Williams Overman Pierce, LLP
Certified Public Accountants and Consultants

Issuance of Proposed Regulations Impacting Valuation of Family Controlled Businesses for Estate, Gift, and Generation Skipping Tax Purposes

Summary

Gift, estate, and generation skipping taxes are imposed on the value of property transferred. Proposed regulations regarding estate planning and valuation discounts were released on August 2, 2016, and if they become final, would significantly impact the availability of minority or lack of control discounts for transfers of family controlled business interests among family members. In general, the effective date will be the date the regulations are published as final regulations. Prop. Treas. Reg. Section 25.2704-3, concerning transfers subject to disregarded restrictions, will apply to transfers occurring 30 or more days after the date of publication

There are both pros and cons to making an 83(b) election that should be discussed with your tax advisor prior to making such an election.

The final regulations apply to property transferred on or after January 1, 2016. For transfers of property on or after January 1, 2015, and before January 1, 2016, taxpayers may rely on the guidance in the proposed regulations, which is identical to the guidance contained the final regulations.

Details

On August 2, 2016, the IRS and Department of Treasury issued proposed regulations amending current regulations under IRC sections 2701 and 2704. If these proposed regulations are made final they will have a profound impact on estate planning and valuation discounts with respect to family controlled entities.

Effective Date of Proposed Regulations

In general, the effective date will be the date the regulations are published as final regulations. Prop. Treas. Reg. Section 25.2704-3, concerning transfers subject to disregarded restrictions, will apply to transfers occurring 30 or more days after the date of publication. A hearing is scheduled to receive comments concerning the proposed regulations on December 1, 2016, thus the regulations will not become final until after that date.

Substantive Changes

The preamble and proposed amendments to the regulations contain 50 pages of complex technical discussions and rules. A full discussion of the rules and issues raised are beyond the scope of this Alert.

In brief, the proposed regulations would accomplish the following:

1. Expand definition of entities beyond simply a corporation and partnership to include LLCs and other entities and arrangements;
2. Create a bright-line test for deathbed transfers (within 3 years of death) that result in a lapse;
3. Treat assignee interests as a lapse subject to transfer tax;
4. Redefine “applicable restriction” to eliminate the state law safe harbor; and
5. Add a new provision disregarding certain restrictions that are not “applicable restrictions,” including any restrictions that prevent an owner from causing a redemption of his or her interest after 6 months’ notice.

Item 5 of this list will have the most impact on estate planning because the focus is on the ability of the owner to have his or her interest redeemed rather than restrictions on the ability to liquidate the entity.

Insights

The proposed regulations would have a significant impact on lack of control and minority discounts for estate, gift, and generation skipping tax purposes when clients transfer interests in family controlled entities. Given that the regulations, as proposed, may become final as early as the end of this year, clients holding interests in family controlled businesses may want to complete estate planning transfers of such interests prior to the date the regulations could be published as final.