

# Supreme Court to Rule on Estate Tax Valuation of Stock Purchased with Corporate-Owned Life Insurance Proceeds

By John B. Waters

If a shareholders agreement sets forth a fixed and determinable price that satisfies the requirements of Code Section 2703(b) and cases interpreting that term, then that price will be respected for federal estate tax valuation purposes. If it does not, then the value of the stock for federal estate tax purposes will be determined based, among other things, on the value of the corporation's assets. The Supreme Court is set to resolve a circuit split as to whether the proceeds of a corporate-owned life insurance policy used to fund a closely held corporation's obligation to redeem a deceased shareholder's stock is a corporate asset to be taken into account for purposes of valuing the stock for federal estate tax purposes where the parties' shareholders agreement did not contain a fixed and determinable price. Prior to 2023 the law appeared settled with both the U.S. Court of Appeals for the Eleventh Circuit in *Estate of Blount v. Commissioner*, 428 F.3d 1338, 96 AFTR 2d 2005-6795 (11th Cir. 2005) and the U.S. Court of Appeals for the Ninth Circuit in *Estate of Cartwright v. Commissioner*, 183 F.3d 1034, 84 AFTR 2d 99-5218 (9th Cir. 1999) holding that life insurance proceeds should not be taken into account as a corporate asset for purposes of valuing the redeemed shares based on the rationale that the proceeds are offset by the related obligation to use those proceeds to redeem the deceased shareholder's stock.

Notwithstanding such a long-standing precedent, in June of 2023 the U.S. Court of Appeals for the Eighth Circuit in *Connelly v. U.S.*, 70 F.4th 412, 131 AFTR 2d 2023-1902 (8th Cir. 2023), rejected that precedent and held that a proper valuation of the corporation must include the life insurance proceeds used for redemption without a reduction in such valuation for the related redemption obligation. In so holding, the Court made the technical argument that a stock redemption is not the payment of a liability, but rather a reduction of surplus, and that such increase in value due to the use of the life insurance proceeds to fund the redemption manifests itself through a corresponding increase in the value of the remaining shareholders' shares.

For shareholders agreements that do not set a fixed and determinable price meeting the requirements of Code Section 2703(b) and cases interpreting that term, the holding in *Connelly*, if upheld, would require a higher purchase price for corporate stock redemptions funded by corporate-owned life insurance (as the insurance proceeds would be corporate assets taken into account in such valuations) than for stock purchases by shareholders under a cross-purchase arrangement funded by shareholder-owned life insurance. This is illustrated by the fact that the estate in *Connelly* sold its stock without taking into account the life insurance proceeds in the valuation of the corporation, making the stock value for estate tax valuation purposes considerably higher than what the estate received for the stock. By contrast, had the shareholders in *Connelly* entered into a cross-purchase agreement with the surviving shareholder using insurance proceeds of a policy held by that shareholder to fund their purchase obligation, then those individually owned insurance proceeds would not have been taken into account in the estate tax valuation of the decedent's shares.

*Connelly* is set for oral argument on March 27, 2024, and hopefully a decision will issue soon afterwards to resolve this conflict. In the meantime, shareholders of closely held corporations who are parties to shareholders agreements that provide for corporate redemptions funded by life insurance should consult with their legal advisers to determine whether their shareholders agreements provide for a fixed and determinable price meeting the requirements of Code Section 2703(b) and cases interpreting that term. If their shareholders agreement does not meet those requirements, then they should consider whether they want to amend their agreement to add a fixed and determinable purchase price and whether, in the absence of such an amendment, *Connelly* adversely impacts their existing arrangement. If it does, they will need to further consider whether they want to amend their agreement currently to take *Connelly* into account or bear the risk of waiting until after the Supreme Court issues its decision to see if any amendments are necessary at that time.

For more information on this topic or any other tax law related topic, please contact any of the following.

**Al Salvatore**

Practice Group Manager  
Corporate, Tax and Transactional  
216.615.4845 | [asalvatore@ralaw.com](mailto:asalvatore@ralaw.com)

**Nancy Franks-Straus**

312.690.4534 | [nfstraus@ralaw.com](mailto:nfstraus@ralaw.com)

**Donna Hartl**

312.580.1250 | [dhartl@ralaw.com](mailto:dhartl@ralaw.com)

**John Waters**

312.582.1685 | [jwaters@ralaw.com](mailto:jwaters@ralaw.com)