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House Bill Attacks Valuation Discounts for Family Entities

Under current law, when an individual transfers a minority interest in a closely-held entity, appraisers often apply significant discounts to the value of the business because there is no readily available market to sell the interest and the owner has no control over the entity (including when and if distributions are made). An estate tax bill was recently introduced in the House of Representatives (HR 436, Pomeroy (D-ND)) that would restrict estate and gift tax benefits associated with closely-held entities, including family limited partnerships ("FLPs"). The bill would prohibit valuation discounts with respect to the transfer of an interest in a closely-held entity (including an FLP) to the extent the entity holds non-business assets such as marketable securities or real estate that is not used in the active conduct of a real estate trade or business.

Under the proposed law, a minority interest in such an entity held by an individual at death or transferred by gift would be subject to two new valuation rules: "business assets" would be valued after taking into consideration applicable marketability discounts, and "non-business assets" would be valued at their full fair market value. In addition, HR 436 would allow a minority interest discount for the "business assets" only if the entity is not controlled by the transferor's family. As proposed, HR 436 would be effective for transfers occurring after the date of enactment.

HR 436 would also make permanent the current \$3,500,000 exemption available to each individual with respect to federal estate and generation-skipping transfer ("GST") taxes, and the 45% top rate for gift, estate, and GST taxes. However, a 5% surtax would be added to estates over \$10,000,000 to phase out the benefit of the estate tax exemption for larger estates. The amendments regarding the estate and GST exemption amounts and the tax rates would apply to gifts made after December 31, 2009 and estates of decedents dying after December 31, 2009.

The Obama administration has not indicated whether it supports this bill and the bill does not have any other sponsors; with more pressing economic issues it may be some time before we know whether this bill, or one like it, will be seriously considered.

If you have any questions, please feel free to contact one of the attorneys listed below.

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