PROPOSED REGULATIONS TARGET ELIMINATION OF VALUATION DISCOUNTS FOR INTRA-FAMILY TRANSFERS

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The Internal Revenue Service recently issued Proposed Regulations that could have a dramatic impact on estate planning and the succession of interests in family-controlled entities between family members by eliminating or severely restricting the availability of valuation discounts in connection with a variety of estate planning strategies. These discounts are frequently used to reduce estate and gift taxes.

Under current law, the value of a non-controlling, non-marketable minority interest in a family-controlled entity might be appraised at a 25% to 40% discount. This discount is based upon the nature of the entity and its assets and the inability of the holder of a minority ownership interest to force a sale or liquidation of the business or sell the interest to someone else. Applying the valuation discount to the interest reduces the value of a gift or a sale of a minority interest for transfer tax purposes.

For example, if Mary has a $40 million estate which includes a $30 million family business and Mary decides to gift a 20% interest in the business to a trust for the benefit of her children, although the gross value of the 20% business interest is $6 million (i.e., 20% x $30 million), the value of the non-controlling, non-marketable interest might be appraised at $3.6 million, utilizing an aggressive aggregate discount of 40%. This discount reduces the amount of the gift for gift tax purposes by $2.4 million (= 40% aggressive discount x $6 million). If the gift was subject to gift tax at the current rate of 40%, the gift tax savings would be $960,000 (= 40% tax x $2.4 million). If the Proposed Regulations are adopted as drafted, the discount would be significantly restricted or eliminated, and the tax savings would be lost.

The Treasury Department is currently receiving comments on the Proposed Regulations and a public hearing is scheduled for December 1, 2016. The Proposed Regulations restricting the use of valuation discounts will not become effective until at least 30 days after they are finalized, which could be as early as December 31, 2016.

If the Proposed Regulations are adopted in their present form, the ability to claim value discounts will be substantially reduced or eliminated. If you have been considering a transaction that anticipates a valuation discount, the window of opportunity to utilize such discounts may be rapidly closing. As year-end approaches, it may become more difficult to structure and implement planning transactions that employ valuation discount strategies.

Please contact one of the following individuals in the Wealth Preservation Group at Berger Singerman to discuss the options that may be available to you to accomplish your estate planning goals in anticipation of the adoption of the Proposed Regulations.

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