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U.S. Supreme Court: Estate tax value of stock is not reduced by contractual obligation to redeem shares

The U.S. Supreme Court today unanimously affirmed the U.S. Court of Appeals for the Eighth Circuit, in upholding the judgment of a district court that the fair market value of stock in a closely-held corporation, for purposes of valuing the stock interest in the corporation held by the estate of a deceased shareholder, included life insurance proceeds intended for the redemption of the deceased shareholder's stock interest.

The case is: *Connelly v. United States*, No. 23-146 (S. Ct. June 6, 2024). Read the Court's opinion

Summary

A corporation obtained life insurance on each of the corporation's two sole shareholders so that if one of the shareholders died, the corporation could use the proceeds to redeem that shareholder's shares. One of the shareholders subsequently died, and the IRS assessed taxes on his estate, which included his stock interest in the corporation. In valuing the estate, and the stock interest in the corporation held by the estate, the IRS took the position that the fair market value of the corporation included the life insurance proceeds intended for the stock redemption without a corresponding reduction in value attributable to the corporation's obligation to redeem. As a result, the IRS sent a notice of deficiency to the estate for just under $900,000 in additional tax liability. The estate paid the deficiency and sued for a refund.

The district court granted summary judgment to the IRS and the taxpayer appealed to the Eighth Circuit Court of Appeals. The Eighth Circuit affirmed the district court. Read *TaxNewsFlash*

The Supreme Court today, in a unanimous opinion, affirmed the lower courts' decisions and resolved a split in the Circuits (as the Eleventh Circuit had reached a contrary conclusion in *Estate of Blount v. Commissioner*). The Court reasoned that the redemption obligation at fair market value did not diminish the value of the shares because it did not affect any shareholder's economic interest. The Court clarified that for estate tax purposes, the value of the shares at the time of death should reflect the total value of the corporation, including life insurance proceeds, regardless of subsequent redemption obligations.

KPMG observation

Redemption agreements paired with life insurance are a fairly common solution to succession planning for closely held companies. In light of the *Connelly* decision, it may make sense to revisit existing buy-sell arrangements. In addition, the *Connelly* decision will need to be carefully considered in structuring and funding such agreements going forward.

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