

Proposed IRS Regulations to Curtail Valuation Discounts to Family-Controlled Entities

By: Thomas Bezigian, Jr.

On August 4, 2016, Proposed Regulations were issued by the IRS which, if finalized, will reduce and potentially eliminate common valuation discounts that have been utilized by families in connection with inter-generational transfers of interests in closely-held family-controlled business entities.

From a valuation perspective, tax and legal professionals currently incorporate applicable restrictions affecting control of family businesses, as set forth in Internal Revenue Code Section 2704, to apply discounts to the value of transferred business interests for lack of control (minority) and lack of marketability, which, in aggregate, typically range from 15% to 40%.

Among other things, the Proposed Regulations amend the definition of applicable restrictions in Section 2704 by creating a new class of disregarded restrictions which will be ignored for valuation purposes, broadening the definition of family control, and imposing a three-year period prior to a transferee's death, during which the transfer of certain interests will be treated as additional transfers subject to transfer tax.

The result is that the Proposed Regulations will significantly restrain individuals and their estates from applying currently available and widely used discounts for estate planning gift and estate tax valuation purposes, and for business succession planning.

The finalization of these Proposed Regulations is subject to a ninety day public comment period, ending on November 2, 2016, during which time the IRS is accepting comments. There will be a hearing in Washington, D.C. on December 1, 2016. The Proposed Regulation, additional information, and the opportunity to submit public comments are available through the Office of the Federal Register's website: <https://www.federalregister.gov/documents/2016/08/04/2016-18370/estate-gift-and-generation-skipping-transfer-taxes-restrictions-on-liquidation-of-an-interest>

It is unknown when or in what form the final regulations will be issued and, in its current form, some aspects of the Proposed Regulation would not take effect until thirty days after issuance. If the final regulation were issued in the current form, the conventional valuation rules would be drastically changed for equity interest transferred between family members. Individuals with wealth transfer and business succession planning goals should take heed of this this significant development and may wish to consider transferring such interests before the effective date of the final regulations to benefit from currently-available discounts.

Please feel free to contact me or the attorney in our office with whom you typically work if you have any questions.

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