Supreme Court Rules a Redemption Agreement Does Not Create an Offsetting Obligation for Valuation Purposes

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In a unanimous decision, the U.S. Supreme Court on June 6, 2024, in Connelly, v. United States, No. 23-146 addressed whether life insurance proceeds (hereinafter "proceeds") used to redeem a decedent's shares pursuant to a redemption agreement (hereinafter "obligation") must be included when calculating the value of those shares for purpose of the federal estate tax. In reaching its decision that the proceeds are included, the Court rejected the taxpayer's argument that the obligation offsets the value the proceeds.

The Court held that obligation does not affect any shareholder's economic interest and no willing buyer would treat the obligation to purchase the shares at fair market as a factor that reduced the value of the shares. The Court rejected the taxpayer's argument that the relevant inquiry of what a hypothetical buyer would pay for shares is the less valuable corporation after the redemption. The Court held that a hypothetical buyer would treat the proceeds that would be used to redeem the obligation as a net asset.

Although not cited in the decision, various amicus briefs filed by several prominent tax law professors stressed that the obligation was not an in the general sense but a change in the corporate structure with the deceased shareholder entitled to his share of the net corporate value.

The Court, in closing, noted that the downside to a stock redemption agreement with corporate owned insurance was the fact that the proceeds would be a corporate asset at the insured shareholder's death. The Court instructed taxpayers wishing to avoid the inclusion of the proceeds to use a cross purchase agreement.

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*This is intended to provide general information, not legal advice. Please contact the authors if you need specific advice.

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