POLICY
AND
TAXATION
GROUP

TALKING POINTS
Proposed Regulations Changes to Section 2704

Treasury's proposed regulations under Section 2704 eliminate or greatly reduce the discounts for lack of control and lack of marketability for "family related entities," and will discourage families from continuing to operate or build their family businesses and pass them on to future generations or others.

How assets are valued makes a dramatic difference for gift and estate tax purposes. For closely held businesses, there are few if any comparable sales and no ready markets, so their value must be determined by estimating the likely sale price between two willing and unrelated parties. A variety of factors are considered, but two key discounts often apply: (i) **Lack of Control** --- if the interest being transferred is not a controlling interest, it is worth less and (ii) **Lack of Marketability** --- if there no ready market for the interest, finding a willing buyer may be difficult and the asset is worth less.

Under current law and established legal precedent, these discounts often are 30 percent or more of the asset value and reflect the underlying economic reality that non-controlling ownership interests and assets without ready markets are have lower values. If finalized, the regulations could thus increase estate and gift tax liabilities by 30 percent or more on family-owned businesses, resulting in fewer family businesses surviving from one generation to the next.

Points to Make to Treasury:

- Since "non-family related entities" can still take the discounts, these changes will unfairly discriminate against families in favor of non-family related entities by creating two completely different ways in which family and non-family entities are valued.

- These proposed changes to Section 2704 will make it more difficult for families to offer ownership to family members who are well positioned to continue to operate the business after the founder of the business ceases to participate for whatever reason.

- The proposed regulations will harm the American economy. Treasury should encourage the creation and growth of family businesses and not discourage the creation and growth of family businesses by unfairly handicapping them.

- The Treasury Department and the IRS are creating an unfair and discriminatory competitive advantage for "non-family related entities" at the expense of family related entities.

Anticipated Timetable:

August 2 – Rule Proposed
November 2 – Comment Period Closes
December 1 – Treasury Hosts Public Hearing
January 20 – End of Obama Administration
30 Days After Publication – Rule takes effect
Finalized as early as **January 2017**

Strategy Going Forward:

Coordinate the submission of comments to the regulatory docket from a broad and diverse range of stakeholders: The goal will be an overwhelming number of comments evidencing that the proposed regulations (i) represent a step backward from the bipartisan, permanent estate tax relief enacted in 2012, (ii) will have immediate, negative economic impacts on the family business community and reduce the level of family business job creation, (iii) are wholly inconsistent with establish legal precedent, and (iv) unfairly discriminate against the unique structures of family held businesses.

Coordinate a federal legislative response to repeal, or limit the scope of, the regulations once finalized: Although the grant of regulatory authority under Section 2704(b) is broad, the legislative history expressly provided that Section 2704 would not affect minority and other similar valuation discounts. The need to clarify congressional intent could thus provide the basis of a legislative response, which might include: (i) additional correspondence from the Hill asking for clarifications and opposing the rule, (ii) legislation to repeal the rule, and (iii) hearings, speeches and other communications making clear the intent of Congress when it adopted Section 2704.

Coordinate a challenge to the legal validity of the proposed regulations: Ultimately, a court will need to determine whether the regulations are consistent with the underlying statute and to what extent legislative history is relevant and controlling.

https://www.federalregister.gov/articles/2016/08/04/2016-18370/estate-gift-and-generation-skipping-transfer-taxes-restrictions-on-liquidation-of-an-interest#open-comment