
Proposed Treasury Regulations Place Family Businesses Under Attack, Again

By Geoffrey N. Taylor

The United States Department of Treasury recently issued proposed regulations designed to significantly reduce or eliminate valuation discounts for federal estate, gift, and generation-skipping transfer tax purposes currently available for gifts of interests in family-controlled entities. The proposed regulations accomplish this by treating the lapse of voting or liquidation rights as a separate, additional gift and by ignoring most restrictions on liquidation for valuation purposes.

The two primary discounts applicable when making gifts of interests in family business derive from the lack of marketability and lack of control inherent to the gifted interests. The interests are not publicly traded or otherwise marketable and, therefore, cannot be readily converted to cash. This is particularly true where, as is typical, the governing documents significantly restrict an owner's ability to liquidate the interest via withdrawal from the entity or a voluntary transfer to a third party. These interests also generally do not carry control over the entity, and the transferee often cannot participate in decisions regarding the entity's operations, the making of distributions, or dissolution. The hypothetical, fully-informed buyer and seller, the benchmark for determining federal transfer tax values, would certainly take these restrictions into account when determining the price at which to purchase and sell the interest.

The IRS understandably hates these discounts, viewing them simply as artificial depressors of transfer tax value and tools for wealthy to avoid paying their fair share. Consistent with their weariness of perceived abuse by taxpayers, federal gift and estate tax returns, Forms 706 and 709, ask whether valuation discounts have been taken on any assets listed thereon and, if so, require the taxpayer to attach an explanation giving the basis for and amounts of the discounts taken. I have often equated the question regarding whether a discount is being taken to asking "would you like the IRS to audit this return?"

Enter the proposed regulations. If finalized in their current form, the proposed

regulations would:

- Treat as an additional gift the lapse of voting and liquidation rights for transfers made within three years of death;
- Eliminate any discount relating to restrictions on a transferee's right to participate in entity decisions; and
- Disregard restrictions on liquidation that are not mandated by law.

Given the impact on nearly every aspect of our lives, schools require students to take one or more courses in government, teaching about the organization and operation of our federal, state, and local systems. A gross oversimplification of the federal system describes three branches: legislative, which makes laws, judicial, which interprets laws, and executive, which enforces laws.

While the process of analyzing, commenting on, finalizing, interpreting, and enforcing the new regulations is in its infancy, one of the many issues raised is almost certain to include whether the Treasury Department has crossed the line between enforcing and creating law by effectively overturning decades of seemingly settled, albeit evolving, case law.

Regardless of potential challenges, taxpayers who may be affected need to act and act soon. These taxpayers own interests in family-owned businesses and may be subject to federal transfer taxes, which, based on current law, includes individuals with estates near or exceeding \$5,450,000 and couples with a combined estate near or exceeding \$10,900,000. There is a 90 day public comment period and a public hearing is scheduled for December 1, 2016, after which the proposed regulations may be revised or published as final.

If you or someone you know may be affected by the proposed regulations, we urge you to contact one of **Maddin Hauser's tax attorneys** without delay.