TAX AND TRUSTS & ESTATES UPDATE

October 2015

New Regulations May Limit Taxpayers' Ability to Discount the Value of Transferred Minority Interests in Family-Owned or Family-Controlled Entities

The Treasury Department may soon issue new regulations that may curtail taxpayers' use of the minority interest and lack of marketability discounts on gifts of interests in family-owned entities. The minority interest discount reflects the inability of the minority owner to exercise effective control over the entity, and the lack of marketability discount reflects the practical difficulty a minority owner would have in selling a closely held interest for which there is no readily available market. These discounts are frequently cited to support appraisals on transfers of closely held interests that reflect a value for the gifted interest that is less than its pro rata value based on the value of the entity as a whole.

For instance, a family-owned or family-controlled entity, such as a limited partnership or limited liability company, may own a closely held business, real estate or marketable securities worth $10 million as a whole. The family member with the controlling interest in such an entity may wish to make gifts to other family members (or to trusts for their benefit) of minority interests in the entity. The underlying equity value of a 10% interest in that entity would be worth $1 million. However, proper application of the minority and lack of marketability discounts in a well-documented appraisal might significantly reduce the value of the transferred minority interest for gift tax reporting purposes well below $1 million.

Section 2704(b)(4) of the Internal Revenue Code empowers the Treasury Department to promulgate regulations that would force taxpayers to disregard "restrictions" on transferred interests to the extent that they reduce the value of such interests for gift or estate tax purposes. Practitioners are concerned that the new regulations might include the minority interest discount and the lack of marketability discount among the restrictions that taxpayers must disregard when valuing transferred interests in entities such as limited partnerships, limited liability companies and other closely-held entities.

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Aside from the substance of these possible regulations, a great deal of uncertainty also exists among practitioners about the scope of such new rules. It remains possible that such regulations, if promulgated: (1) may apply only to passive entities and not to actively managed family businesses; and (2) may not be applied retroactively to the date they are proposed and so would not go into effect until they have been finalized, which could take several months or longer.

Nevertheless, if you are considering a plan to transfer interests in a family-owned entity in the near future or want to learn more about how doing so can be integrated into your larger estate planning goals, please contact us.

Does Your Power of Attorney Need a Fresh Look?

A power of attorney can be the most important estate planning document you have. It's a relatively simple document, but it can save significant agony and expense for your family if at some point you are unable to act for yourself. If you do not have a power of attorney and you become disabled, your family will need to bring a judicial proceeding (with expert witnesses) to have you declared incompetent and to have someone appointed as your guardian. That's an expensive and sometimes heart-breaking process.

For those who do have a power of attorney already, it's a good idea to check it again, especially as you grow older. Most of us name our spouse as the initial agent on our power of attorney. But as we grow older, it may not make sense for the spouse to be the sole holder of the power of attorney. Acting on behalf of a disabled person under a power of attorney can be a big job – often more time-consuming and problematic than being an executor of an estate. In addition to dealing with the management of assets, paying of bills, etc., the agent may also be dealing with staffing issues for caregivers, and general day-to-day personal care of the disabled person. That's a job that maybe warrants "sharing" it with other named agents on the power of attorney, especially if one of the agents (your spouse, for example) is elderly or not in good health, either.

We would encourage anyone who has not recently taken a look at their power of attorney to do so, and to consider (especially if they have named just one agent) if other agents should be added, including perhaps successor agents, who could serve if your initial agent could not, for any reason, act for you. That can be done by adding other agents to the power of attorney, or doing new (and separate) powers of attorney for any agent you might want to add.

The power of attorney can spare you and your family lots of heartbreak and expense, but you need to have agents named in it who are ready, willing and able to serve.

And if you don't have a power of attorney in place already, get one!

Executors Stay Tuned: Estate Tax Valuation Reports to the IRS and Estate Beneficiaries Will Soon be Mandated

A new tax law now requires consistent income tax basis reporting by estates and their beneficiaries. The new rule requires executors of estates that file a federal estate tax return to notify the IRS of the value of all property reported on the return and to provide each estate beneficiary with a statement of the finally determined estate tax value of each property interest the beneficiary receives from the estate (since the beneficiary's basis will in most cases be the same as or derived from that estate tax value). The IRS has not issued forms on which to report such information and has delayed the compliance date for the law until February 29, 2016 to allow it time to issue additional guidance.

Although we do not yet know what complying with the reporting requirements will entail, the new rules are sure to impose an additional administrative burden and significant expense on all affected estates.

As Sherman Wells continues to expand, we would like to warmly welcome two new members to the Tax, Trust & Estates Group:

Allison S. Clayton, Counsel

Allison has extensive experience in both New Jersey and New York advising clients on their estate planning, estate administration and fiduciary litigation needs. Prior to joining Sherman Wells, Allison was an associate in the Trusts & Estates Practice Group of Katten Muchin Rosenman LLP in New York City. She was also previously an associate in the Trusts & Estates Practice Group of Lowenstein Sandler LLP. Allison attended the University of Wisconsin-Madison for her undergraduate studies where she received a BS, with distinction. Allison is a graduate of the William and Mary Law School. She is also a member of the New York State Bar Association, Trusts and Estates Section, and is a past co-chair of the Recruitment Subcommittee of the New Members Committee. In addition to being an exceptional private client attorney, Allison is also a mother of two young children, Sloane and Harry.

Mary Ellen Myers Greene, Fiduciary Accountant

A graduate of the University of Oklahoma in 1981, Mary Ellen went on to attend the University of Oklahoma College of Law where she received her law degree in 1986. After having worked in private practice, including at the law firm of Budd Larner, P.C., and raising two lovely daughters, Alexandra and Melanie, Mary Ellen is now working with us in the estate administration area, marshalling estate assets, administering trusts and preparing federal and state fiduciary income tax and estate tax returns. She has been a wonderful addition to our already highly skilled team of fiduciary specialists.

Welcome to the Sherman Wells Team, Allison and Mary Ellen!

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