Alerts

Death of the Family Discount?

For years, practitioners have been able to rely on the benefits of valuation discounts when incorporating transfers of business interests into gift and estate tax planning. The window to take advantage of these discounts may be closing. The estate and gift tax community is anticipating that the U. S. Treasury may issue new proposed regulations that may end the ability to take discounts on intra-family transfers of closely held businesses as early as late summer of this year.

Section 2704(b) provides that valuation discounts shall disregard liquidation restrictions and certain “other restrictions” prescribed by regulation when a business interest of a family controlled entity is transferred to a family member and the restriction does not ultimately lessen the value to the receiving family member. These proposed regulations are expected to address these “other restrictions” that are so vaguely referenced in the code. We can only speculate the details, but discounts may be disregarded on transfers of the typical passive family holding company or family controlled companies in general.

A hypothetical potential example of this change would be the typical gifting transaction where Parents wish to transfer units of family business to their children. If we assume the assets in the LLC are appraised for $8,000,000, then the fair market value of the LLC or entity units/shares are normally transferred at a “discount” due to lack of control and lack of marketability. These discounts vary greatly depending on the assets in the LLC and its operating agreement. However, it is not uncommon for business valuation experts to appraise units with discounts ranging from 30% to 50%. If we assume a 40% discount, and a gift to two children of 49% each, than the value of the transfer for gift tax purposes would be ($8,000,000 X 98% X 60%) or $4,704,000. The difference in potential estate or gift tax due to the discount is $1,254,000 ($7,840,000 less $4,704,000 or $3,136,000 x 40% estate/gift tax rate). The cost of this gift would increase by $1,254,000 if the Treasury regulations were to eliminate discounting.

Treasury has indicated that the final regulations may become effective retroactively to the date the proposed regulations were issued, so now is the time to address planning with transfers of family business interest for individuals with taxable estates. The next few months may be a brief window in time to make transfers before the effect of these regulations. We encourage you to plan to get ahead of these new potential changes.

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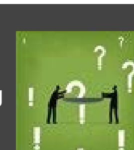

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