

U.S. Treasury Department Proposes Estate Tax Changes that Will Hamper Family Business Survival and Cost Jobs

The Obama administration's Office of Tax Analysis has proposed a series of changes in tax planning that will make it more difficult for family businesses to continue over future generations. Each of these changes should be rejected in order to help ensure the survival of family businesses, their workers, and their communities.

1. Removing minority and lack-of-marketability discounts.

When a family business owner gifts ownership in the company to his or her children, the children typically become "minority" owners. Their shares are worth less to prospective buyers than the majority owner's shares.

The IRS currently grants minority discounts as a way of recognizing that the "minority owner" of a family business (one who owns less than 50% of a business) cannot obtain the same price-per-share as the "majority owner" (one who owns more than 50% of a business). Minority discounts allow a minority owner to value shares lower when reporting to the IRS, and thereby reduce overall tax liability. No family business owner should be forced to pay more in taxes than the price the shares would obtain in the market.

Further, family business owners often place restrictions on the sale of the shares that they gift to their children, in order to ensure that ownership of the business stays within the family. These restrictions – a lack of marketability – reduce the value of the shares. Current law recognizes the reduced value with special discounts for estate tax purposes. Eliminating these reasonable discounts will force family business owners to report higher values to the IRS than they could expect to obtain from a buyer, and thereby pay higher taxes at death. Treasury's proposed changes clearly discriminate against families.

2. Nullifying the Effectiveness of Grantor-Retained Annuity Trusts.

Some family business owners create a grantor-retained annuity trust (GRAT) to reduce the tax exposure of their business as it grows. The GRAT enables a family business owner to gift appreciation in the value of the trust to his children without tax penalty to the family business. However, the GRAT is only effective if the family business owner is alive at the end of the term of the trust. Consequently, family business owners will set up short-term, 2-year trusts in order to increase the likelihood that they will survive the GRAT's term.

Treasury's proposed changes will make GRATs ineffective by only allowing for long-term, 10-year trusts.

3. Arcane Technical Rules on the Reporting of Tax Basis.

Family businesses face a myriad of reporting requirements that can only be handled by their tax-attorneys. Most of these requirements simply serve to create work for their attorneys, driving up the tax-planning costs for family-business owners and shifting capital away from job-creation and other productive activities. Obama has proposed to force even those families who are below the estate tax exemption threshold (\$3.5 million) to file an estate tax return – a cost of \$5-10 thousand.

This change and others will force family business owners to complete mountains of new paperwork, which means thousands of dollars in new attorney fees.