Economic and Market Insights

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What Is the Impact of Proposed IRS Regulations on Family Businesses?

Background

On Aug. 2, the US Treasury released proposed regulations under Section 2704 of the Internal Revenue Code that could impact owners of family businesses who use valuation discounts to lower their estate and gift tax liabilities. The IRS and family business owners have debated family business valuation discounts for decades. The latest development comes as the Treasury Department releases this new set of proposed regulations that will make it harder for wealthy business owners to transfer assets to heirs without paying estate and gift taxes. Thomas Bassett, Tax Manager at The Commerce Trust Company, takes a moment to answer some questions about the proposed regulations.

Q. Is my business entitled to a discount now?

Under the current law and regulations, the value of your ownership stake in the business may be entitled to valuation discounts based on lack of marketability or minority ownership position. The proposed regulations would severely limit and possibly eliminate those discounts.

Q. Should I be concerned about the proposed regulations under 2704?

If your family has a family-owned business, or a family LLP or LLC that owns marketable securities or real estate, these proposed regulations are relevant to your estate and gift tax planning. Your tax advisor won't be able to determine the impact to you until the regulations are final, but now is a good time to review your business ownership and estate-planning strategy.

Q. How soon do I need to act?

The proposed regulations were released on Aug. 2 and are subject to a 90-day comment period. If accepted, parts of the rule could take effect 30 days after the final version is released. It is possible that existing businesses could be grandfathered or the regulations could be modified or withdrawn, but it would be a risk to plan on either scenario. Furthermore, even if the regulations are adopted as final, expect future court challenges to them as the debate between the IRS and the taxpayer continues. This timeline means that final regulations will not be in effect until the end of 2016 or the beginning of 2017, at the earliest.

Q. What does this mean for me?

The release of these proposed regulations is a significant move from the Treasury Department that has been anticipated for months. Over the next 90 days we'll learn more about how the public reacts and how the Treasury responds. If your estate tax plan depends on discounts, it's worth a conversation with your tax advisor.

While you are visiting your tax advisor, you may want to explore alternative tax strategies such as a Grantor Retained Annuity Trust (GRAT) or a sale to an Intentionally Defective Grantor Trust (IDGT). The federal interest rates used in those transactions have been low for some time and are even lower in August than they were in July, making these attractive options. Your tax advisor may be waiting to revisit those topics with you, in light of the sense of urgency these proposed regulations have created to wrap up transactions involving family businesses.

Every business owner's situation is different. Contact your Commerce Trust Private Client Advisor or call 1-855-295-7821 for help coordinating your team and facilitating changes needed to your plan to help reduce or eliminate estate or gift taxes.