Higher Taxes Projected for Transfer of Minority Interests in Hard to Value Assets

August 11, 2016
Hinshaw Alert

On August 2, 2016, the U.S. Department of the Treasury announced proposed regulations to limit or possibly eliminate a strategy long utilized to reduce the fair market value of certain assets transferred during life or at death to family members for gift and estate tax purposes.

It has long been accepted that a gift of a minority interest in assets, such as real estate or a business, is not worth a proportionate share of the full market value of the asset, due to the lack of control of the whole asset and lack of a viable market for a sale of that fractional interest to a third party. This has resulted in appraisals at 20, 30 and even higher percent discounts from the value that would be attributable to the value of the whole asset. Lower appraisals reduce the estate and gift taxes paid on the transfer. If the proposed changes become permanent as written, taxes on these assets will increase.

It should be noted that only decedents' estates valued at more than $5.45 million ($10.9 million per married couple) are currently subject to federal estate taxes, and individuals making gifts are only subject to the federal gift tax for gifts totalling more than $5.45 million during their lifetime. So this proposed change only affects the wealthy. However, this planning should not be overlooked by persons with estates much smaller than $5.45 million ($10.9 million per married couple). Estate tax exemptions have been frequently changed by Congress. Bills have been introduced, unsuccessfully so far, to reduce it to a $3.5 million estate (and gift) tax exemption, and will likely be introduced in a future session of Congress. Also, inflation will certainly be a factor.

Gifts completed, and wills and trusts signed, prior to the effective date will be "grandfathered" regardless of possible future reductions in estate and gift tax exemptions. The proposed regulations will be put into final form after a 90-day comment period and after the time it takes the Treasury Department to accept any changes. They would then become effective 30 days after issuance. So it is possible that these changes could become effective by the middle of 2017.

If you may be affected by gift or estate taxes and are considering major gifts or if your estate plans currently do not utilize valuation discounts, please contact your regular Hinshaw attorney to discuss how the strategy may be beneficial.

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