

ESTATE PLANNING**THE END TO DISCOUNTS FOR TRANSFERS OF INTERESTS IN FAMILY BUSINESS ENTITIES!**

by Henry C. T. (Tip) Richmond, III

The ability to use transfer and liquidation restrictions in legal documents to reduce the value of an interest in a family-controlled (or “closely-held”) business entity (e.g., partnership, corporation, limited liability company) for lack of marketability and/or lack of control (minority interest) for gift, estate and generation-skipping transfer purposes has been a significant tool for clients and their tax advisors for many years. Congress took steps to limit the use of discounting techniques when it enacted Section 2704 of the Internal Revenue Code in 1990.

Generally, Section 2704 stipulates that in situations where there is a lapse of any voting or liquidation right in a business (designed to reduce the value of a business interest), but the transferee and the transferee’s family control the entity before and following the lapse, the full value (v. discounted value) of the interest must still be included in the decedent’s estate. Also, taxpayers placed certain restrictions on closely-held business interests transferred within the family for the purpose of reducing the value of the interest transferred. To counter this strategy, Section 2704(b) provides that when a business interest is transferred within the family, certain “applicable restrictions” will be ignored when determining the value of the transferred interest for gift, estate and generation-skipping transfer tax purposes if the family retains the ability to eliminate the restriction after the fact.

Since the enactment of Section 2704 there have been a number of developments that have allowed taxpayers to avoid or limit the applicability of Section 2704 to intrafamily transfers of a family business interest during lifetime and/or at death, including but not limited to, several Tax Court decisions, increasing use of a limited liability company (“LLC”) to own the business, making the recipient of the transfer (a “transferee”) an “assignee” rather than a full owner, using charities (and other non-family members) as transferees of nominal interests in the family business entity, careful drafting of the specific characteristics of a restriction on transfer and liquidation rights, and in some states, enactment of state laws that supported the discounting goal.

The IRS announced a year ago that it expected to issue new rules under Section 2704 late this summer that would cause certain transfer and liquidation restrictions to be disregarded in determining the value of a transfer (during lifetime or at death) or liquidation of an interest in a family-controlled business entity (e.g., an LLC, partnership or corporation). These regulations, if and when final, would significantly limit this highly effective strategy.

The IRS delivered on its promise when it released proposed regulations on August 2nd of this year. There is a 90-day comment period during

which interested persons may submit written comments to the IRS for its consideration. The IRS has scheduled a public hearing for December 1, 2016. The regulations are proposed to be effective 30 days after the date the Treasury Department publishes them as final in the Federal Register. In light of expected significant written comments and extensive discussion at the December 1st hearing, most experts do not believe the regulations will become final until sometime in 2017.

The transfer tax planning implications are significant, and consultation with your tax advisors to determine how these proposed regulations could affect you, your family and your wealth transfer strategy is essential – the sooner the better!

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