Anticipated Changes in IRS Regulations May Impact Use of Valuation Discounts in Estate Planning

Attorneys

Michael A. Backer

Michael A. Backer and Nita S. Vyas

Greenbaum, Rowe, Smith & Davis LLP Client Alert

August 2015

Valuation discounts can play an important role in tax planning for the estate of a high net worth individual. Many of our clients have used valuation discounts for lack of control (also known as minority discounts), and for lack of marketability, to save significant gift and estate taxes when transferring minority interests in family controlled entities such as limited liability companies or family limited partnerships to a spouse and/or descendants. There is now a concern that the IRS may soon issue regulations that will sharply curtail the ability of taxpayers to use valuation discounts in their estate planning.

At an American Bar Association Section of Taxation meeting earlier this year, Cathy Hughes, an official with the U.S. Treasury's Office of Tax Policy, commented on various proposed regulations and anticipated regulations. She indicated that proposed regulations for Section 2704(b) of the Internal Revenue Code (IRC) could be released before the ABA Section’s fall meeting, scheduled for September 17-19, 2015. Ms. Hughes further noted that tax professionals could look to the Obama Administration’s prior budget proposals on valuation discounts for insight about what the proposed regulations might provide.

Section 2704 was enacted in 1990 as part of Chapter 14 of the IRC. Its purpose was to prevent the reduction of taxes through “estate freeze” techniques that were designed to reduce the value of a taxpayer’s estate, and to discount the value of property transferred to beneficiaries for estate and gift tax purposes without reducing the economic benefit passing to those beneficiaries.

To address the concern that taxpayers were imposing restrictions on transferred property that had the effect of artificially reducing its value for estate and gift tax purposes, Section 2704(b) provides that certain “applicable restrictions” that would normally justify discounts in the value of transferred property will be ignored in valuing interests in family-controlled entities if those interests are transferred to (or for the benefit of) family members.

Valuation discounts on inter-family transfers have been targeted for years. Since 2010, the Obama Administration's budget proposals have contained proposals that would restrict or eliminate valuation discounts on transfers of interests in family-controlled entities.

Tax planners anticipate that IRS regulations to limit valuation discounts are on the way. Although the effective date of the new regulations is uncertain, it seems likely that only those transfers completed prior to the effective date will not be subject to the new rules. Accordingly, families with taxable estates for U.S. estate tax purposes should strongly consider establishing and thus transferring interests in controlled entities to family members soon, in order to avail themselves of the favorable provisions which are still available under current law.

Our Tax, Trusts & Estates Department provides a full spectrum of services to individuals and families, businesses, corporate trust departments, executives and other professionals, and non-profit or tax exempt entities residing or doing business in New Jersey. For more information, please contact **Michael A. Backer**, Department Chair and co-author of this Alert with **Nita S. Vyas**, Counsel in the Department.