure they meet your current needs.

A recent United States Supreme Court decision has prompted many business owners to reassess their buy-sell agreements. The *Connelly v. United States* case involved two brothers who were the only shareholders of a closely held corporation. To plan for a successful continuation of their business, the two brothers entered into a stock redemption buy-sell agreement. When one of the brothers died, the company redeemed his shares using life insurance proceeds purchased for this purpose. When determining the company's value for federal estate tax purposes, it was agreed that the company's value included the life insurance proceeds. However, the estate argued that the obligation to redeem the shares offset this value.

The Court ruled that the life insurance proceeds would be included in the company's value, and the obligation to redeem the shares was not considered a liability. Consequently, the value of the deceased brother's stock in the company, included in his estate, was increased by his pro rata portion of the death benefit from the policy on his life.

Reasons to review your exit plans might include:

- Addition of new owners
- Exit of another owner
- Growth in company size
- Involvement of family or key employees in the business
- Changes in the law



Example of This Arrangement

Assume two business owners each have a 50% share in a business worth \$20 million.

They enter into a buy-sell agreement to determine the transfer of ownership when one owner passes away.

This plan is a stock redemption agreement where the company owns life insurance policies on each owner with a death benefit of \$10 million.

When one owner dies, the life insurance death benefit increases the company's value to \$30 million.

Since the buy-out does not create a liability on the company's part, there is no offsetting deduction for the death benefit.

The deceased owner's share is now worth \$15 million inside their taxable estate instead of \$10 million.



Does the Connelly Decision Apply to Your Business?

The *Connelly* decision is relevant to specific buy-sell agreements. To determine its impact on your business, consider these questions:

1. Is your business taxed as a C or S corporation?
2. Do you have a stock redemption or entity purchase buy-sell agreement in place?
3. Is the buy-sell agreement funded with corporate-owned life insurance?

If you answered “yes” to all three questions, the *Connelly* decision likely affects your business, making a review of your buy-sell agreement essential. Even if your business does not fit into these categories, it's beneficial to review your plans to ensure they align with your current goals.

Bottom Line

The Connelly decision provides another reason to regularly review your buy-sell plan to ensure it remains suitable for your business. Depending on the situation, stock redemption agreements involving life insurance could make sense for some business owners. However, if this approach is not the most tax-efficient design, there are other options to consider.

- Cross-purchase buy-sell
- Insurance LLC or partnership
- Cross-endorsement buy-sell

The best option depends on several factors specific to you and your business. Having a business planning team, comprised of your experienced attorney, accountant, financial advisor, and life insurance professional can help you review your goals and determine which buy-sell agreement is most suitable and tax-efficient for your situation. Changes in circumstances and laws can impact prior planning, but careful review and adjustments can help prevent adverse consequences and ensure a smooth business continuation.

Contact your financial professional today to discuss the role life insurance can play in your business planning.



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