Moritt Hock & Hamroff LLP
ATTORNEYS AT LAW
STRENGTH IN PARTNERSHIP™

ALERT

October 2016

Proposed Regulations 2704

On August 4, 2016, Proposed Regulations under Section 2704 of the Internal Revenue Code ("Proposed Regulations") were published in the Federal Register that, when finalized, will eliminate most valuation discounts in connection with the transfer of interests in family controlled corporations, partnerships, limited liability companies and other business entities. When Congress enacted Section 2704, it was designed to attack several perceived loopholes in the estate and gift tax laws. Section 2704(b)(4) authorizes the Treasury Department to issue regulations to "provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee." By its terms, Section 2704 addresses (1) lapses of voting and liquidation rights in family controlled entities, and (2) restrictions that prevent liquidation of family controlled entities. Such rights and restrictions are ignored in valuing interests in family controlled entities.

The Proposed Regulations can be summarized as follows:

- With regard to lapsing voting and liquidation rights, the current rules would no longer apply if the holder of the transferred interest were to die within three years of the transfer. The intent of the three year rule is to attack deathbed transfers that would shift control away from the transferor.
- As for the Applicable Restrictions that are to be ignored for valuation purposes, the proposed rules eliminate the focus on restrictions that are more restrictive than the relevant state law default rules and instead encompass virtually any restriction that limits the ability of an entity to liquidate.
- In addition, the Proposed Regulations create a new class of restriction that is to be ignored in valuing any interest in a family controlled entity— the "Disregarded Restriction" and this restriction includes any provision that limits or permits the limitation of the holder of an interest to compel liquidation or redemption. The "Disregarded Restriction" assumes for valuation purposes that each holder of an interest in a family controlled entity has the right to liquidate or redeem the interest for its proportionate share of the entity's net asset value in cash or other property payable within six months of exercise.

This Alert was written by Moira A. Jabir.

Moira A. Jabir, an associate in the Trusts and Estates Department, focuses her practice on trust, estate and tax matters.

Any matters raised in the Alert should be addressed to Ms. Jabir. She can be reached at (516) 873-2000 or by email at mjabir@moritthock.com.

> There is also proposed guidance for determining when a nonfamily member's holdings in entity should be ignored for purposes of determining family control, as well as the broadening and clarifying of other rules relating to family control and attribution of family ownership.

If adopted, as published, the Proposed Regulations will have a dramatic impact on estate planning for owners of family controlled entities and, most significantly, it will restrict or eliminate minority or lack of control discounts for family controlled entities for gift, estate or generation skipping transfer tax purposes, thereby increasing the tax cost of transfers of family controlled entities. The proposed regulations will also result in basis increases as estate tax values increase.

The Proposed Regulations are only that – proposed. Further, there is some question as to whether the Proposed Regulations exceed the regulatory authority of the Treasury Department under Section 2704, but that issue will not be resolved (if at all) until a court considers the regulations long after they have been finalized. Notwithstanding this, a public hearing on the Proposed Regulations is scheduled for December 1, 2016 and it is anticipated that the regulations will be finalized in early 2017.

Therefore, if you hold an interest in a family controlled corporation, partnership or other entity, it is crucial to consider whether you want to make any transfers to family members now before the Proposed Regulations become final, in order to claim any meaningful valuation discount when reporting the transfer. Action should be taken before the anticipated effective date in order to utilize the current rules regarding gift and sale of "discounted" assets. This can be accomplished by various estate planning techniques including by gifts, sales to grantor trusts, GRATs and/or CLATs.

As always, the Trusts and Estates Department of Moritt Hock & Hamroff LLP is pleased to answer any questions you may have regarding the Proposed Regulations and its potential impact on your planning surrounding family controlled corporations, partnerships, limited liability companies and other business entities.

◆ ◆ ◆ ◆ ◆

This Alert is published solely for the interests of friends and clients of Moritt Hock & Hamroff LLP for informational purposes only and should in no way be relied upon or construed as legal advice.

.