IRS PLANS TO DISALLOW MINORITY INTEREST DISCOUNTS FOR FAMILY-CONTROLLED ENTITIES; ACTION MAY BE REQUIRED BEFORE YEAR-END

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Private Clients, Trusts and Estates Alert

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Gifts and bequests of interests in family-owned companies have traditionally been valued at their fair market values for purposes of calculating the gift or estate tax on the transfer. In valuing these transfers, there is often a discount applied to reflect the lack of marketability or lack of control associated with owning a non-controlling interest in the company. These valuation discounts are commonly referred to as minority interest discounts.

On August 2, 2016, the Internal Revenue Service published proposed tax regulations dramatically changing the rules for the valuation of interests in family-controlled entities. If adopted, the regulations would effectively disallow any minority interest discounts upon the transfer of interests in family-controlled companies to other family members for gift, estate, and generation-skipping transfer tax purposes.

The proposed regulations are issued to interpret Section 2704 of the Internal Revenue Code, which deals with special valuation rules applicable to transfers of family-controlled business entities like corporations, partnerships, and limited liability companies. In determining the value of an interest in a family-controlled business entity for purposes of gift, estate, and generation-skipping tax, the ability to redeem or liquidate the interest will be disregarded. Instead, the interest will be valued as if the recipient would have a "put" right to redeem the interest for a pro rata share of the underlying value of the company, regardless of whether or not such a redemption or put right actually existed. These proposed modifications to the current rules will have the effect of denying minority interest discounts in intra-family transfers.

Based upon the language of the proposed regulations, these new rules may very well become effective as early as January 2017. If and when they become final, the continued use and consideration of valuation discounts in gift and estate tax planning will be lost in most situations. The regulations will also affect the valuation of a person's remaining family-owned business assets at the end of one's lifetime, and the resulting estate tax liability. The future valuation of interests in intra-family transfers is uncertain until the proposed regulations are final; however, any gifts or other transfers made before the proposed regulations are final will not likely be subject to the modifications to the current rules. Consequently, clients owning interests of family-controlled entities who eventually plan to pass their interests to descendants or other family members may choose to make transfers to other family members within the next several months in order to try to take advantage of the valuation discounts available under the current rules.

Please let us know if you wish to discuss the details of these rules and planning opportunities that may be available over the next several months.

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