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The proposed regulations would also add a new section, 25.2704-5, to address restrictions on the liquidation of an individual interest in an entity and the effect of insubstantial interests held by persons who are not a family member. According to the ...

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Recently, the IRS released its proposed rules on estate, gift and generation-skipping transfer taxes and restrictions on liquidation of interest (REG-163113-02). Although only in draft form, ultimately this may have a significant impact on the valuation of an intra-family ownership interest if implemented.

The regulations were published in the *Federal Register* on August 4, 2016.

These regulations pertain to the IRC Section 2704, which provides special rules for valuing intra-family transfers of interest in corporations and partnerships subject to lapsing voting or liquidation rights, and restrictions on liquidation in determining the value of the transferred interests. The proposed regulations will affect certain transferors of interests in corporations and partnerships and are designed to prevent the undervaluation of such transferred interests.

The proposed regulations would amend:

- Section 25.2701-2 to address what constitutes control of an LLC or other entity or arrangement that is not a corporation, partnership, or limited partnership.
- Section 25.2704-1 to address deathbed transfers that result in the lapse of a liquidation right and clarify the treatment of a transfer that results in the creation of assignee interests.
- Section 25.2704-2 to refine the definition of the term “applicable restriction” by elimination of the comparison to the liquidation limitations of state law.

The proposed regulations would also add a new section, 25.2704-3, to address

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disregarded restrictions include one that:

- (a) limits the ability of the holder of the interest to liquidate the interest;
- (b) limits the liquidation proceeds to an amount that is less than a minimum value;
- (c) defers the payment of the liquidation proceeds for more than 6 months; or
- (d) permits the payment of the liquidation proceeds in any manner other than in cash or other property, other than certain notes.

If a restriction is disregarded under the proposed section 25.2704-3, the fair market value of the interest in the entity is determined, assuming that the disregarded restriction did not exist, either in the governing documents or applicable law. Fair market value is determined under generally accepted valuation principles, including any appropriate discounts or premiums.

Before these proposed regulations are adopted as final regulations, consideration will be given to comments submitted to the IRS. A public hearing on the proposed regulations is scheduled for December 1, 2016.

As mentioned, these regulations are still in draft form and only proposed; however, if implemented as currently constituted, these regulations could have a significant impact on the ultimate determination of the fair market value of an intra-family ownership interest relied upon for estate and gift tax purposes. If you are considering transferring an ownership interest in a closely held business to another member of your family, then it may make sense for you to make this transfer sooner rather than later.

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