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Family entity valuation discounts at risk

Proposed regulations under Section 2704(b) may be released this fall which would disallow certain discounts on the value of family-controlled entities for transfer tax purposes.

Currently, Section 2704(b) provides that certain restrictions that would normally justify valuation discounts are to be ignored in valuing interests in family-controlled entities transferred to other family members if, after the transfer, the restrictions will lapse or may be removed by the family. Since the enactment of Section 2704(b) in 1990, however, court decisions and new state statutes have limited the restrictions that are ignored. Consequently, statutory proposals to expand the category of disregarded restrictions under Section 2704(b) were included in the Obama Administration's proposed budgets for fiscal years 2010 through 2013. The proposals were absent from subsequent budgets, causing speculation that the Treasury Department would pursue regulations that would disregard more restrictions.

Treasury Department officials recently indicated that proposed regulations under Section 2704(b) may be released as early as mid-September 2015. The proposed regulations could prohibit discounts for liquidation restrictions that are more restrictive than a specified regulatory standard (currently, restrictions are compared to the terms of applicable default state law). The proposed regulations may also disregard limitations on a transferee's ability to be admitted as a full member of the entity. Additionally, for purposes of determining if a restriction may be removed by family members, certain interests held by third parties (including charities) may be deemed to be held by the family.

There are indications that the proposed regulations will be effective as of their release date. If released, it is unclear whether such proposed regulations will affect all family-controlled entities or if they will distinguish between entities holding primarily marketable securities and entities operating active businesses.

Clients considering transfers of interests in family-controlled entities are advised to take steps to accomplish such transactions as soon as possible due to the potential changes in the law.

The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.