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IRS Proposal Severely Limits Valuation Discount Planning

Last month the United States Treasury issued proposed regulations to Section 2704 of the Internal Revenue Code. It appears that these regulations will have a dramatic effect on the ability of taxpayers to utilize minority interest and lack of marketability discounts in connection with the sale or gift of interests in closely held entities (whether those entities hold passive investments or an active trade or business). The regulations would apply to both lifetime transfers and transfers at death.

Some of the pertinent provisions regarding the proposed regulations include the following:

- Under the proposed regulations, most restrictions contained in an entity's operating agreement are to be ignored for valuation purposes. Historically, restrictions in operating agreements have justified discounts when valuing an owner's interest in the entity. The proposed regulations, however, would disregard restrictions in an entity's operating agreement unless the restriction is both mandatory under state law and cannot be overridden by the operating agreement. It appears from the proposed regulations that, for valuation purposes, because most restrictions will be disregarded, the owner of the entity would be deemed to have the ability to liquidate his or her ownership interest in the entity and receive a pro-rata share of the entity's assets. This "liquidation right" severely limits the discount, if any, applicable to the owner's interest in the entity.

- Under current law, some of the restrictions under Section 2704 are inapplicable if a non-family member owns a portion of the entity. For example, a charity could be included as an owner to avoid the application of Section 2704. Under the proposed regulations, Section 2704 would still apply to an entity which has a non-family owner if the non-family member's interest has been owned for less than three years, the interest is less than 10% of the ownership interests, and the aggregate value of all non-family owners is less than 20% of all ownership interests. These requirements will make it difficult for clients to include a non-family member owner to avoid the application of the proposed regulations.

- Under the proposed regulations, there will be a look back period for transfers made within three years of death. Specifically, if, prior to a transfer, the transferor had the ability to liquidate the entity based on his or her ownership interest in the entity, and after the transfer, the transferor no longer has the ability to liquidate the entity, then, upon the transferor's death, any discount attributable to the transferred interest would be included in the decedent's estate for estate tax purposes.

There are many more technical details regarding the proposed regulations that are beyond the scope of this article.

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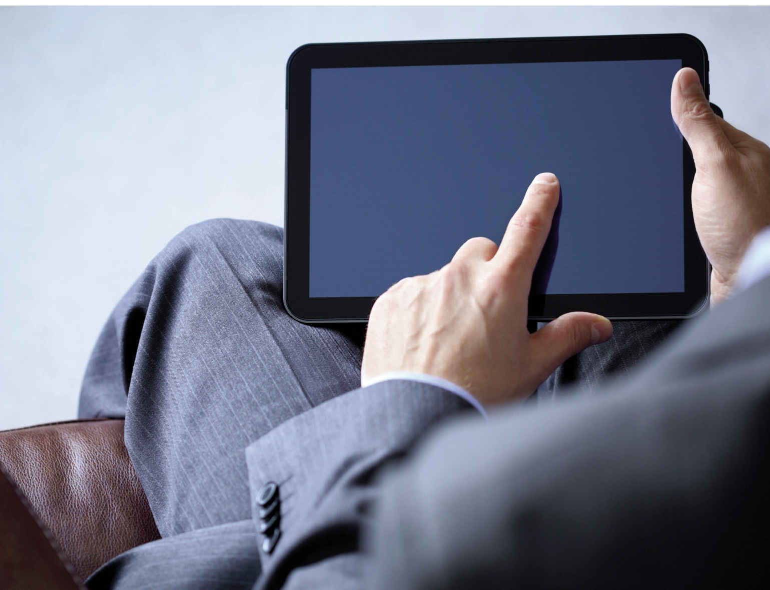
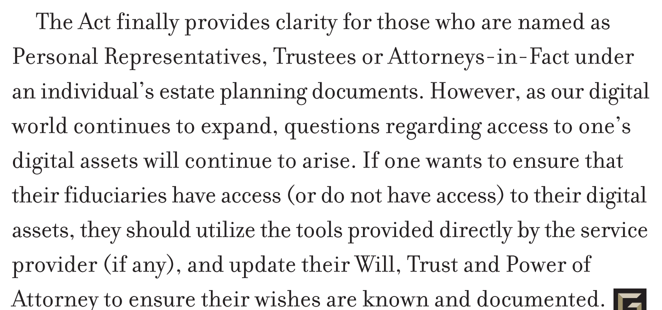
Florida Fiduciary Access to Digital Assets Act

On July 1, 2016, Florida's new Fiduciary Access to Digital Assets Act (the "Act") became effective. The purpose of the Act is to provide direction for fiduciaries (i.e., personal representatives, trustees, guardians, or agents under a durable power of attorney) with respect to accessing another's digital assets. A "digital asset" means an electronic record in which an individual has a right or interest, and includes, but is not limited to: (i) personal e-mail accounts; (ii) electronically-stored information, such as information stored in the cloud, on a computer or other digital device; (iii) content uploaded onto websites (including photos and documents); and (iv) rights in digital property, such as domain names or digital entitlements associated with online games. Fiduciary access to another's digital assets became a topic of national interest as Facebook and Yahoo had public battles with family members of deceased loved ones over access to their deceased family member's account. Many social media websites (such as Facebook, Twitter and LinkedIn) and e-mail service providers (such as Gmail, Yahoo and Hotmail) have strict user agreements which seek to protect the privacy of their customers. However, these user or "terms-of-service" agreements often restrict access to fiduciaries who may need such access to another's digital assets in order to carry out their fiduciary duties. For example, historically, a personal representative had to only collect a decedent's mail in order to find out what assets the decedent owned. However, as banking and bill payments have moved online, it has become increasingly difficult for personal representatives to determine the extent of an individual's assets after he or she dies. The Act addresses these issues by setting forth specific laws regarding a fiduciary's access to an individual's digital assets, either during one's incapacity or upon one's death. The Act also allows individuals to plan for the disposition of their digital assets and ensure that their digital assets are accessed (or not accessed) by certain individuals pursuant to the terms of their estate planning documents.



If a service provider such as Facebook, Gmail or Yahoo provides a user with specific options regarding access to the user's account upon their death, then the options chosen by the user on the website itself would control despite what the individual's Will or other estate planning documents indicate. For example, Facebook now has a "Legacy Contact" feature that provides its users with options on how they would like their account to be handled upon death and the level of access the designated legacy contact would have. In addition, Google has an "Inactive Account Manager" feature that serves the same purpose. Users are encouraged to utilize these features as it will allow their designated representative quick access to their account without court intervention or delay in the event of death. If a user does not take advantage of the specific options offered by a service provider or "custodian" (as defined in the Act), then the individual's estate planning documents would control who has access to their digital assets.

The Act permits individuals to specifically indicate whether their appointed fiduciary under a Will, Trust or Power of Attorney has access to their digital assets and the level of access the fiduciary has. The Act differentiates between the "catalog" of one's electronic communications and the "content" of one's electronic communications. A user's catalog of electronic communications would, for example, include information regarding who the user sent e-mails to and received e-mails from, along with the time and date of each e-mail. Essentially, this means the fiduciary will be able to see the names of those individuals with whom the user sent and received e-mails, but the fiduciary will not be able to read the contents of the e-mail itself. The content of an electronic communication, on the other hand, means the substance or text of the communication. This would include the contents of each e-mail sent or received by the user. Pursuant to the Act, the user, in their estate planning documents, can now specify whether their appointed fiduciary has access to only review the catalog of their communications or whether their fiduciary has full access to see the contents of all their communications.



The Act finally provides clarity for those who are named as Personal Representatives, Trustees or Attorneys-in-Fact under an individual's estate planning documents. However, as our digital world continues to expand, questions regarding access to one's digital assets will continue to arise. If one wants to ensure that their fiduciaries have access (or do not have access) to their digital assets, they should utilize the tools provided directly by the service provider (if any), and update their Will, Trust and Power of Attorney to ensure their wishes are known and documented.

Designated Representatives– A Grantor's Best Friend?

Estate planning often involves the use of trusts. Trusts may be irrevocable trusts created during your lifetime or upon your death. Florida law imposes the obligation on Trustees of irrevocable trusts to provide "Qualified Beneficiaries" (i.e., beneficiaries who are currently eligible to receive trust distributions and those beneficiaries who would become eligible to receive trust distributions if either the current beneficiary's interest terminated or the trust terminated) with information concerning the trust and its administration. The information that the Trustees must provide to the beneficiaries (discussed below) is often voluminous. Recognizing this potential burden, Florida law allows the grantor of a trust to appoint a Designated Representative to receive this information on behalf of the beneficiaries.

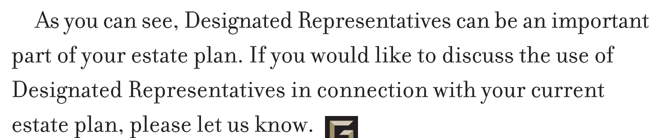
Trustees are required to provide the Qualified Beneficiaries with a copy of the trust instrument (if requested by a Qualified Beneficiary), information concerning the trust's assets and liabilities and the particulars concerning the administration of the trust. In addition, Trustees are required to send detailed accountings to the Qualified Beneficiaries at least annually and upon termination of a trust. There are also a number of circumstances under Florida law when information must be provided to Qualified Beneficiaries, including trust modification and termination proceedings, the exercise of the trustee's authority to "decant" a trust (which involves the distribution of trust assets from one irrevocable trust to a new irrevocable trust), the merger of multiple trusts, the division of a trust into multiple trusts, the appointment and removal of Trustees, and the approval of certain transactions by the Trustees.

This information that Trustees must provide to Qualified Beneficiaries may be problematic for grantors. For example, the grantor may want to keep their finances private from the beneficiaries, may want to ensure an efficient trust administration (i.e., there could be multiple beneficiaries necessitating burdensome reporting requirements), may want to protect a beneficiary whose relationship with other beneficiaries may be strained, or may want to protect a beneficiary whose knowledge of the trust or access to its assets may cause the beneficiary to change their behavior in a negative manner (i.e., increase the likelihood of complacency, substance abuse problems or financial problems).

While the grantor of a trust cannot waive a Trustee's duty to notify, account to, and respond to the requests for information by Qualified Beneficiaries, Florida law provides that a Designated Representative can be appointed to receive this information on behalf of a Qualified Beneficiary. The Designated Representative would represent and bind the Qualified Beneficiaries of the trust. In making the appointment, the grantor can also limit the Designated Representative's authority. The grantor should also consider appointing successor Designated Representatives (or a procedure for the appointment of successor Designated Representatives) in case the named Designated Representative is unable to serve for any reason.

In addition to limiting disclosures of trust information, effective use of the Designated Representative provision can also make trust administration more efficient and provide protection to the Trustees. As indicated above, there may be multiple beneficiaries of a trust. The use of a Designated Representative can enhance trust efficiency by reducing administration expenses because it can be used to minimize otherwise required disclosures, and it can also reduce the burden of getting approval (or lack of objection) from a large class of people. In addition, many provisions of Florida law only require Trustees to give trust information to Qualified Beneficiaries. A Trustee who only accounts to or provides notice to Qualified Beneficiaries may be subject to liability from all beneficiaries unless such other beneficiaries are otherwise adequately represented. Effective use of the Designated Representative allows the Trustees to notify and account only to the Designated Representative who may be able to represent and bind all beneficiaries, not just Qualified Beneficiaries. This is particularly useful to a grantor whose objectives include providing protection to a Trustee who acts in good faith. Of course, the Designated Representative could have liability if he or she does not act in good faith.

As you can see, Designated Representatives can be an important part of your estate plan. If you would like to discuss the use of Designated Representatives in connection with your current estate plan, please let us know.



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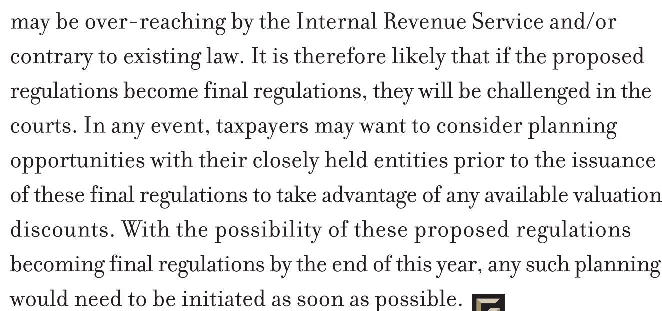
It is important to note that the proposed regulations affecting valuation discounts will not apply until 30 days after being published as final regulations. The Internal Revenue Service has scheduled a public hearing on these proposed regulations on December 1, 2016. It is anticipated that the regulations will not become final regulations until after the public hearing. Consequently, it is likely that the regulations will not apply to any transfers made in 2016 (except that the three year look back period discussed above may apply).

Many commentators have indicated that the proposed regulations may be over-reaching by the Internal Revenue Service and/or contrary to existing law. It is therefore likely that if the proposed regulations become final regulations, they will be challenged in the courts. In any event, taxpayers may want to consider planning opportunities with their closely held entities prior to the issuance of these final regulations to take advantage of any available valuation discounts. With the possibility of these proposed regulations becoming final regulations by the end of this year, any such planning would need to be initiated as soon as possible.



Exclusion of Stock Sale Proceeds Under Section 1202 of the Internal Revenue Code

Many of our clients have started their own business or received stock in exchange for services. For some clients, Section 1202 of the Internal Revenue Code of 1986, as amended, will provide a way to exclude some or all of the proceeds from the sale or exchange of the stock in the corporation. For clients who are (1) eligible taxpayers under Section 1202, (2) owned stock in a "Qualified Small Business" ("QSB") as defined by Section 1202, and (3) acquired the stock within the appropriate timeframe, each of which is explained in this article, Congress provided a rare treat when it renewed and permanently extended Section 1202 in the 2015 "extenders bill" (formally titled the Protecting Americans from Tax Hikes Act, or the "PATH Act") – the ability to recognize substantial appreciation on low-basis assets without any trade-off.

What is a Qualified Small Business?

A QSB is a domestic corporation which (1) is taxed as a C corporation for federal income tax purposes, (2) has aggregate gross assets which at all times did not exceed $50 million, (3) used at least 80% of its assets by value in the active conduct of a "Qualified Trade or Business" during substantially the entire time the taxpayer owned his or her shares in the corporation.

A Qualified Trade or Business is any trade or business *other than* (1) one in which the principal asset of such trade or business is the reputation or skill of one or more of its employees (e.g. law, engineering, performing arts, consulting, athletics, financial services, etc.); (2) banking, insurance, financing, leasing, investing, or similar business; (3) any farming business, (4) any business involving the production or extraction of materials which permits a depletion deduction; and (5) any business of operating a hotel, motel, restaurant, or similar business.

Who are Taxpayers Eligible for the Section 1202 Exclusion?

If the corporation is a QSB, the taxpayer must have (1) held the stock in the QSB for more than 5 years and (2) received the stock:

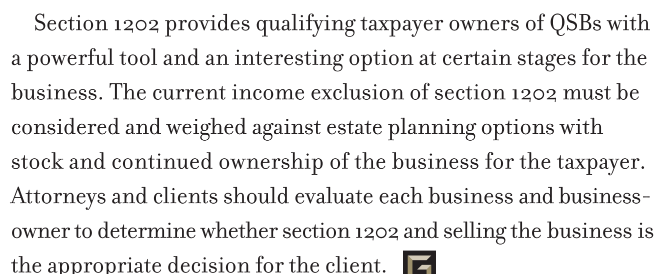
(a) as part of an original issuance either directly from the company or through an underwriter, and
(b) in exchange for
  (i) money or other property, or
  (ii) services provided to the corporation other than as an underwriter of such stock.

As noted above, a qualifying taxpayer may *not* be a corporation. In certain circumstances, a taxpayer who holds QSB stock indirectly, through a pass-thru entity, may be able to use the section 1202 exclusions.

What is the Exclusion under IRC 1202?

If the corporation meets the QSB requirements and the taxpayer meets qualifications set forth above, section 1202 provides the following permissible gain exclusions:

Date Stock Acquired:	**Percentage of Gain Excludable:**
On or before February 17, 2009	50%*[1]
After February 17, 2009 and before September 28, 2010	75%
On or after September 28, 2010	100%



Section 1202 provides qualifying taxpayer owners of QSBs with a powerful tool and an interesting option at certain stages for the business. The current income exclusion of section 1202 must be considered and weighed against estate planning options with stock and continued ownership of the business for the taxpayer. Attorneys and clients should evaluate each business and business-owner to determine whether section 1202 and selling the business is the appropriate decision for the client.

1 If the QSB was an "empowerment zone business" and the QSB stock was acquired between December 21, 2000 and February 17, 2009, up to 60% of the gain on the disposition may be excluded.

1. All references to available/allowable estate tax exemptions and credits relate only to persons who are U.S. citizens; references to gift tax exemptions/exclusions generally apply to U.S. citizens and U.S. Lawful Permanent Residents (i.e., "green card" holders). While most transfer tax savings techniques discussed can be fine-tuned to benefit non-U.S. citizens, the results will differ and must be addressed on a case-by-case basis.

2. **The 2016 Annual Exclusion** is an aggregate of $14,000 per donee, from each donor; or $28,000 per couple, if a husband and wife file a "split gift" Gift Tax Return on gifts made from either of their assets this year. **Medical/Tuition ["ed/med"] Exclusion Gifts** allow a donor to pay an unlimited amount for anyone's medical or tuition expenses (including health insurance premiums), if paid directly to the service provider, without incurring any gift tax or use of their unified credit; and, if properly structured, ed/med gifts should not reduce the $14,000 amount available to be given to the same person by a donor each year.

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