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## IRS regulations promise to shake things up

**E**arly this month, the IRS released proposed regulations under Section 2704 of the Internal Revenue Code. If adopted, the proposed regulations will have far-reaching implications in the estate planning world.

The proposed regulations set out to significantly reduce the availability of valuation discounts in transferring interests in family entities, including limited partnerships and limited liability companies.

### Background

In 1990, Section 2704 of the Internal Revenue Code was passed with the intention of limiting the aggressive use of valuation discounts. However, over the past 25 years, several tax court cases and state laws have undermined the IRS' ability to enforce the rules. Since 2003, the IRS has listed valuation discount concerns in their "Priority Guidance Plan" every year.

Under current law, the IRS allows valuation discounts in the transfer of such interests by gift or upon death in family-owned businesses to account for lack of control or lack of marketability.

Such valuation discounts allow taxpayers to gift or transfer minority interests in family entities to family members at a discounted gift or transfer tax cost, which in turn allows clients to maximize wealth transfer between generations and reduce estate tax consequences.

For example, if mom owns a 10 percent limited partnership interest in a family limited part-

nership with assets valued at \$20 million, the fair market value of 10 percent of the underlying assets of the partnership is \$2 million. However, taking into consideration conservative discounts for lack of control and lack of marketability of 25 percent, the discounted value of mom's limited partnership interest is only \$1.5 million.

If mom elects to gift her limited partnership interest to a trust for the benefit of her daughter, mom will utilize only \$1.5 million of her lifetime gift tax exemption of \$5.45 million. In this way, mom has effectively transferred \$2 million outside of her taxable gross estate, including any future appreciation of the interest.

### Likelihood of passing

The current proposed regulations will undergo a lengthy process prior to being finalized. The proposed regulations entered a public comment period running through Nov. 2, and there will be a public hearing to discuss the proposed regulations on Dec. 1.

After that, the IRS and the Treasury Department will consider the comments shared before issuing the final rules, which would become effective 30 days after formal publication in the Federal Register.

Thus, it is likely that any regulations which ultimately become final may not become effective until sometime in 2017. The regulations as proposed are expected to receive tremendous pushback. Many question if they

### THE BUZZ



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are overreaching. While it is unclear which of the proposed regulations will pass, it is possible that valuation discounts for transfers of minority interests in family-owned entities may be entirely eliminated.

*[T]he IRS allows valuation discounts in the transfer of such interests by gift or upon death in family-owned businesses ...*

### Planning opportunities

The implications of these proposed regulations are nothing to sneeze at.

If the regulations are issued in their current form, a significant

opportunity to transfer wealth and reduce gift and estate taxes will be lost. For clients with taxable gross estates (in excess of \$5.45 million for a single person or \$10.9 million for a married couple with a properly structured estate plan), the federal estate tax is egregious at 40 percent for every dollar in excess of the exemption.

And, Illinois remains an expensive state in which to die, adding a 10 percent to 28.5 percent tax on every dollar in excess of \$4 million (or \$8 million for a married couple).

To add a further wrinkle to the estate planning landscape, rumors abound that if Hillary Clinton is voted into office, the federal estate tax exemption (currently \$5.45 million) may be reduced to \$3.5 million. With the uncertainty surrounding Congress and the IRS and Treasury's actions, clients with taxable gross estates are encouraged to utilize all or a portion of their lifetime gift and estate tax exemptions of \$5.45 million and effectuate gifting of minority interests in family-owned entities as soon as possible to take advantage of the current tax law and maximize wealth transfer.

For those interested in taking advantage of the current valuation discounts available for lack of marketability and lack of control, time is of the essence.

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