PUBLICATION

Treasury to Withdraw Controversial Section 2704 Proposed Regulations

October 12, 2017

The Treasury Department announced on October 2, 2017 that it plans to withdraw proposed regulations under I.R.C. Section 2704 ("Proposed 2704 Regulations") that would have reduced or eliminated certain valuation discounts for family-owned and operated businesses.

Generally, I.R.C. Section 2704 (i) disregards certain restrictions on the ability to liquidate family-controlled corporations and partnerships when determining the fair market value of an interest for transfer tax purposes and (ii) treats as a taxable transfer the value lost when a voting or liquidation right in a corporation or partnership lapses. Since its enactment, much of I.R.C. Section 2704 has been eroded due to changes in state law and case law developments.

On August 4, 2016, the Treasury Department issued the Proposed 2704 Regulations for the purpose of giving I.R.C. 2704 more effect and addressing the perceived abuse of valuation discounts for transfers of family-owned business interests. Immediately after releasing the Proposed 2704 Regulations, the Treasury Department received a significant number of comments and criticisms from attorneys, CPAs, family-business owners and valuation experts. Commentators argued, among other issues, that the Proposed 2704 Regulations were unclear, overly broad and created unrealistic valuations.

The first hint of potentially withdrawing the Proposed 2704 Regulations was on April 21, 2017 when President Trump signed an Executive Order directing the Treasury Department to review all significant tax regulations issued on or after January 1, 2016 and identify regulations from such time period that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the federal tax laws; or (iii) exceed the statutory authority of the Internal Revenue Service. A June 22, 2017 interim Report specifically identified the Proposed 2704 Regulations as meeting at least one of the foregoing criteria. Then, in a Second Report dated October 2, 2017, the Treasury Department recommended that the Proposed 2704 Regulations be withdrawn immediately. In quoting the Second Report, the "regulations would have made it difficult and costly for a family to transfer their businesses to the next generation." Further, the Second Report stated that "Treasury and the IRS now believe that the proposed regulations' approach to the problem of artificial valuation discounts is unworkable." The Treasury Department and the IRS plan to publish a withdrawal of the proposed regulations shortly in the Federal Register.

From a planning perspective, for the present time, valuation methodologies concerning transfers of minority interests in family-owned businesses should remain as they were prior to the issuance of these proposed regulations. If you have any questions about this alert or how these proposed regulations might affect your business, please contact any member of the Firm's Tax Group.