MEYER SUOZZI

CLIENT ALERT

September 6, 2016 www.msek.com

Treasury Launches Attack on Discounts Used For Valuation of Family-Controlled Entities

Treasury Issues Proposed Regulations

The Department of the Treasury (IRS) recently issued Proposed Regulations which, if finalized in their current form, would eliminate most valuation discounts for transfers of family-controlled closely held entity interests, including active operating businesses. Once the Proposed Regulations become effective, which could be as soon as the end of December, the ability to claim valuation discounts may be substantially reduced or virtually eliminated. The Proposed Regulations are presently under a public comment period, which will be followed by a public hearing, and it is not known if the Proposed Regulations will be significantly modified or even derailed before they become effective. It seems likely, however, that regulations significantly curtailing valuation discounts on transfers of family-controlled entity interests will be adopted, as the IRS has been working toward this goal for years.

How Discounts Operate

The following is a basic illustration of how discounts operate, and the potential impact of the Proposed Regulations. Assume that Charles, who is not married and has made no prior taxable gifts, owns a 100% interest in a family business valued at $10 million, and he wants to gift 30% to each of his two children, in trust. Under current law, the 30% interest would be valued to reflect a discount for lack of ability to control the business and a discount to reflect the lack of marketability of the interest. As a result, the value of the 60% interest transferred to the two trusts might be appraised at $3.6 million, assuming a 40% effective combined discount. Charles would report the $3.6 million gift on his federal gift tax return but would not owe a federal gift tax, since the gift would be absorbed by his unused federal gift tax exemption of $5.45 million. If, however, this same transaction were to take place following the effective date of the Proposed Regulations, the valuation discounts would be eliminated, and the value of the gift would be equal to the pro-rata share of the underlying assets, or $6 million, resulting in a gift tax owing of $220,000.

2016 Elections

The upcoming 2016 presidential and congressional elections could result in other estate, gift and generation-skipping transfer tax roll-backs as well. One proposal includes the reduction of the estate tax exemption from its current $5.45 million to $3.5 million, the elimination of inflation adjustments to the exemption, reduction of the gift tax exemption from $5.45 million to $1 million, and an increase in the tax rate from 40% to 45%. Other proposals have included the restriction or elimination of commonly used techniques such as GRATs and sale transactions to grantor trusts.

Planning

Those who have been considering making transfers by gift or sale of closely held entity business interests should act expeditiously and contact us.

Our Trusts and Estates Law practice group includes the following attorneys:

Patricia Galteri
pgalteri@msek.com
(516) 592-5790

Nathaniel L. Corwin
ncorwin@msek.com
(516) 592-5740

Jayson J.R. Choi
jchoi@msek.com
(516) 592-5799

Carmela T. Montesano
cmontesano@msek.com
(516) 592-5720