Trust & Estates Alert: IRS Clarifies Proposed Regulations on Valuation Discounts for Family-Owned Businesses

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In August, the U.S. Treasury Department released proposed regulations to Section 2704 of the Internal Revenue Code. Currently, Section 2704 allows taxpayers with family-owned businesses to take advantage of valuation discounts when transferring interests in their businesses to family members for gift, estate, and generation-skipping transfer tax purposes. When the proposed regulations were issued, most commentators and practitioners concluded that the proposed regulations would eliminate or greatly reduce conventional lack of control and lack of marketability valuation discounts.

(For a more detailed discussion of the proposed regulations, see our Fall/Winter 2016 *Estate Planning Matters!* newsletter: "Proposed IRS Regulations to Take Away Valuation Discounts for Family-Owned Businesses.")

In late October, Catherine Hughes, an attorney advisor with the Treasury Department's Office of Tax Policy, publically addressed the proposed regulations. Hughes stated that the proposed regulations are not meant to eliminate discounts that are based upon restrictions associated with applicable state law. These discounts include conventional lack of control and lack of marketability discounts.

Instead, according to Hughes, the proposed regulations are meant to address "artificial" discounts that arise from limitations imposed by partnership agreements, operating agreements, and other organizational documents that are not associated with state law. For example, assume a partnership agreement gives a partnership the right to redeem limited partnership interests in exchange for a twenty year note. This redemption right is not associated with state law. In the past, appraisers could reduce the value of the limited partnership interests due to the redemption right. Under the proposed regulations, discounts like this would no longer be available.

Based on Hughes' comments, it is likely that the final regulations will be revised to clarify that conventional lack of control and lack of marketability valuation discounts for gifts of interests in family-owned businesses are still available. However, we will not have certainty until the final regulations are issued. While final regulations could be issued any time after December 1, 2016, Hughes indicated that Treasury is not trying to

finalize the regulations before the end of the year or even prior to the end of the current administration on January 20, 2017.

Please contact an attorney in Gray Plant Mooty's Trust, Estate & Charitable Planning group if you have questions about the proposed regulations.