



August 11, 2016

## **WILL YOUR ESTATE INCREASE BY 30% IN 2017?**

### **NEW PROPOSED REGULATIONS LIMITING VALUATION DISCOUNTS FINALLY PUBLISHED BY IRS**

Last summer we wrote<sup>1</sup> in detail about impending proposed new regulations under Section 2704 of the Internal Revenue Code (“IRC”) that would disallow certain transfer tax valuation discounts of interests held in family-controlled entities. At long last, on August 4th (almost a year later than expected), the treasury department published<sup>2</sup> the proposed regulations. These new regulations will take effect potentially as early as January 2017.

The proposed regulations prove to be far more onerous and all-encompassing than anticipated. Although the manner in which the regulations achieve its goals is complex, the result is that valuation discounts for interests in any type of family entity<sup>3</sup> – regardless of whether the entity is a holding company or an actual existing “family” business – will more or less be eliminated.

It should be noted that IRC Section 2704 and the new proposed regulations only pertain to discounting *ownership interests in entities* (based on the theories of lack of control and lack of marketability). Other methods of discounting – such as discounting the value of a tenancy-in-common interest<sup>4</sup> in real property may still be available. However, the IRS may argue (and has on occasion argued) that a tenancy-in-common arrangement should be classified as a partnership, which would bring such interest back within the purview of the new regulations.

The proposed regulations ultimately may be modified based on feedback the IRS receives during a hearing on the subject scheduled for December 1st in Washington D.C., and from comments provided by practitioners and academics.

The regulations also may be modified as a result of a court challenge to its validity. A potential legal challenge to the Treasury’s authority to enlarge the scope of the regulations in this manner, is the argument that Congress, when enacting IRC Section 2704, never intended to eliminate all family discounts. If a challenge is brought on these grounds, a court will ultimately have to review the legislative history and decide whether the proposed regulations run afoul of the intent of Congress.

The regulations will be finalized sometime following the December 1st hearing and would become effective 30 days thereafter.

Tremendous tax benefits will be lost when these new regulations are adopted (in whatever form). We therefore recommend that individuals with potentially taxable estates (i.e., estates with a value in excess of the Federal and/or state estate tax exemption amounts) take advantage of valuation discounting by transferring interests in family entities while such discounts are still recognized.

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*Please contact our firm to discuss whether intra-family wealth shifting using valuation discounts is an appropriate strategy for you or your clients based on your (or your clients') specific circumstances.*

*The information contained in this article is for general informational purposes only. It is not intended as professional counsel and should not be used as such.*

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<sup>1</sup> [GW Article\\_Sep.2015\\_End of Summer Last Licks.pdf](#)

<sup>2</sup> <https://www.federalregister.gov/articles/2016/08/04/2016-18370/estate-gift-and-generation-skipping-transfer-taxes-restrictions-on-liquidation-of-an-interest>

<sup>3</sup> Under the current regulations to Section 2704 a “family entity” exists when at least 50% of the interests in an entity is owned collectively by the taxpayer and his or her family members (i.e., ancestors, lineal descendants, brothers and sisters and the respective spouses of those relatives as well as the spouse of the taxpayer and the spouse’s ancestors and lineal descendants and their respective spouses).

<sup>4</sup> The rationale for this discount is that it appropriately reflects the rights of the other tenancy-in-common owner(s).