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## IRS Takes Aim at an Estate-Planning Strategy

**It is targeting the use of partnerships and companies to pass a family business or securities to children at a discounted**

**The Internal Revenue Service has signaled it may propose new rules on certain asset valuations by this fall.**

By Liz Moyer - June 26, 2015

The Internal Revenue Service is taking aim at the way wealthy families value certain assets they are passing along to heirs, a move that could crimp estate planning.

Family limited partnerships and limited liability companies long have been used to help pass family-owned businesses to younger generations in a way that may reduce gift or estate taxes. They also have been used in recent years to pass down portfolios of publicly traded securities at a discount, something the IRS is looking to end, some estate lawyers say.

In a typical arrangement, a family limited partnership is set up by a husband and wife to own a business or securities that they expect will increase in value over time. The couple acts as general partners and makes gifts of limited-partner interests to their children. Those gifts remove the assets from the couple's estate for estate-tax purposes even though the couple retains control of the assets.

A key appeal of this strategy is that the combined value of the limited-partner interests is discounted, after evaluation by an appraiser, from the value of the underlying assets—which can mean a lower tax bill.

The value is lower because the limited partners don't control the assets and the individual limited-partnership interests are less marketable than the underlying assets.

Todd Povlich, a partner at Lawrenceville, N.J.-based Management Planning who specializes in valuing closely held businesses and partnerships, says a typical discount range for securities held in them is currently 30% to 38%, based on publicly available market data and his firm's own analysis. Curtailing the discount could especially affect families with "balance sheets dominated by highly liquid assets," he says.

Under IRS rules, the partnership has to serve a legitimate business interest, but that definition is wide enough to include family involvement in investment decisions related to a securities portfolio, lawyers say.

There is language in the tax code that supports discounts for lack of control and marketability, lawyers say. The law doesn't specify the magnitude of acceptable discounts, and disagreements between the IRS and taxpayers frequently get resolved in cases before the U.S. Tax Court.

The tax code also says the Treasury Department can add restrictions on asset discounts. Based on recent comments by IRS officials at industry gatherings, lawyers expect the department will propose to significantly limit or prevent these discounts, especially for entities holding primarily marketable securities.

It long has been an issue on the IRS's agenda, tax lawyers say. Cathy Hughes, a tax lawyer in the Treasury Department's Office of Tax Policy, told attendees at an American Bar Association meeting in May that proposed regulations could be out before the ABA's next taxation section meeting in mid-September, according to several accounts of those present to hear her comments. An IRS spokesman declined to comment beyond Ms. Hughes's remarks.

**Meanwhile, “there’s a great deal of consternation about these [expected] regulations,” says Richard Dees, a partner in the private-client group at McDermott Will & Emery. “There could be a great freeze in the ability to do transactions of all types.”**

In one case heard in Tax Court last year, the estate of someone who had a partial interest in a \$52 million portfolio of government bonds and blue-chip stocks battled with the IRS over the discount. The estate's original appraisal put the discount at 70% of the underlying \$10.4 million market value. After dueling appraisals, the court decided on a \$6.5 million valuation, which was a discount of 38%.

A new limit on discounts would thwart an estate-planning strategy that is often used by wealthy individuals or couples who already have used up their exemptions for giving financial gifts during their lifetimes. In 2015, the exemptions are \$5.4 million for individuals and \$10.8 million for a couple.

**People who have assets above and beyond those thresholds and want to make additional gifts while alive “are out of dry powder,” says Jonathan Forster, a tax lawyer at Greenburg Traurig in Tysons Corner, Va. So they have a particular incentive to use discounts to reduce the size of their taxable gifts.**

**Judith Saxe, a senior wealth strategist at Atlantic Trust, the Atlanta-based U.S. wealth-management arm of Canadian Imperial Bank of Commerce, says the IRS's action potentially could curtail discounts on other assets, including privately held businesses. “There’s a worry that the definition will be broader than intended,” she says.**