


Proposed Regs Seek to Close Estate and Gift Tax Preference

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The IRS on August 2 released guidance designed to close a tax preference on valuing interests in corporations and partnerships for estate, gift, and generation-skipping transfer tax purposes.

The proposed regs (REG-163113-02 ) under [section 2704](#) address the treatment of some lapsing rights and restrictions on liquidation in determining the value of or the transferred interests in corporations and partnerships that result in undervaluation of the transferred interests.

The proposed regs amend the existing regulations to address deathbed transfers that result in the lapse of a liquidation right, clarify the treatment of a transfer that results in the creation of an assignee interest, redefine the meaning of "applicable restriction," and propose new guidance on restrictions on the liquidation of an individual interest in an entity and the effect of insubstantial interests held by persons who are not members of the family.


Mark Mazur, Treasury assistant secretary for tax policy, said in a statement that the proposed regs would eliminate a preference "that certain taxpayers have long used to understate the fair market value of their assets for estate and gift tax purposes."


According to Mazur, "It is common for wealthy taxpayers and their advisors to use certain aggressive tax planning tactics to artificially lower the taxable value of their transferred assets." Mazur added that "Treasury's action will significantly reduce the ability of these taxpayers and their estates to use such techniques solely for the purpose of lowering their estate and gift taxes."

Ronald D. Aucutt of McGuireWoods LLP explained that the proposed regulations target taxpayers who put valuable property into entities such as family-owned partnerships or corporations just for the purpose of reducing the value in the property. "To the extent that the value of the interest in entity in the aggregate is less than the interest in the value of the property, the IRS sees value as escaping the estate and gift tax, and that's what they are after," he said.

The proposed regs are broad and comprehensive, Aucutt said, but added that he thinks overall they will be workable and will achieve the government's objectives. "I do think they are within the statutory authority, and I expect others will disagree," he said.

Robert J. Kovacev of Steptoe & Johnson LLP told Tax Analysts that the proposed regs appear to be an attempt to reverse an adverse Tax Court decision in *Kerr v. Commissioner*, 113 T.C.


449 (1999) . According to the proposed regs, cases such as *Kerr* and other developments have rendered the current section 2704 regulations "substantially ineffective in implementing the purpose and intent of the statute."

According to Kovacev, "reversing IRS losses in court is not a sufficient justification for issuing regulations" under *Altera Corp. v. Commissioner*, 145 T.C. No. 3 (2015) , which requires "reasoned decision-making on the merits."

Treasury may have a difficult time satisfying the *Altera* standard if members of the estate planning, business economics, and valuation communities file comments pointing out that the proposed regulations are a departure from accepted valuation norms, Kovacev said.

James F. Hogan of Andersen Tax LLC agreed that the proposed regs address the issue the IRS had in *Kerr*, which limited the application of [section 2704\(b\)](#) to restrictions on liquidation of an entire interest in an entity. According to Hogan, the proposed regs eliminate the ability to make an end run around section 2704(b) by giving a de minimis interest to a charity or other nonfamily member. The proposed regs create a "very clear test," he said.

Aucutt said the proposed regs provide clarity to an issue where previous guidance was developed on a case-by-case basis by judges. "You never really get a complete set of holistic guidance that way because judges only have to deal with the case in front of them," he said, adding that the rules will be simpler and more efficient for estate planners.

Criticizing the guidance, Richard Dees of McDermott Will & Emery said the proposed regs appear to eliminate all valuation discounts. "Liquidation restrictions and minority and marketability discounts are flip sides of the same coin; you can't separate the two," said Dees, who in August 2015 sent a letter  to the IRS and Treasury addressing concerns he had with the rumored changes the proposed regs would make.