Proposed Regulations Under IRC Section 2704

Client Advisories

11.18.2016

For many people the concept of making gifts of property or equity interests in entities such as corporations, partnerships or limited liability companies to loved ones during lifetime or making devises to them by Will after death has been a commonplace Estate Planning tool. What also has been common is the use of a reduction in value for gift and estate tax purpose of those gifted interests or the retained interests when less than fifty (50%) percent of the equity is transferred or retained. That reduction in value is called the “Lack of Control” Discount. A further reduction in value is received when the interest transferred is not readily marketable because of restrictions imposed in the agreement controlling the transfer of those interests. That reduction in value is called the Lack of Marketability Discount. When both Discounts are taken, the taxable value of the gift made or interest retained can be reduced by as much as 40% to 45%, so that a twenty (20%) percent interest in an LLC which owns unencumbered real estate with a fair market value of $2,000,000.00 would not have a taxable value of $400,000.00, but might only have a taxable value of $240,000.00.

These “Discount” Planning Tools are now under attack by means of proposed changes in Internal Revenue Code Section 2704 Regulations. The proposed Regulations are very complex, but the “bottom line” is very simple. Under most circumstances, those two discounts (Lack of Marketability and Lack of Control) will no longer be applicable to many transfers of, or retention of, “Minority” equity interests in closely held entities.

The “good news” is that these new Regulations will not take effect until at least the end of this year or, as many experts project, the end of March or April of next year. Because of the new President-elect taking office in January 2017, they may never be effected, but many Planners who are aware of the extreme negative effect of the Regulations are advising their clients to determine if gifting, with discounts, is of importance to them. If so, they should act now or potentially be barred from the use of these discounts that have been available to us up to now.

If we can be of assistance to you in evaluating the benefit of gifting before the change in the 2704 Regulations become effective, please contact Frank R. Demmerly, Jr. or Richard Jon Contant or another member of the Estates and Trusts Department in Hackensack, N.J., at (201) 342-6000, in Haddonfield, N.J. at (856) 795-2121, or in Princeton at (609) 580-3700.

DISCLAIMER: This client advisory is for general information purposes only. It does not constitute legal or tax advice, and may not be used and relied upon as a substitute for legal or tax advice regarding a specific issue or problem. Advice should be obtained from a qualified attorney or tax practitioner licensed to practice in the jurisdiction where that advice is sought.