ARIZONA STATE UNIVERSITY

CORPORATE & BUSINESS LAW JOURNAL FORUM

VOLUME 6 | OCTOBER 2024 | NUMBER 8

COMMENTARY

Connelly v. United States: End of the World for Life Insurance?

BY CHENBING XU*

Background

On June 6, 2024, the United States Supreme Court ruled in *Connelly v. United States* that life insurance proceeds should be included in the business' fair market value calculation for estate tax purposes.

Michael and Thomas Connelly were the sole shareholders in Crown C Supply.[1] The brothers entered into a buy-sell agreement to ensure that Crown would stay in the family if either brother died.[2] Under the agreement, the surviving brother would have the option to purchase the deceased brother's shares.[3] If he declined, Crown itself would be required to redeem the shares.[4] To ensure that Crown had enough money to redeem the shares, it obtained $3.5 million in life insurance for each brother.[5] Michael died, and Crown used $3 million in life insurance proceeds to redeem the shares.[6] According to the IRS, the corporation's fair market value should include the $3 million life insurance proceeds, thus, owed an additional $889,914 in taxes.[7] The estate paid the deficiency, and Thomas, acting as executor, sued the United States for a refund.[8]

---

* J.D. Candidate, Class of 2026, Sandra Day O'Connor College of Law at Arizona State University

[1] *Connelly v. United States,* 602 U.S. 257, 265, 144 S. Ct. 1406, 1412, 219 L. Ed. 2d 31 (2024).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

Did the court get it right?

The decision makes sense. Before *Connelly*, corporations used *Blount* as a precedent.[9] In that case, the Eleventh Circuit held that insurance proceeds should be ignored when offset by a corresponding redemption obligation.[10] In other words, a court should consider what a buyer would pay for shares that make up the same percentage of the less-valuable corporation after the redemption.[11] The U.S. Supreme Court overturned Blount by addressing that for calculating the estate tax. The whole point is to assess how much Michael's shares were worth at the time that he died --- before Crown spent $3 million on the redemption payment.[12] This is supported by statutory language, which defines the gross estate as the value at the time of the decedent's death.[13]

Furthermore, logically speaking, life insurance could be considered a financial investment. The corporation pays a small premium and expects to receive a higher return at one point in the future. Thus, why should we make an exception for this kind of investment?

Issues & Solutions

People might think the ruling makes it more difficult for small businesses to redeem shares, so it's a bad policy. Small businesses might have to liquidate their assets to purchase the shares. However, I don't think this is the end of the world for life insurance.

Businesses need to review their buy-sell agreements carefully.[14] There are alternatives, such as cross-purchase agreements, a separate limited liability company holding life insurance proceeds, split-dollar life insurance, or a trusted buy-sell agreement.[15] Businesses should also review their life insurance policies, and in most cases, the policies can be improved.[16] The decision definitely is not the end of the world; on the contrary, the ruling

---

9 *Est. of Blount v. Comm'r*, 428 F.3d 1338 (11th Cir. 2005).

10 Adam Chodorow, *Valuing Corporations for Estate Tax Purposes*, 3 HASTINGS BUS. L. J. 1, 25 (2006).

11 *Connelly*, 602 U.S. at 265.

12 *Id.*

13 26 U.S.C. § 2033; 26 C.F.R. § 20.2031-1(b).

14 *Impact of Supreme Court Decision in Connelly v. United States on Buy-Sell Agreements*, TRUENORTH FIN. STRATEGIES (July 29, 2024), https://truenorthcompanies.com/blog/financial-strategies/impact-of-supreme-court-decision-in-connelly-vs-united-states-on-buy-sell-agreements.aspx.

15 *Connelly v. United States: Corporate Redemption Policies Can Mean More Tax*, JOHNSTON ALLISON HORD (Aug. 12, 2024), https://www.jahlaw.com/connelly-v-united-states-supreme-court-ruling-impacts-estate-tax-news-and-events/#:~:text=United%20States%3A%20Corporate%20Redemption%20Policies,insurance%20policies%20payable%20to%20shareholders.

16 TRUENORTH FIN. STRATEGIES, *supra* note 14.

guarantees no business can take advantage of the policy and ensure the succession planning is tax-efficient.[17]

[17] *Id.*