THE (DREADED) PROPOSED 2704 REGULATIONS

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Introduction

- The United States Department of Treasury issued proposed regulations in August 2016
- Designed to reduce significantly or eliminate valuation discounts for gifts of interests in family-controlled entities
- Lapse of voting or liquidation rights is treated as a separate, additional gift
- Disregard restrictions contained in governing agreements and applicable law

Background

- Fair market value:
  - Willing buyer and willing seller
  - Knowledge of relevant facts
- Lack of marketability
- Minority interest.
- Scrutiny:
  - Inclusion in donor's estate due to:
    1. Donor's retained economic interest;
    2. Donor's retained ability to control economic interests; or

Foreground – Proposed Regulations

- Application
  - Gifts to family members where family controls the entity
  - Control means 50% ownership, owning a general partner interest, or being able to liquidate an LLC
- Lapse of voting or liquidation right - New three year recapture rule
  - If donor gives a noncontrolling interest but loses control as a result of the gift (e.g., 51% member gives a 2% interest), donor is deemed to have made a gift equal to the value of the control in addition to the gift of the 2% interest

Foreground – Proposed Regulations (Continued)

- State law restrictions effectively eliminated
  - "Default" state law restrictions no longer considered
  - Only "mandatory" restrictions considered
- New "disregarded restrictions"
  - A restriction is ignored if it limits the recipient's ability to compel liquidation for cash for an amount less than "minimum value"
  - This imputed put right would effectively eliminate discounts

Now What?

- Public hearing is scheduled for December 1, 2016
- Proposed regulations would also affect other planning strategies such as GRATs and sales to grantor trusts
- Is the IRS softening its position?
- Meet with clients and other advisors and analyze clients' situations