

Excerpt from

# Proposed IRC Section 2704: Potential Impacts on Estate and Gift Valuations

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A BVR SPECIAL REPORT



1000 SW Broadway, Suite 1200, Portland, OR 97205

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## **What It's Worth**

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## Introduction

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Shockwaves reverberated through the business valuation world when the U.S. Treasury released (on Aug. 2, 2016) proposed regulations under Section 2704 of the Internal Revenue Code. The proposed regulations are designed to severely limit the use of valuation discounts for any type of family-owned entity for transfer tax (estate, gift, and generation-skipping) purposes. While it was expected that the government would target what it perceives as the aggressive use of discounts for family limited partnerships holding marketable securities, the valuation profession was stunned to see that active family businesses were also included in this new crackdown.

As soon as the proposed regulations were released, valuation professional organizations, including the American Society of Appraisers (ASA), the National Association of Certified Valuators and Analysts (NACVA), and the American Institute of CPAs (AICPA) formed task forces to study the proposed regulations and prepare formal comments. “Weird logic,” “make-believe,” “bad timing,” and “new definition of FMV” are just some of the remarks valuation experts made over the proposed regulations, which “fly in the face” of years of accepted valuation theory. One observer likened the opposition to the battle with the Department of Labor over classifying appraisers as fiduciaries for ESOPs. After a concerted effort by the valuation profession, the DOL backed off of that proposal.

The legal profession has also mobilized, and attorneys have observed that there are several grounds for challenging the proposed regulations. For example, the regulations don’t align with the legislative grant of regulatory authority. Also, they are inconsistent with applicable statutes and legislative history. Of course, the proposed regulations would have a big impact on family wealth planning. If they are adopted as written, families with businesses and investment holding entities will have a powerful incentive to initiate or complete transfers before these regulations take effect.

Hard hit would be family-owned businesses. Incredibly, the proposed regulations would create a two-tiered tax system where a family-owned business would pay higher taxes on transfers than a third-party-owned business. As a result, family businesses might be forced to sell or take on debt to pay the additional tax burden. Groups representing small businesses have also taken action. For example, The S Corporation Association submitted formal comments that do a great job of laying out the problematic issues.

In Congress, bills have been introduced in the House and the Senate to block the proposed regulations. Because of the timing, the challenge will be to build sufficient support on this issue to compel Congress to take action before the end of the year.

The new rules would not be effective until 30 days after the final regulations are published. But, before that can happen, a public hearing will be held in Washington, D.C., on Dec. 1, 2016.

The purpose of this special report is to sort out and explain the business valuation issues embodied in the proposed regulations. We point out, however, that the proposed regulations are extremely complicated and valuation, legal, financial, and tax experts continue to study them. Many questions the proposed regulations raise have no definitive answers, but this publication presents the most current information available.

BVR is following the proposed regulations closely. We will report on the December 1 public hearing as well as any other developments related to the proposed regulations as they unfold. As the owner of this special report, you will receive these news updates via email as soon as they are released. In the meantime, we hope you find this special report helpful in understanding IRC Section 2704 and its potential impacts on the valuation community.

Sincerely,



Andrew Dzamba  
Executive Editor  
Business Valuation Resources

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