August 30, 2016

The IRS is Rewriting the Rules on Valuation Discounts

ESTATE PLANNING, INTERNAL REVENUE SERVICE, TAX
BY MICHAEL DARPINO

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On August 2, 2016, the Internal Revenue Service (the "IRS") unveiled proposed regulations under Section 2704 of the Internal Revenue Code that threaten to restrict or eliminate the use of valuation discounts in connection with transfers of interests in certain family businesses. These proposed regulations, if and when made final, will have sweeping ramifications on the estate planning for owners of family-controlled entities.

By way of background, valuation discounts play a crucial role in the estate planning playbook of high-net-worth families. Business owners who transfer interests in entities to family members can often save estate, gift and generation-skipping transfer taxes by availing themselves of lack-of-marketability and minority interest discounts that would not be available if the underlying assets were transferred outright. The IRS has long disfavored these discounts and now intends to crack down on perceived abuses in the valuation of family entities.

The mechanics of the proposed regulations will be addressed in a separate writing. Generally speaking, the proposed regulations will achieve their effect by first treating the lapse of certain voting and liquidating rights as an additional transfer. In addition, restrictions imposed on the ownership of family-owned entities that support valuation discounts will be ignored.

It is important to remember that only transfers that occur after the proposed regulations are published as final will be affected. A public hearing on the proposed regulations is scheduled for December 1, 2016, and the new rules could take effect as early as the beginning of next year. This means that taxpayers have a very limited window of time in which to initiate intrafamily transfers at a discounted value. Taxpayers considering the transfer of an interest in a family-owned entity are well advised to act immediately to avoid forfeiting the benefit of valuation discounts.

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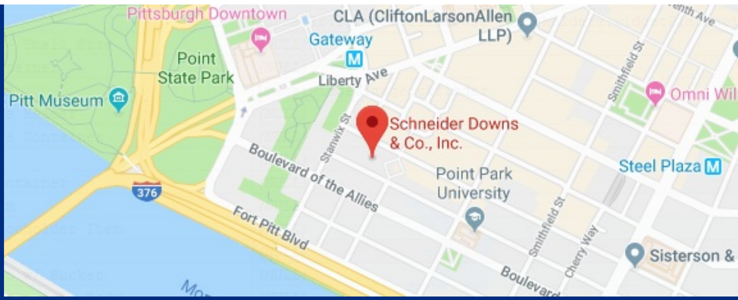

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