

PUBLICATION

Proposed Estate Tax Legislation Will Eliminate or Reduce Valuation Discounts for Family Entities and Will Freeze Credit Amount at \$3,500,000

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The federal estate tax exemption (the amount of assets that can pass estate tax-free) increased from \$2,000,000 to \$3,500,000 for individuals dying on or after January 1, 2009. The federal gift tax exemption remains at \$1,000,000, and the maximum estate and gift tax rate remains at 45%. Under current law, if a person dies in 2010 there will be no estate tax, and for individuals dying in 2011 and after, the estate tax is reinstated with only a \$1,000,000 exemption and a maximum estate and gift tax rate of 55%. It is widely anticipated that Congress will enact legislation this year concerning the estate and gift tax, in order to avoid the current law's full repeal in 2010.

On January 9, 2009, the "Certain Estate Tax Relief Act of 2009" (HR 436) bill was introduced in the House, proposing to freeze the estate tax exemption at \$3,500,000, freeze the maximum estate tax rate at 45% (50% for some estates over \$10,000,000), and eliminate or reduce valuation discounts for transfers of interests in closely-held entities such as limited partnerships, limited liability companies and corporations. Other various provisions are included in the proposed bill, as well.

Under current law, when an individual transfers an interest in a closely-held entity by gift or at death, the interest is valued at its fair market value on the transfer date. Since closely-held entities are not publicly traded, and since the interests transferred in such entities typically do not represent a controlling interest, appraisers will often apply both a lack of marketability discount and a lack of control or minority interest discount when they value the interest being transferred. The proposed bill provides that, with the exception of an entity that is actively traded, there may be no lack of control or minority interest discount when valuing the transferring interest. Also under the bill, the value of any "nonbusiness" assets held by the entity must be determined as if the transferor has transferred those assets directly to the transferee with no valuation discount allowed. For example, an entity that does not operate a business and holds only cash and marketable securities would be subject to this provision.

The bill provides that the new law shall apply to transfers after the date of enactment. This means that any transfer where discounts are important, and where the transfer would be affected by the bill, must be completed before enactment. There is, however, always a chance that this bill could be changed in the final version to be applied retroactively.

There are also several other proposed bills dealing with estate tax currently pending in the House, and there is no certainty that the provisions concerning valuation discounts will be included in the final legislation. Nevertheless, if you anticipate making a gift of an interest in a closely-held entity or entering into a transaction taking advantage of a discounted interest (such as a sale to a Grantor trust) this calendar year, it would be prudent to complete the gift or transaction as soon as possible.