Proposed IRS Regulations Endanger Discounts on Family-Owned Entities

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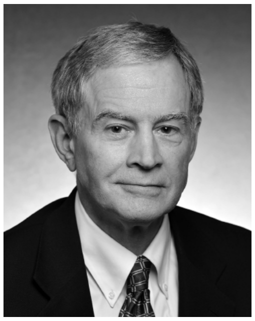

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On August 2, 2016, the Internal Revenue Service (IRS) issued proposed regulations that would significantly limit the use of valuation discount techniques associated with family-owned businesses. Valuation discounts are currently available for intra-family gifts and sales of interests in Family Limited Partnerships (FLPs), Family Limited Liability Companies (FLLCs) and closely held corporations. Such entities (and the discounts available to them) have been valuable investment vehicles used to minimize taxes associated with wealth transfers. Currently, a family member may create a FLP or FLLC, which are typically used to run and manage a business or an investment portfolio often consisting of a combination of real estate and marketable securities. The family member may then contribute a dollar amount to the entity and later sell or gift interests in the entity to another family member. Because these interests are not readily marketable to the public and often lack controlling authority, meaningful valuation discounts (often up to 35%) may be applied to reduce the value of the assets transferred. While this is one extremely simplified example, the new regulations are intended to eliminate almost all opportunity for lack of marketability and control discounts for all closely held interests owned by a family.

These proposed regulations are the IRS's answer to limit what they perceive as aggressive use of discounting techniques which have been made easier by state laws undermining their ability to enforce Code Section 2704. Passed in 1990, Code Section 2704 was intended to limit discounts on transfers to family members. Under Code Section 2704, the IRS seeks to disregard all control restrictions in governing documents for valuations purposes for gifts to family members. The IRS has scheduled a hearing for December 1, 2016, and indicated that the final regulations will not be effective until at least 30 days after they are finalized. Generally, these hearings last weeks or even months before the proposed regulations are finalized. There will certainly be some opposition voiced by various groups at this hearing.

Those with family-owned entities may want to consider utilizing currently available discounting techniques if they anticipate a taxable estate. While the final form of the regulations is still unknown, if you are already in the process of setting up a partnership or making gifts, timing may be critical. If you have an estate tax issue and are considering a family gift or sale that involves discounting an interest in a family-owned entity, time is running out. These types of transfers are complicated and not only take time to complete, but also involve tax attorneys and appraisers who are about to become very busy. Do not wait, act now. ■

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Please contact Truxton Trust should you have any questions or concerns.

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