# ADVISORY ALERT

The Internal Revenue Service has proposed regulation changes that impact tax credits of stock gifts or sales to family members in a family business environment. As a result, the valuation discounts that have been a cornerstone to family business succession planning may no longer be available for certain transfers. These changes could go into effect as soon as the next 120 days.

Due to the extreme change the IRS proposed legislation will have on the family business planning environment, we asked our general counsel, ShuffieldLowman, to provide an Advisory Notice detailing the impact IRS 2704 would have on planning and potential outcomes.

As always, if you should have any questions, please call us at 407-578-4455. Thank you for your continued trust and confidence in our services.

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## Proposed Regulations Eliminate Discounts

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The Internal Revenue Service closely scrutinizes transfers between family members of stock, units, and partnership interests ("Stock") in any corporation, limited liability company, or partnership that is family-owned (a "Family Business"). The Service has announced proposed regulations that eliminates the use of valuation discounts that would otherwise decrease the estate and gift tax value of such Stock when transferred by sale or gift to family members. If any of your clients are considering a gift or sale of Stock in a Family Business, they may want to consider taking action right away to implement the planning.

When Stock in a Family Business is transferred between family members, valuation discounts are commonly applied for, among other things, lack of marketability and lack of control. The lack of marketability discount is based on the fact that a Family Business cannot easily be sold on the open market and is not publicly traded; so, the true value of the Stock is actually worth less than a pro rata portion of the total value of the underlying assets. The lack of control discount is based on the fact that a non-voting interest or a minority interest that does entitle the owner to a vote (but not unilateral control of the entity) is worth less to an arm's length purchaser than if they could control the entity. These discounts are designed to reflect the true economics of a Family Business from the view point of a third party purchaser.

Valuation discounts have been an effective tool to reduce or eliminate federal estate and gift taxes on transfers of Stock in Family Businesses for many years. The Service, however, has long sought to limit the benefit of this tool. This has been especially true when the Service determines that the Family Business in question has no legitimate "business purposes." The proposed regulations address the Service's concerns by eliminating all discounts. We expect attorneys, accountants, appraisal experts, and other planners to comment in the next ninety (90) days about the validity and public policy implications of the proposed regulations. However, the very real possibility is that the proposed regulations will be effective when the final version is published, which might occur in as little as one hundred and twenty (120) days.

The new regulations do basically two (2) things. First, when valuing Stock in a Family Business certain restrictions on liquidation rights are disregarded when such rights lapse after a transfer (for instance if the General Partner of a partnership dies) or if after a transfer the restrictions may later be removed by the transferor or the transferor's family. Second, any lapse of voting or liquidation rights is deemed to be a transfer to the other family member/owners in the Family Business. Both rules only apply if one (1) or more members of the family has control of the Family Business both before and after the transfer or lapse. Control may occur when certain voting or equity thresholds are met; furthermore, ownership by a particular family member will be attributed to related family members, making it hard not to pass the threshold of control. In plain English, this means that valuation discounts will no longer be available for transfers of Stock in a Family Business to family members.

Existing Family Businesses would not be "grandfathered" under the proposed regulations. Only gifts or sales completed prior to thirty (30) days after the effective date of the final regulations would be exempt from the new rules. It is also very likely that regardless of how broad or narrow the final regulations may be, the ultimate validity of the regulations will be determined through taxpayers litigating this issue in the Tax and Federal Courts. Therefore, once the new regulations are made final, we may not have any certainty in this area for the next several years while legal battles are fought with the Service.

Because of the uncertainty of the new proposed regulations, we recommend that clients who may be inclined to transfer Stock in a Family Business, whether by gift, sale, or both, consider all of their planning options as soon as possible to determine if they should go ahead with some transfers prior to the issuance of the final regulations.

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If you should have any questions, please call us at 407-578-4455 or reach out to your succession planner.