# Treasury Department Issues Proposed Regulations Impacting the Valuation of Family-Owned Businesses

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**PRACTICE AREAS**

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For years, owners of family-controlled companies have taken advantage of applicable valuation discounts to advance their objectives in transferring wealth and company ownership to future generations in a tax efficient manner. On August 2, the Treasury Department issued proposed regulations under Internal Revenue Code Section 2704 to curb the use of valuation discounts in such circumstances. If adopted, these regulations will result in increased wealth transfer taxes (*i.e.*, estate and gift taxes) for these families.

Among other things, the proposed regulations:

- Reduce the applicability of "lack of control" and "lack of marketability" discounts in valuing transfers of interests in family-controlled companies between family members when the interests transferred are subject to restrictions on liquidation. An individual's family members include: (1) his or her spouse, (2) any ancestor, (3) any lineal descendant, (4) any sibling, and (5) any spouse of an ancestor, lineal descendant, or sibling.
- Expand the circumstances in which the lapse of certain voting and liquidation rights applicable to an owner's interest in the company will be treated as a taxable gift (if transferred during life) or a taxable bequest (if transferred at death).
- Apply to: (1) corporations, including subchapter S corporations, (2) partnerships, including limited

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partnerships, and (3) limited liability companies. It is also important to note that the proposed regulations apply not only to "passive" entities (*i.e.*, holding companies for real estate assets and/or marketable securities), but also to operating entities (*i.e.*, those engaged in an active trade or business).

It is common in a family-controlled company context to place restrictions on an owner's right to liquidate his or her interest, and many reasons for the restrictions are non-tax in character. For example, the primary goal is ordinarily the preservation of the family-owned nature of the company. If the proposed regulations are adopted, any restrictions on liquidation rights will largely be ignored for purposes of valuing the transferred interest. This means the transferor may be subject to a significantly increased gift or estate tax bill.

The proposed regulations are subject to a 90-day comment period, followed by a public hearing scheduled on December 1, 2016. Sometime after the public hearing – possibly as soon as the next day, but possibly months in the future – Treasury will issue the final regulations. Final regulations will not be effective until 30 days after the regulations are published as final regulations.

Given the potential financial impact to owners of family-controlled companies, now is the time to determine the impact of the proposed regulations on your business and estate planning goals.

Koley Jessen's Estate and Business Succession Planning and Tax Practice Groups will continue to closely monitor developments related to these regulations to understand the impact on our clients' planning efforts.