

IRS Attacks Family Business Entity Discounts

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PRACTICES Tax-Exempt Organizations and Private Foundations, Trust and Estate Administration, Family Office, Family Wealth and Estate Planning, Private Clients and Estate Planning, Tax

The long-awaited attack has arrived – the IRS recently issued proposed rules intended to reduce or eliminate valuation discounts for family-controlled business entities. These proposed regulations will take effect no sooner than December 1, 2016, and until then, the current rules developed under existing statutes, regulations, and court decisions will govern valuations.

The proposed regulations under Section 2704 of the Internal Revenue Code, if adopted as final regulations, would significantly curtail valuation discounts on transfers of interests in closely-held family business entities (active businesses or not), such as limited partnerships, limited liability companies, and corporations.

Under current law, a non-controlling interest in a closely-held family business is valued for federal gift and estate tax purposes based on what an unrelated third party would pay for that interest, taking into account the absence of a market for sale of the interest and inability of the buyer to control the business or force a sale or liquidation. Once finalized, the proposed regulations could effectively eliminate these types of discounts for family entities. Although the proposed regulations certainly reflect the IRS's current position and interpretation of existing law, they are generally not binding on taxpayers until they are finalized. A public hearing is scheduled for December 1, 2016, and final regulations likely will not be effective until after that date.

If you have been considering a gift or sale of an interest in a family-owned business, you should consider whether to complete the transaction before December 1, 2016. Please contact one of the following lawyers to discuss any questions you may have on application of these proposed rules to your specific situation.

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