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Re: Family Limited Partnerships and Family Limited Liability Companies
Valuation Discounts in Jeopardy

Dear Clients, Friends and Colleagues:

A time-honored technique for the transfer of wealth to the next generation has been the family limited partnership, and in modern times, the family limited liability company. A key benefit in using such a gifting vehicle has been the valuation discount available for such entities.

In a family estate planning entity, generally speaking, assets are contributed into the entity by the senior generation, and gifts of entity interests (which do not have voting rights) are made to the next generation. The gifting of these interests is eligible for a valuation discount because the gifted interests have no "control" or input over the management of the entity, are generally illiquid and are not marketable without the consent of the senior generation.[*]

The discount has been a tried and true arrow in the quiver of estate planners. Today, that discount is in jeopardy.

The tax community is expecting a new regulatory initiative by the IRS/Treasury Department that may be coming out as early as Labor Day. (One basis for this remark derives from the American Bar Association's ("ABA's") recent Taxation Section meeting: Cathy Hughes (an Estate and Gift Tax Attorney in the Office of Tax Policy of the U.S. Treasury Department) noted that proposed regulations that will substantially alter the discount landscape could be released before the fall ABA Section meeting (scheduled in September).

Note that the IRS will be issuing the new valuation regulations after Congress failed to act on a Treasury recommendation to make legislative changes to restrict or eliminate valuation discounts. Consistent with the Obama Administration play book, what cannot be done legislatively may be done by the executive branch.

The understanding we have is that the new regulatory scheme will <u>deny</u> a discount for the gifting of interests in family controlled entities for elements such as lack of marketability, illiquidity, and lack of control in connection with transfers of interests to family members in a family-controlled entity, <u>unless</u> the entity is engaged in an active trade or business. (For example, if the entity conducts a car wash or mercantile business, then the discount may be allowable, but if the entity holds marketable securities (stocks, bonds and the like) or real estate, then it is considered a non-active business and the discount for the gifts in such an entity will be denied.)

We believe that the new regulations, which, presumably, will be promulgated in early September, will not have retroactive effect.

In our opinion, the discount generally taken in connection with gifting of non-controlling interests in family limited partnerships is a component of the valuation methodology for determining the fair market value of the interest conveyed. (But our opinion is not controlling the IRS…).

<u>What To Do</u>:

If you plan on making significant gifts to a family limited partnership or family limited liability company and want to be availed of the traditional valuation discount, you should move expeditiously during the month of August.

By moving <u>expeditiously</u>, one can avoid the risk of the valuation discounts being curtailed (at least for 2015). Of course, these regulations will be controversial and they may hit speed bumps within the IRS promulgation process. Time will tell.

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* Current law generally allows taxpayers to transfer minority interests in family controlled entities to the next generation at a significantly reduced value after giving effect to valuation discounts. Generally, Section 2704 of the Internal Revenue Code, provides that if an interest in a family-controlled entity is transferred to family members, discounts reflecting <u>certain</u> types of restrictions are disregarded in valuing the transferred interest. However, the disregarded valuation restrictions do <u>not</u> include discounts for lack of marketability, lack of control and illiquidity.

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