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## IRS attorney signals looming restrictions on discount techniques

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IRS attorney Cathy Hughes (Estate and Gift Tax Attorney – Advisor, Office of Tax Policy) created waves at the American Bar Association's Section of Taxation meeting in May. During discussions at the meeting Ms. Hughes signaled the Service's intent to release new proposed regulations under IRC §2704(b)(4) by mid-September. Those proposed regulations would likely include new "disregarded restrictions" built into family entity strategies that would, in turn, reduce or eliminate the use of valuation discounts in those entities.

IRC §2704(b) was imposed to limit the use of certain "applicable restrictions" in family business entities like family limited partnerships (FLPs) or family limited liability companies (FLLCs). When included in strategy designs, those applicable restrictions would otherwise cause a reduction in the value of equity interests in the entities, allowing wealthy families to leverage gifts or sales of equity interests in family entities, shifting more wealth to other beneficiaries.

Over the past few decades courts have whittled away at the §2704(b) limitations, consistently finding in favor of taxpayers whose entity valuations reflected discounts for minority interests (i.e., lack of control) and lack of marketability. Although discounts have been more generously given for entities that have underlying business operations, although discounting has also been successful in family entities that hold securities and do not operate businesses.

The Service has often challenged valuation discounting strategies in court, generally with limited success. Without much help from the judiciary, the Service turned to the President's budget proposals for help. From 2010 through 2013 the Obama federal budget Green Book included proposals to eliminate valuation discounting on family entities.

Draft budget provisions to eliminate valuation discounts were dropped in the President's proposals from 2014 to the present, but commentators predict that this is not due to a philosophical shift; rather, many believe that the administration plans to exercise its regulatory powers under existing §2704 rather than pursue new legislative action in the federal budget.

If past budget proposals are prologue to proposed regulations, we might expect to see the addition of "disregarded restrictions" which would dramatically reduce the impact of valuation discounts, especially in family entities that do not have actual business operations.

There is further speculation that existing family entities would not be "grandfathered" under the proposed regulations. Only gift or sale transactions that are completed before the effective date of the proposed regulations would be grandfathered.

The window may be rapidly closing for wealthy families to take advantage of valuation discounting in family entities. For clients who wish to shift significant value out of their estates and into the hands of others, the time to complete the plans and transfers is now.

Attorneys and advisors must reach out to clients immediately to determine if they're candidates for family entity strategies and wealth shifting using valuation discounts. For clients who already have family entity strategies in place, they should strongly consider accelerating their gift or sale programs before the opportunity to leverage those transactions through discounting is gone.