



Valuation Discounts for Estate Taxes

The Issue

On August 2, 2016, the U.S. Department of Treasury proposed changes to federal estate tax regulations that will have a significant, negative impact on small and medium businesses, including hardwood lumber businesses. The proposed regulatory changes under Code Section 2704 potentially prohibit the use of any type of discounts that are customarily applied in valuing assets and property for both tax and non-tax purposes. These include discounts for both minority interests and lack of marketability. The proposed changes add considerable complexity to the process of valuing and transferring closely-held interests, adding to the costs and burdens for family business owners.

Background

Since 1958, the measure of value for estate and gift tax purposes has been closely aligned with the value used for non-tax purposes; that is, the price at which interests in the company would be sold to an unrelated third party. Traditionally, in valuing interests in a family business, an appraiser will first value the entire business on a controlling, marketable basis, and then adjust this value with discounts for:

- *Lack of control / minority interest* – Owners who do not have a majority of the interests in a business generally lack the authority to influence how the business is run.
- *Lack of marketability* - All things being equal, investors have a preference for assets that can be easily traded, such as stocks of publicly traded companies, and will typically pay less for investments that are not very liquid. Interests in privately held companies are typically illiquid relative to these publicly traded investments.

Implementing the changes as proposed would lead to payment of estate tax on such interests using values that far exceed the values that would be used if the interests were actually sold. In effect, a tax on value that does not exist.

Hardwood Federation Position

The Hardwood Federation supports federal tax policies that ease transition burdens and ensure the continued viability of family owned hardwood businesses including family owned lands, which supply the bulk of our raw materials. The Hardwood Federation supports continued efforts to lower the estate tax rate and opposes measures to increase the estate tax rate which would be the case under the proposed regulatory changes to Section 2704.

The proposed regulations do not become effective until at least December 1. Prior to that date, the Hardwood Federation requests that the Treasury Department withdraw the proposed regulations, or, at a minimum, add a clearly defined exception for active businesses.