A Pitfall of Company Owned Life Insurance

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A recent Supreme Court case, *Connelly vs. United States*, decided on June 6, calls into question the strategy and tax efficiency of using company owned life insurance to fund a redemption agreement upon the death of a shareholder.

In *Connolly*, two brothers owned a building supply company. As part of the succession plan the company owned a policy on each of the brothers. The proceeds of the policy were to be used by the company to redeem a deceased brother's shares. One of the brothers passed away and the proceeds of the policy were used by the company to purchase the shares of the deceased shareholder from his estate. All worked as planned. Then came the IRS and estate tax valuations.

The IRS, when valuing the company for estate tax purposes, argued that the value of the company was the value of the company prior to the brother's death plus the life insurance. The Supreme Court agreed. The result is that the value of the business was increased for estate tax purposes to include the value of the life insurance.

As a result of this case it is suggested that if you have an insurance policy intended to be used to fund a redemption plan, you have the structure reviewed to see whether the result in *Connelly* can be avoided.

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