

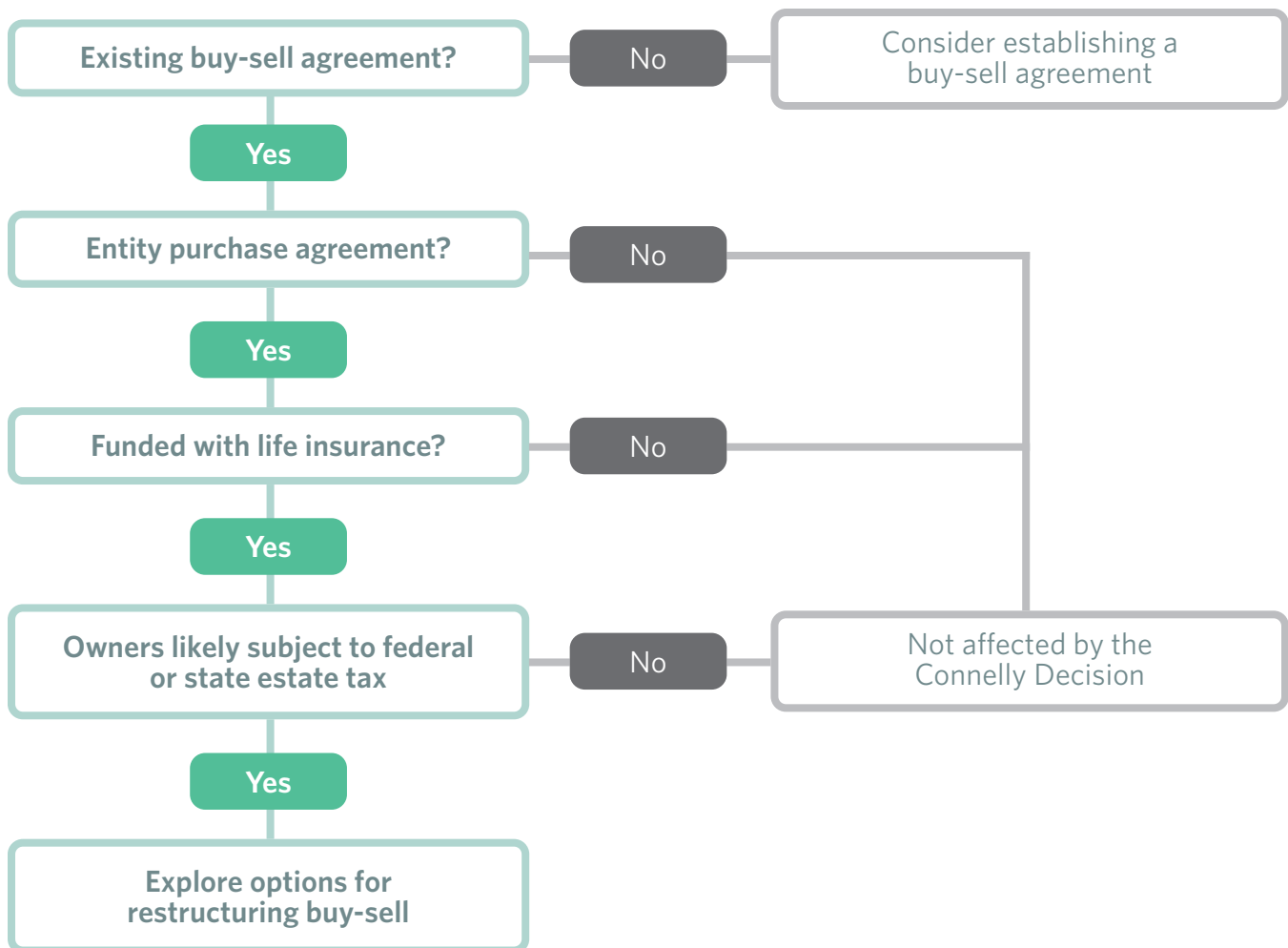
Responding to the Supreme Court's Connelly Decision

NAVIGATING BUY-SELL AGREEMENTS POST CONNELLY

Buy-sell agreements are put in place to protect business owners and are often funded with life insurance. As laws change, however, it is important to review these agreements for compliance with the current environment. The recent Supreme Court decision in *Connelly v. US* (the Connelly Decision) has raised concerns about whether the owners of a closely held business need to “fix” their buy-sell agreement.

The decision held that the life insurance death benefit received by a corporation is an asset of the corporation. Therefore, the Court found that the value of a deceased owner’s interest in the business – for purposes of the federal estate tax return – includes a pro rata share of the death benefit. Existing buy-sell agreements typically exclude life insurance from the purchase price set for an owner’s interest.

Not all business owners are affected by the Connelly Decision:



WHAT'S NEXT?

If owners and their advisors do believe their buy sell is affected by the Connelly Decision, how should they respond? The following page includes a very high-level summary of potential options. Determining which is suitable will require a close analysis of the particular circumstances involved.

Options	Explanation	Considerations
Revised Entity Purchase Agreement	Update valuation clause to include insurance proceeds.	<ul style="list-style-type: none"> ▪ Purchase price in excess of insurance proceeds will be paid with an installment note.
New Cross Purchase Agreement	Each owner holds a policy on the life of every other owner.	<ul style="list-style-type: none"> ▪ Total number of policies needed is $n * (n - 1)$ where n is # of owners. ▪ Transfer for Value problems in repositioning existing policies. ▪ No centralized controls to make sure policies remain inforce.
New Cross Endorsement Agreement	Each owner holds a policy on their own life, endorses some of the death benefit to every other owner.	<ul style="list-style-type: none"> ▪ Transfer for value problems from endorsement of death benefits. ▪ No centralized controls to make sure policies remain inforce. ▪ Potential inclusion of endorsed death benefit in taxable estate.
New Business Continuation General Partnership	Each owner becomes a partner in a partnership established to hold one policy on the life of each owner.	<ul style="list-style-type: none"> ▪ Premiums are funded by after-tax contributions by each partner. ▪ Partnership agreement specially allocates death benefits only to the non insured partners. ▪ Will the IRS seek to use the Connelly Decision to claim inclusion of partnership owned policy death benefit? To be determined...

SUMMARY

Even if owners and their advisors don't think the Connelly Decision applies, the case is a reminder that circumstances change. A buy sell agreement should be periodically reviewed to assess how well it would work given current conditions including valuations, ownership shares, liquidity needs, intended retirements or succession, etc.

Your Palladium Group team stands ready to support advisors and their business owner clients in evaluating their buy sell agreements so that they better understand the issues and their potential options when they consult their attorney.