

The Bankler Report

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INTRODUCTION

Speaking at a recent meeting of the Tax Section of the ABA (American Bar Association), Catherine Hughes, Estate and Gift Tax Attorney Advisor in the Office of Tax Policy in the US Treasury Department, said that the IRS will be issuing regulations in the near future to restrict or eliminate valuation discounts on transfers of interest in family-owned entities.

Current Law

Currently, there are no differences in the valuation methodology used when taxpayers transfer minority interests in an entity to a third party. It is irrelevant whether the entity is an operating business or an investment entity. When it is properly planned, documented, and executed taxpayers are allowed to use valuation discounts when transferring minority interests in family entities (even if that entity invests solely in marketable securities) to family members. Typically, these discounts reduce the value of the interest transferred by over 40% thereby reducing transfer costs, including gift and estate taxes. .

Changes

New regulations may add additional categories of restrictions that could be disregarded in determining the value of interests that family controlled entities transfer to each other. The regulations would probably limit the availability of minority ownership and lack of marketability discounts. They could also revive the concept of the family attribution rules (already contained in the Internal Revenue Code and invoked in numerous specified transactions) under the pretext of limiting liquidation and other restrictions. In addition, the application of the new rules could be limited to investment entities. Hopefully there will be an exemption for operating entities.

Because the new regulations are likely to become effective for any transfers occurring after issuance, now is the time to act. This is especially important for taxpayers with significant wealth tied up in liquid assets that would normally be transferred through partnership or LLC structures.

Contact us should you have any questions or if we can assist in addressing these tax law changes.