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Time-Sensitive: Give it Away While There is Still Time

Proposed Regulations for Internal Revenue Code § 2704 Significantly Limit Valuation Discounts for Intra-Family Transfers

On August 2, 2016, the United States Department of the Treasury (the "Treasury Department") issued broad and sweeping Proposed Regulations under Internal Revenue Code § 2704 which, if enacted, would significantly limit the ability of families to utilize valuation discounts for transfers of closely-held corporations, partnerships, and limited liability companies. As a result, estate planning options for the tax efficient transfer of ownership in family entities will significantly be restricted.

Under current law, individuals can increase the amount of wealth they shift to their family members by utilizing valuation discounts on transfers of closely-held enterprises. This is accomplished, in part, by transferring (during life or at death) minority and non-voting interests to other members of the family. Because each family member receiving the ownership interest lacks control of the entity, the value of each such interest is reduced to reflect that lack of control. In addition, the value of each minority interest is further reduced because it is not freely marketable – there is a limited market for selling a minority or non-voting interest in a closely-held entity. When combined, these discounts for lack of control and lack of marketability significantly reduce the value of the asset for estate and gift tax purposes. However, because all (or almost all) of the ownership interest remains within the family, the family retains control over the entity and could theoretically enjoy a value greater than the discounted value.

The Treasury Department has long targeted valuation discounts for lack of control and lack of marketability, particularly when they occur in the context of intra-family transfers. The Treasury Department, however, has been largely unsuccessful in the court in its attempts to challenge the discounts.

Now, with the proposed regulations, the Department of Treasury has limited, if not entirely eliminated, the availability of the discounts for lack of control and lack of marketability where there is an intra-family transfer. Should the proposed regulations be enacted, an individual could no longer discount for transfer tax purposes the value of an ownership interest as part of an intra-family transfer of a closely-held entity. Thus, individuals who wish to transfer ownership of a family business to other family members will face greater exposure for estate and gift tax liability.

Despite the potentially significant impact of these proposed changes, it should be emphasized that nothing has yet been enacted. There is a 90-day period during which the public may submit written comments on the proposed regulations, followed by a public hearing on December 1, 2016. The final regulations will then be published sometime thereafter, but it is unclear how long that may take. The final regulations could also be different from the proposed regulations. Moreover, many commentators view the proposed regulations as exceeding the authority of the Treasury Department and, thus, subject to court challenge.

This potentially leaves a very limited window of opportunity to structure tax efficient transfers under current law.

To discuss your estate plan and various options, please contact Martin A. Schwab, any of the attorneys in our Trust and Estate Practice, or the attorney in the firm with whom you are regularly in contact.