

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

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SUBJECT

SECTION 2704 PROPOSED REGULATION COMING POSSIBLY IN FALL OF 2015

SUMMARY

Catherine Hughes, Office of Tax Policy of the US Treasury Department, recently spoke at the American Bar Association Conference. Part of her discussion indicated that proposed regulations under IRC section 2704 will likely be introduced in the fall of 2015. Those regulations may limit the availability of lack of control and lack of marketability discounts for transfers of closely held interests among family members. Accordingly, clients contemplating the transfer of closely held business interests should consider making those gifts as soon as possible, prior to the issuance of the proposed regulations.

DETAILS

IRC Section 2704 & Applicable Restrictions

IRC Section 2704 was enacted in 1990 to eliminate perceived valuation abuses concerning certain lapsing voting and liquidation rights as well as certain restrictions on liquidation. Specifically, the statute addresses transfers of interests in controlled corporations or partnerships among family members. In valuing those transfers “applicable restrictions” are to be disregarded. An “applicable restriction” is any restriction that effectively limits the ability of a corporation or partnership to liquidate and, (i) where either the restriction lapses, in whole or in part, after the transfer, or (ii) the transferor or family members can remove the restriction, in whole or in part.

An applicable restriction, however, does not include any restriction imposed by federal or state law, nor any reasonable restriction which arises as part of financing to the corporation/partnership with a person who is not related to the transferor or transferee, or a member of the family of either. Many states enacted statutes that caused a restriction to be imposed by state law such that discounts for those restrictions were still permitted.

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Section 2704(b)(4) provides that the IRS can issue regulations that would disregard other restrictions if the restriction has the effect of reducing the value of the transferred interest, but does not ultimately reduce the value of such interest to the transferee. Under this provision, the IRS intends to issue proposed regulations.

When Will the Regulation Take Effect?

It is not known if this Regulation will be effective as of the date of the Proposed Regulation, or as of the date of issuance of the Final Regulation. If gifts, as described above, are contemplated, the safest approach is to make them prior to issuance of the Proposed Regulation in late summer or early fall of 2015.

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