

Succession planning

The rules are about to change the way family businesses are valued

INTERVIEWED BY CHELAN DAVID

The IRS has released proposed regulations that will significantly change the way family businesses are valued by discontinuing valuation discounts. At this time, however, there is still the opportunity to use valuation discounts to reduce the tax burden when transitioning family-owned entities, at least for a couple more months.

“If you have any interest in gifting or business transition planning, now is the time to do it,” says Peter J. Smith, a member at Semanoff Ormsby Greenberg & Torchia, LLC.

Smart Business spoke with Smith about the changing rules, the importance of moving forward quickly and how an attorney can aid in the process.

How do you anticipate the gifting rules will change?

Historically, when the owner of a closely held business wants to transfer an interest to the next generation through gifting, bequest, or through a generation-skipping transfer, the asset has to be valued for purposes of gift or estate taxes.

Normally, the interest can be discounted up to approximately 35 or 40 percent for various reasons including lack of marketability or if a minority interest is being transferred.

On Aug. 4, 2016, the IRS published proposed regulations that will have the effect of doing away with the discounts. There is a 90-day public comment period followed by a public hearing scheduled on Dec. 1, 2016.

At this time, it is expected that the regulations will become final. When the discounts are removed, it will become much more costly to gift and transfer

PETER J. SMITH
Member
Semanoff Ormsby Greenberg & Torchia, LLC

(215) 887-4132
psmith@sogtllaw.com

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interests in closely held businesses or real estate companies.

How does business succession planning work?

Business succession planning comes in many shapes and sizes. Nevertheless, the general principals are the same – to take advantage of the annual gift tax exclusions and lifetime exemptions to transfer assets tax-free.

The annual exclusion is \$14,000 per person, per year. If you are married, your spouse can also gift up to \$14,000, even if the asset is not titled in his or her name. Such gifts incur no tax and have no filing requirement. You can also use your lifetime exemption. The lifetime exemption is \$5.45 million per person and \$10.9 million with a spouse using what is called “portability.” While this may sound like a lot, there is no guarantee this will remain either.

In President Obama’s 2017 budget, he is seeking to reduce the exemption amounts for estate and generation-skipping transfer taxes to \$3.5 million, reduce the lifetime gift tax exclusion to \$1 million and increase the top federal tax rate from 40 percent to 45 percent. With an uncertain political future ahead, we can never be certain what the lifetime exemption amounts will be.

How can an attorney help with the process?

An attorney can help coordinate estate planning with business succession planning and a gifting plan to maximize use of the exemptions and minimize taxes.

For example, they can help secure the documentation necessary to take advantage of the valuation discounts. Normally, an attorney with their client will retain a valuation expert to perform a formal valuation of the company or the real estate asset.

Based on the valuation and applying the types of discounts described above, assets can be transitioned without incurring any taxes and with minimal use of your lifetime exemption.

If you wait until after the IRS regulations become final, you will lose the benefit of the discounts.

Why is it important to move forward quickly with gifting or business succession plans?

A portion of the proposed regulations become effective 30 days after they become final. Now is the time to take advantage of the valuation discounts. It might not be a transition of an entire interest; perhaps only a small or partial interest. But if you wait, it could cost you a lot more. ●

