

# Business Owners: How a New Supreme Court Ruling Could Blow Up Your Estate Plan

by **MICHAEL SIPE, President — CrossPointe, Inc. & STU MALAKOFF, CFP, CDFA, CPFA, CRPC, President — Bend Wealth Advisors**

If your business has multiple shareholders, read this article carefully. Chances are you have a buy-sell agreement in place. If you do not currently have a buy-sell agreement, I suggest you contact your corporate attorney immediately and get one drawn up.

In short, a buy-sell agreement is negotiated among a corporation's shareholders to define in advance how the corporation and its surviving shareholders will address the shares owned by a deceased shareholder. Will the corporation redeem the shares of the deceased shareholder from his/her estate, and if so, under what terms? Will one or more of the other shareholders purchase the shares from his/her estate, and if so, under what terms?

As a mergers and acquisition advisor and business coach for 34 years, as president of CrossPointe Private Equity Advisors, I have witnessed the upset and chaos that results when a shareholder dies and there is no buy-sell agreement in place. Here are some of the challenges.

The remaining shareholders are now in an unplanned, unwilling partnership with the estate and/or the family of their deceased partner. Everyone is distraught, especially the family of the deceased. Family members may wish to get involved in the operation of the business. This usually does not sit well with the other shareholders and can be very disruptive. No methodology for valuing the shares has been established. Neither the corporation or the shareholders have the cash on hand to fund a redemption or purchase of the shares. The estate wants maximum value for the shares, and it wants the most cash possible. The remaining shareholders want a modest valuation, minimal cash outlay and favorable seller financing. The raw emotions of all involved make resolving these challenges extremely challenging. Relationships can be broken, and the controversy can be devastating to business operations. Too often, everything ends up in litigation and everyone loses — except the lawyers.

The solution, for as long as I can remember is for the buy-sell agreement to establish a valuation methodology to be followed in the event of a shareholder death, as well as establishing how the share redemption or purchase will be funded. One very common approach for funding the purchase price has historically been for the corporation to purchase a life insurance policy on each shareholder with the intent that if one died, the life insurance proceeds would fund the purchase of their shares in cash. The goal was that the corporation would pay the premiums, the insurance proceeds would be estate tax-free, and the operating profits of the company would be unaffected.

Although, as you might guess, the IRS has wanted to tax the decedent's estate in the amount of the insurance proceeds, this life insurance approach to funding buy-sell agreements has been upheld judicially until now. For example, in the 2005 case of *Estate of Blount v. Commissioner*, a federal appeals court held that such a payout was



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excluded from a corporation's value because it was offset by a liability — the obligation to repurchase the owner's shares.

In a recent case, *Connelly v. United States*, the Connelly's corporation, which had a market value of \$3.86 million (excluding the insurance value) was deemed by the IRS to be worth \$6.8 million when the founder died, and the \$3 million policy payout occurred. This resulted in an unexpected additional \$900,000 in estate taxes, based on the estate's 77% ownership of the corporation. The case went to the Supreme Court.

Now, in a little-noticed decision, issued in June, the Supreme Court unanimously agreed with the IRS in *Blount* and reasoned that the requirement to repurchase a decedent's shares wasn't offset to the insurance payment because it wasn't a liability like a debt. Instead, the exchange of shares for dollars provided something of value to the firm.

So, if your buy-sell agreement is funded by life insurance, it's time to immediately revisit and validate or revise your strategy. Stu Malakoff, President of Bend Wealth Advisors, offers this guidance:

A cornerstone of a good financial plan is that it be reviewed and — if warranted — changed whenever life circumstances, financial objectives and regulations such as tax law have materially changed. *Connelly v. United States* is a ruling that has caused us to reach out to potentially impacted clients — those with i) closely held businesses, ii) family-owned businesses, or iii) other small business owners — and especially those businesses with life insurance policies in place to provide liquidity or to facilitate redemption agreements at the death of an owner.


Along with their advisor team (especially in tax and estate planning), we are helping our clients evaluate the right structure for any buy-sell arrangements and are encouraging them to determine fair market value of the business. Cross-purchase arrangements could be adopted instead of redemption agreements because, even though they can pose increased cost and complexity to owners, such agreements can help save even more money by avoiding additional estate tax...as much as a 40% tax at the federal level. A cross-purchase agreement would prevent the life insurance's value from being added to the corporation's valuation. In turn, the lower valuation lessens the likelihood that estate tax would apply at the death of a given owner. Alternatives to a cross-purchase agreement include a cross-endorsed Insurance LLC, as well as trust-owned life insurance.

The timing of the Supreme Court ruling coincides with another significant


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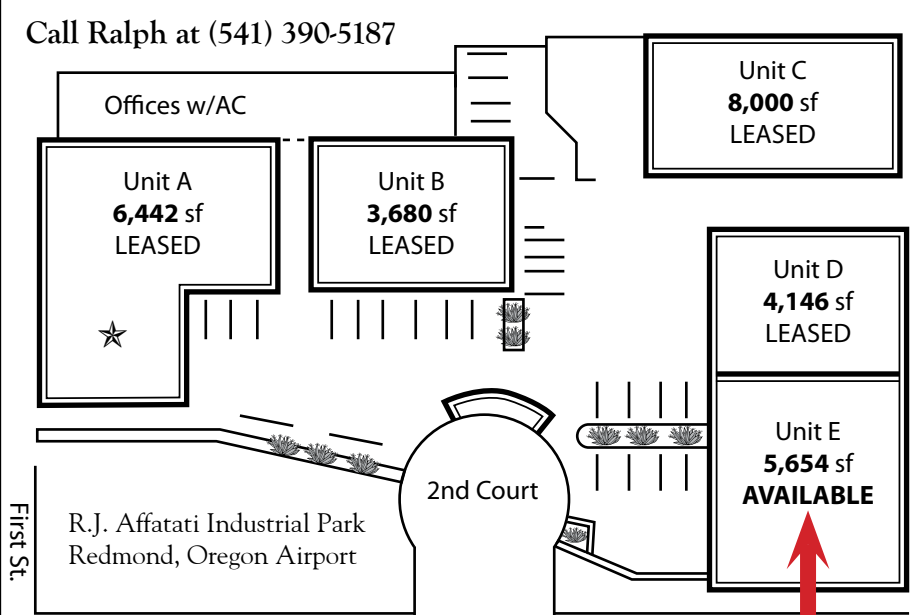
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## Urban Growth Boundary

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affordable housing, an affordability requirement in Oregon that would be one of the strongest in the United States.

Resources will also be made available to encourage climate-friendly development for new affordable housing construction to incorporate energy-efficient design, reduce energy costs for low-income residents, and stabilize operational costs for owners. These incentives are designed to help reduce the energy burden for low-income Oregonians across the state.

For the City of Bend to qualify for this one-off accelerated expansion, it needs to prove housing need based on rent burden — households that spend more than 50 percent of their income on rent and utilities expenses are considered severely cost-burdened. Currently, Bend qualifies, but it may not in the future as the percentage of rent burdened has actually decreased because of people moving out of the city due to affordability concerns.

The City will obtain housing data from U.S. Department of Housing and Urban Development (HUD) later this summer, which will give staff a better idea about whether the City will continue to qualify. Because of this unknown, City staff members recommended expediting the process to try to seize the opportunity in a timely manner.

The expansion development must be in a single site, but multiple property owners could assemble to develop a single area, but the lots would need to be contiguous, or just separated by a right of way. Other location requirements are that the site must be on non-resource land — i.e., not zoned for farm or forest. In its simplest form, a UGB, is a regional boundary, set to control urban sprawl by mandating that the area inside the boundary be used for urban development and the area outside be preserved in its natural state or used for agriculture.

BreAnne Gale, a senior planner with the City's Growth Management Division, said interest in this streamlined expansion opportunity is motivated by the need for affordable housing, to catch up on the City's underproduction in recent history. Typically, UGB expansion can take several years to develop, plan, and realize. "Staff has spent a lot of time and effort over the last month drafting the selection application format, and we are looking to publish notices calling for site applications mid-August," Gale said. "We want to cast the net pretty widely, including utilizing a list of existing interested parties. Applications should include a draft concept plan showing how they meet the requirements of the bill with elements such as adequate serviceability, and a breakdown of the number of units and their composition, including the affordability requirement.

"The more information an applicant provides the better, and the City Council will decide if the proposal meets or exceeds city requirements," she continued. "We would also refer applicants to the June 20 meeting where councilors posed questions regarding areas such as compatibility and multi-modal connections consistent with council goals.

"We are aiming to have a Q&A session by early September, as well as offering pre-application meetings to go over compatibility. There will be a council work session on November 20, with a decision narrowing down to one site as soon as the following meeting December 4. There will also be a public input component, and we are planning an online open house to look at all applications, together with a public

comment period and the opportunity to offer testimony at meetings. Once the decision is narrowed down to one site, the concept plan will be refined, and we would hope to adopt the UGB expansion as an amendment to the General Plan and annexed into the city limits by mid-2025." The bill also requires that any site have a mix of both residential and commercial development.

The City embarked on its last UGB expansion in 2016 and even with the one-time addition coming from SB 1537, the City anticipates needing to expand further in coming years. Bend's population is predicted to grow from 111,000 to 156,000 people by 2045, requiring more than 19,000 new housing units, according to a 2023 analysis. New planned developments are still under construction on land included in the 2016 expansion, which added 2,380 acres among ten areas on all sides of the city. The process took years and involved more than 70 public meetings.

New developments proposed through the UGB fast-track would still be subject to the city's master planning process with the City Council having discretion in choosing a proposal. The UGB reduces sprawl by allowing for new types of development in specific areas with the city's current boundary. In order for new development to occur, the city must determine how to adequately serve these new areas with infrastructure like roads, sewer, and water. Then, the expansion areas need to be annexed into the city limits before they are officially part of the City of Bend.

Senate Bill 1537 addresses Oregon's housing supply and affordability crisis as decades of underbuilding have left the state with a severe housing shortage that is driving up rents, home prices, and worsening its homelessness plight.

The state is currently behind by 140,000 housing units and needs to produce over 440,000 units in the next 20 years to keep pace with demand. Furthermore, too many Oregonians can't afford to live where they work, and employers are losing potential hires who cannot find an affordable place to live. Many Oregonians are being forced to leave their communities and some are leaving the state entirely. To address this critical economic and livability issue impacting all Oregon communities, the state must dramatically increase the production of housing units — up to 80 percent over current construction trends — to get Oregon on track to meet its future needs.

SB 1537 is a first step, and the key provisions of the bill were developed following months of stakeholder outreach to hear from local communities, climate organizations, homebuilders, and others on what tools are needed to address the ongoing housing crisis. While this tool does allow expedited and limited expansions for cities that have a need, it also has a series of requirements to ensure that expansion areas are the type of communities that Oregonians want: complete communities with diverse housing choices, a mix of densities, stores and restaurants, parks and open space, walking and biking infrastructure, affordable homeownership opportunities, and more.

Land cannot be high-value farm or forest land outside of urban reserves already designated for future urban development and is capped at no more than 75 or 150 acres, depending on city population. The tool is designed to ensure that as Oregon communities grow, they can accommodate urgently needed affordable and middle housing production, while also retaining the state's natural beauty and diverse neighborhoods.

Funding for Housing Production Tools SB 1537 includes a \$500 million investment package from existing state resources requested by Governor Tina Kotek to unlock more housing production by providing funding to build core infrastructure like water and sewer to support new housing development, and funding to moderate-income housing.

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change to estate planning: the reduction of the estate tax exemption to \$5.6mm per individual (adjusted for inflation from 2017) scheduled for the end of 2025. Therefore, revisiting your estate plan — which requires having a solid handle on the value of your taxable estate — is especially timely. I've seen these types of sweeping changes several times during my 22-year career as a financial advisor and life insurance producer; it seems that change is the one constant in federal tax law. Revisiting your estate plan from time to time has also become a constant.

You could find that estate taxes may not be a concern even with the sunset of current estate tax exemption levels, in which case — an entity-redemption plan may still be the right approach if you own a closely held business. But you need a current, accurate fair market valuation to make that determination. Leverage your advisor team to optimize the financial outcome for you, your business, and the important people and

causes in your life.

**Closing thoughts:** Corporations with multiple shareholders should seriously consider having a buy-sell agreement. The company should be valued when the agreement is put in place and the methodology for future valuation should be established in writing in the agreement. Shareholder exit strategies should be established, not only to address untimely death but also to provide a planned exit path for shareholders during life. CrossPointe can help with these issues.

Bend Wealth Advisors, your CPA, and your estate and tax planning attorneys can help you design a redemption or repurchase plan to fund your buy-sell agreement in a manner that's appropriate to your situation. Take the SCOTUS decision as a wake-up call. Meet with your professional advisors and act now to avoid the potential of chaos, business disruption, and a painful tax bill in the event of the death of a shareholder.

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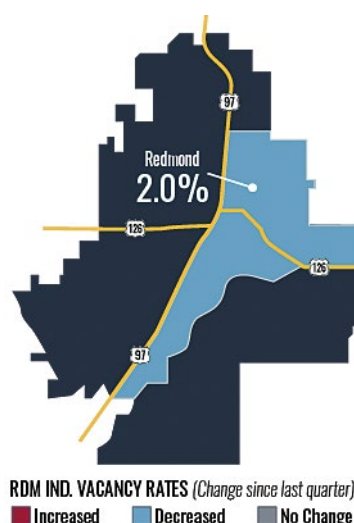
## Compass Points

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demand for industrial product from investors and owner/users, sales activity remained slow during the quarter. Higher interest rates and shortage in inventory have contributed to a slower sales market.

### REDMOND INDUSTRIAL MARKET by TERRY O'NEIL, Broker — Compass Commercial Real Estate Services

Compass Commercial surveyed 93 buildings totaling 1.77 million square feet for the second quarter Redmond industrial market report of 2024. The Redmond industrial market experienced 23,400 SF of positive absorption resulting in the vacancy rate decreasing from 2.59% in Q1 2024 to 2.02% in Q2 2024. There is now 35,866 SF of industrial space



currently available in Redmond.

**LEASING:** Demand for space in the Redmond industrial market has somewhat softened with tenants seeking spaces between 1,500 SF and 5,000 SF. Leasing activity increased throughout the quarter with over 23,000 SF of industrial space being leased. One new industrial building totaling 13,701 SF was added to the survey this quarter.

**RENTS:** Lease rates in the Redmond industrial market have begun to stabilize at the top of the market. Average asking rates are between \$0.90 and \$1.25/SF/Mo. NNN depending on the condition and size of the space. Asking rates for new projects under construction remain between \$1.10 and \$1.25/SF/Mo. NNN.

**CONSTRUCTION:** There continues to be between 20,000 SF to 50,000 SF of industrial space in the pipeline, including a 23,400 SF industrial building on NE Jackpine Court slated for completion in October 2024. There continues to be a significant amount of square footage that is being built as owner-user buildings or pre-leased space.