

Newly Proposed IRS Regulations Would Severely Curb Valuation Discounts

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In an August 2015 Client Alert, we noted that the Internal Revenue Service (IRS) was planning to issue regulations that might curtail the ability of taxpayers to use valuation discounts (also known as minority and marketability discounts) in connection with their estate planning. Earlier this month, the IRS and the U.S. Department of Treasury finally issued those proposed regulations. As expected, the new regulations, if adopted, would significantly limit the valuation discounts that are currently available to taxpayers for estate and gift tax purposes.

Valuation discounts for lack of control and lack of marketability have played an important role in the tax planning of high net worth individuals. Many of our clients, as well as taxpayers across the country, have taken advantage of valuation discounts applicable upon the transfer of minority interests in closely-held businesses or family limited partnerships (FLP). Such transfers, typically made to a spouse, descendant, or a trust for the benefit of a spouse or descendant, can result in significant gift and estate tax savings.

These transfers have been structured in a number of ways. A taxpayer may transfer a minority interest in an existing family business to the taxpayer's beneficiaries, or may transfer real estate or a block of marketable securities to a newly created FLP and then transfer a minority interest in the FLP to beneficiaries.

The valuation discounts (which can range from 15 percent to 40 percent or even higher) for minority interests in FLPs reflect the fact that the interests are not readily convertible to cash, and the holder of a minority interest cannot force the FLP to pay a dividend or redeem the interest. The proposed regulations, which have been issued pursuant to Section 2704 of the Internal Revenue Code, would severely limit the use of valuation discounts by, among other things, allowing the IRS to disregard restrictions contained in a governing instrument of a family controlled entity. By way of example, currently a taxpayer may transfer an interest in an FLP whose underlying assets are worth \$10 million to descendants at a transfer tax cost of \$7 million (assuming a 30 percent valuation discount), resulting in a potential transfer tax savings of \$1.2 million. In the event the proposed regulations become final, the ability to accomplish such savings will likely be lost.

It is important to note that the proposed regulations have not yet been finalized and should not affect transfers that occur prior to the date the regulations are published in final form. A public hearing on the proposed regulations has been set for December 1, 2016, and final regulations may go into effect 30 days after publication. We will keep you advised as to the status of these regulations, and strongly encourage

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all families with taxable estates to consider availing themselves of the favorable valuation discounts which are still available under current law.

To learn more about the information provided in this Alert, please contact the author, Nita S. Vyas, Counsel in the firm's Tax, Trusts & Estates Department. Ms. Vyas and the other attorneys in this practice area provide 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.