

CONSIDERATIONS FOR BUY-SELL AGREEMENTS AFTER CONNELLY

	Entity Purchase/Redemption	Cross-Purchase	Insurance LLC
Brief Description²	Business redeems interest of deceased owner upon triggering event	Remaining owners agree to purchase the interest of an exiting owner upon triggering event	LLC owns insurance and business owners are members ³ Ownership percentages should match operating business ownership
Overall Structure	Business and owners enter into redemption agreement which sets purchase price and terms of buyout	Business owners enter into cross-purchase agreement to buy each other's interests in the business upon specified triggering events, setting forth purchase price and terms of purchase owners use insurance proceeds received at death of exiting owner to purchase the exiting owner's interest pro-rata	LLC buys insurance policies and is owner and beneficiary of each policy on the lives of owners Utilize independent manager to avoid incidents of ownership by owners Death benefits specially allocated to surviving owners to fund buyout of exiting owner
Funding Mechanism	Business purchases insurance on the lives of owners, resulting in the need for only one policy per owner	Each owner buys life insurance on the other owners ("cross-purchase" arrangement), resulting in multiple policies per owner if more than 2 owners	LLC buys insurance, allowing cross-purchase structure without multiple policies per owner
Payment of Premiums	Business pays the premiums	Individual policy owner pays the premium Disparate premium cost can result when owners ages and/or health status differ Consider split-dollar arrangement	Members contribute capital which are used to pay premiums; Rely on flexibility for allocation of premiums to avoid disparate impact of cost of life insurance (younger owners paying premiums on older owners) Consider split-dollar arrangement

¹ This chart is limited to situations where death is the triggering event.

² Any of these techniques could be structured as a hybrid agreement with other owners having the first right to purchase.

³ Trusts could be used as owners in lieu of individuals or in lieu of LLC.

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Estate and Certain Income Tax Implications to Consider	<p>Comply with IRC Section 2703</p> <p>Transfer for value rule (IRC Section 101)</p>	<p>Comply with IRC Section 2703</p>	<p>Policies owned separately from operating business. Structure operating agreement to negate incidents of ownership (IRC Section 2042) held by insured members to avoid risk of application of <u>Connelly</u>.</p> <p>Transfer for value rule exception for partners in a partnership (IRC Section 101)</p>
Applicable Case Law	<p><u>Connelly</u> (redemption obligation did not offset insurance)</p> <p>If 2703 is satisfied, <u>Connelly</u> should not apply.</p>	<p>Avoids issue in <u>Connelly</u> because the insurance is not owned by the entity. Therefore, its value is not included in the entity's valuation.</p>	<p><u>Connelly</u> PLR 200214028 and PLR 200747002 address this technique</p>
Is Insurance an Asset of the Business?	<p>Yes under <u>Connelly</u> ruling⁴</p> <p>See Footnote 2 in <u>Connelly</u> (a redemption obligation may offset insurance value)</p>	<p>No</p>	<p>No, asset of separate entity</p>
Alternative Structure	<p>Consider whether redemption obligation could be offset per Footnote 2 of Supreme Court opinion.</p> <p>Consider transition from redemption agreement to cross-purchase agreement and "rental" of death benefits under a split-dollar arrangement</p>	<p>If <u>Connelly</u> would not cause adverse estate tax result, redemption would be alternative structure</p>	<p>Consider whether to create separate LLCs for each owner's policy to mitigate 2042 concerns and application of <u>Connelly</u> (which may be addressed through special allocations)</p>

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⁴ Under prior case law, insurance was not included in company's value.

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Action Items After Connelly	<p>Review agreement Advise clients to monitor compliance with formalities of agreement annually</p> <ul style="list-style-type: none">• Routinely obtain valuation;• Review structure of redemption obligation <p>Can insurance be distributed without adverse income tax consequences?</p>	<p>Not impacted by <u>Connelly</u></p>	<p>Consider impact of <u>Connelly</u></p> <p>Consider separate LLCs</p> <p>Structure may be easier to exit or terminate after some owners die</p> <p>If terminated, distribution of policy should avoid transfer for value</p>



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For more than two decades, Natalie Perry has advised clients on strategies for achieving tax-efficient estate planning and income tax planning. She focuses her practice on advising high-net-worth individuals and their families on how to structure their estate plans creatively to accomplish their goals for the transfer of their wealth.

As part of the process, Natalie helps educate clients on the importance of planning and the nuances of implementing the technique. As a registered certified public accountant (CPA), Natalie brings a deep understanding of the complex and ever-changing tax laws her clients face.