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TAX AND WEALTH ADVISOR ALERT: VALUATION DISCOUNTS MAY BE UNDER ATTACK BY THE TREASURY

The IRS may very soon have another arrow in its quiver to attack valuation discounts on transfers of equity interests to family members. For those clients who have a plan that utilizes discounted giving, it is critical to have these plans examined by an estate planning expert and perhaps fully executed as soon as possible.

Based upon statements from various IRS and Treasury officials at recent conferences, it is likely that the Treasury Department will be issuing regulations under Code section 2704 that either eliminate or severely limit the use of discounts in valuing equity interests transferred between family members. The regulations under Code section 2704 currently address restrictions on liquidation. However, section 2704 also provides: "The Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family if such restriction has the effect of reducing the value of the transferred interest for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee."

What is interesting is that while this language seems broad enough to empower the Treasury to address (and eliminate) valuation discounts of any type with intra-family transfers, the legislative history to Code section 2704 would indicate otherwise. Specifically, the legislative history provides that "the bill does not affect minority discounts or other discounts available under present law." Without getting into an in-depth dissertation on administrative authority, regulations that are in contravention of legislative history are subject to taxpayer attack.

The bottom line is that it is easier to avoid an IRS fight than to engage in one. Therefore, for clients that are relying on discounted giving, the time to act is now.