

# The IRS takes aim at family businesses

The editorial pages of *The Wall Street Journal* only rarely touch on the federal estate tax, but they did so on September 5, 2016. In an opinion piece titled “A Stealth Death Tax Increase,” the editors objected to newly proposed regulations under IRC §2704. “Since Congress does not agree that the Internal Revenue Service should suck more cash out of family firms, Treasury Secretary Jack Lew is up to his usual tricks, trashing established interpretations of tax law to bypass the legislative branch. . . . Until now, the IRS permitted realistic value for portions of closely held corporations and partnerships.” The proposed regulations would effectively end valuation discounts for minority interests and lack of control in family settings (but not for transactions among nonfamily members).

IRC §2704 was added to the tax code in 1990 to limit valuation discounts for certain transfers to family members. Perhaps the provision has not been as successful as its proponents had hoped, because the IRS has lost several important cases in this area. A number of the proposed regs. are aimed at reversing those outcomes.

## ”Deemed puts”

The biggest change included in the proposed regs. is that a right to liquidate an interest in six months’ time will be imputed, regardless of any other restrictions on the interest, even if a right to liquidate does not exist and never will exist. The lack of a right to liquidate an interest or force the liquidation of the entity has been the bedrock justifying valuation discounts for lack of marketability and lack of control. There are many other elements in the proposed regs., but the “deemed put” is the one that drives a stake through the heart of minority interest discounts for intrafamily transfers.

Although the proposed regs. will apply prospectively, they also include a recapture rule for transfers within three years of death. Thus, even transactions that already have occurred could be vulnerable.

These new rules will apply regardless of the size of an estate, even to nontaxable estates.

## The real target

What “abuse” was the IRS going after with these proposed regs.? Estate planner Ronald Aucutt was quoted in another *Wall Street Journal* piece, as suggesting that the target was the strategy of placing marketable securities into an LLC and taking discounts as shares are distributed to the family [“The Controversial Way Wealthy Americans Are Lowering Their Estate Taxes,” August 19, 2016]. Substantial estate taxes may be avoided in this way. The family waits until three years after the owner’s death (when the statute of limitations has expired), then dissolves the LLC. “This drives the IRS crazy,” he said.

However, the proposed regs. are not limited to partnerships or corporations that serve as portfolio repositories, but hit operating businesses as well. Many tax observers have objected that these rules are overly harsh and unrealistic in the context of a family-owned operating business.

## Prospects

A public hearing on the proposed regulations is scheduled for December 1, 2016. If they are finalized immediately, they could become effective as soon as the first of next year. Many believe that there is a push to have the new rules finalized

before President Obama leaves office.

The outlook is further clouded by the disparity in views on the future of the estate tax among the presidential candidates. Donald Trump advocates eliminating the estate tax entirely, which would moot the proposed regulations. Hillary Clinton favors reducing the exempt amount and increasing the tax rate, which would make the proposals even more painful for family-owned businesses. What's more, in the event that Hillary Clinton does win the presidency, the odds of the Democrats retaking the Senate also increase considerably. Should that happen, many other proposals for tightening up the estate tax, as included in each of President Obama's budget messages, stand a reasonable chance of enactment as well.

For that reason, many estate planners are getting in contact with their wealthier clients, warning them of the coming changes. The proposed regs. could be a game changer, writes estate planner Martin Shenkman, if they are adopted without significant modification. Year-end estate planning in 2016 could rival the frenzy of 2012, when many were concerned that the federal estate tax exemption might fall to \$1 million.

© 2016 M.A. CO. All rights reserved.