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IRS Proposes Restrictions on Transfers of Closely Held Businesses

Is your manufacturing or distribution company a family-owned business? If so, how far along are you on your estate planning? It might be a good idea to speed things up in light of proposed regulations from the IRS regarding the transfer of interests in closely held businesses.

IRC Section 2704 relates to estate, gift and generation-skipping transfer taxes and the value of interests in closely held businesses. Its intent is to limit valuation discounts for gift and estate tax purposes in family-to-family transfers of interest in family-owned or closely held businesses.

Currently, when assessing the value of ownership interests in these types of businesses for estate and gift tax purposes, it's common practice to discount the value to reflect lack of marketability and control of the shares. The proposed regulations would significantly impact the valuation discounts on these types of transfers, resulting in increased estate taxes.

For example, the current law treats a lapse of voting or liquidation rights as a taxable event if the individual and his or her family members control the entity immediately prior to the lapse. The new regs state that when a person transfers an interest in a way that creates a lapse — and the transfer happens within three years of the transferor's death — there is an additional transfer potentially subject to tax.

The result of this change would be the elimination or substantial limitation of the valuation discounts for these transfers.

The proposed regulations have caused a stir in the estate planning and valuation community. When they were put out for public comment, the reaction was severe. The regs were expected to become final sometime in 2017, but the negative reaction may give the IRS pause.

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With this in mind, talk to your estate planning advisor to determine your next best steps.



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