

Impending Events May Limit Estate Planning Opportunities: Now is the Time to Review Your Goals and Objectives

Article By:

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We wanted to bring to your attention two possible changes that could have a significant impact on estate planning: rules proposed by the U.S. Treasury Department that would eliminate certain valuation discounts on gifts made during lifetime and at death, and potential changes to the gift and estate tax laws as a result of the outcome of the November election. The potential changes provide a compelling impetus to review client estate planning goals and objectives prior to year-end.

Valuation Discounts

The U.S. Treasury Department recently issued long-awaited proposed regulations for Internal Revenue Code § 2704. These regulations are intended to substantially eliminate valuation discounts that are currently available to transfers of ownership interests in family businesses and other closely-held entities.

The concept behind valuation discounts as they stand is straightforward: if a gift is made of a non-control, illiquid minority position, the value of that gift needs to take into account the discount that a willing buyer would place on the value of that interest. So if, for example, 100 percent of a privately held entity is worth \$15 million, a third-party buyer would not pay \$5 million for a 33 percent interest; rather, the value of that 33 percent interest would be substantially discounted to take into account both the illiquidity of the interest and the minority position. It would be common for a third-party appraiser to attach a value to that 33 percent interest of \$3.35 million, \$3 million, or even lower.

The proposed regulations would eliminate that discount in most cases. Although the proposed regulations may be changed based upon public comments and a hearing that is currently scheduled for December 1, 2016, we recommend proceeding as if the proposed regulations will become final regulations. The expectation is that the proposed regulations would not become “final” until January 1, 2017, at the earliest.

The November Election

Under current law, each person can pass tax free \$5.45 million of assets without the imposition of a federal estate or gift tax. Together, a married couple can give, during lifetime or at death, nearly \$11 million of assets free of federal tax. The Democratic candidate has made a proposal that would

reduce the amount that can pass tax free at death to \$3.5 million per person, or \$7 million in total. This proposal includes a provision that would limit tax-free lifetime gifts to \$1 million per person. The Republican candidate has made a proposal to eliminate the gift and estate tax altogether.

Putting It Together

Under current law, assuming a reasonable 28 percent discount and proper structure, \$15 million of assets can be transferred at a value of approximately \$11 million. The \$15 million of assets, along with any subsequent appreciation on those assets, can be permanently sheltered from estate and gift taxation under current law. If valuation discounts are ended, then only \$11 million can be transferred tax free (the benefit of the discount, \$4 million, is lost), and any change to the estate and gift tax law could reduce that amount further. While we of course cannot predict exactly what, if any, changes will be made, neither change is likely to be effective prior to year-end 2016.

We encourage clients to review their individual circumstances and to contact an attorney from the Trusts and Estates Team to discuss how these pending changes might affect their planning. There are techniques that can balance the transfer of the appreciation of the assets with the need to maintain an income stream. On the other end of the spectrum, there are still opportunities to continue to indirectly transfer additional assets (for example, through the use of grantor trusts) where current cash flow is not a concern.

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National Law Review, Volume VI, Number 250

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