

Tax Planning

Update for Business Owners

by Gerald M. Morello, Jr., Esq.; Robert E. Emmitt, Esq.



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We just completed a long, tumultuous presidential election, and the only thing that remains certain still is death and taxes. To a great extent, we do not know if and how a Trump presidency will affect the federal tax system. President-elect Trump campaigned on the promise of lowering the top corporate tax rate from 35%, to 15%. He also promoted the idea of allowing owners of small businesses the option to elect a flat tax of 15% on pass-through income. He also expressed his willingness to eliminate the alternative minimum tax and the net investment income tax, and eliminate the estate tax for all estates worth less than \$10 Million, while requiring estates over the \$10 Million amount to pay capital gains tax on the inherited wealth. Due to the contentious nature of politics in Washington, D.C., we do not know if and when any of these plans or policies will be implemented. However, there have been recent developments that will greatly impact federal transfer tax rules and regulations.

I. Changes to the Regulations

On August 2, 2016, the United States Treasury issued proposed regulations under the authorization contained in Section 2704(b) of the Internal Revenue Code. Although the details of how the proposed regulations accomplish it are complex, they would virtually eliminate all minority discounts and lack of control discounts for family controlled entities, whether active businesses or not, for federal estate, gift, and Generation-Skipping Transfer (GST) tax purposes. The new regulations would clarify the Internal Revenue Code's concept of control, aggregate certain transfers made within three (3) years of death and those occurring at death, and introduce new restrictions on business interests that would be ignored for wealth transfer tax valuation purposes (known as "Disregarded Restrictions").

II. Current Planning Opportunity that Will Be Lost

For many years wealthy individuals and business owners have learned that gifting away their property and/or some of their ownership interest(s) in a business entity (shares of stock, LLC membership interests, and partnership interests), while still maintaining control over the property or business, is an advantageous way of passing on property or a business to the next generation, while receiving significant discounts for estate tax purposes. In the business setting, a family owned company can convert their stock into voting and nonvoting shares, with the nonvoting shares representing up to 99% of the company's issued and outstanding shares. After the recapitalization, the owner can then gift the nonvoting shares (only) to his or her children and extended family members. Ultimately, the original owner can gift away up to 99% of the value in the company, but still retain 51% or more of the voting interest in the company, thereby retaining control.

The main advantage of a recapitalization and gifting plan is that you are able to reduce the value of your estate, so as to avoid potential estate tax. There are also underlying valuation benefits that are not so apparent. In particular, under the current rules, the Internal Revenue Service and the U.S. Tax Court allow you to discount the value of a business interest that is transferred and/or the business interest you continue to

hold due to lack of control and lack of marketability. These discounts allow you to, in fact, transfer more value in the company free from gift tax, while also avoiding estate tax upon your death.

People don't own an active, operating business are not "out of luck." In fact, many wealthy people establish passive investment holding companies for the sole purpose of taking advantage of the discounts that are currently allowed, and the IRS and the U.S. Tax Court will allow the discounts if the company is set up appropriately.

Unfortunately, the proposed regulations issued under Section 2704 would, if adopted in final form, have a significant impact on the wealth transfer tax valuation of family controlled businesses. Essentially, almost no minority discounts

would be allowed. Although an apparent exception is made for restrictions mandated under state or federal law, it seems doubtful there will be any such laws available as only laws under the United States may apply and any restriction contained in such a mandatory statute will not apply if the entity could have been formed under another statute of the state (or federal law).

III. Effective Date of the Proposed Regulations

Your estate and/or business could be affected greatly by these new rules. Therefore, it is important for you to take advantage of the current rules before the proposed regulations become effective. A hearing on the proposed regulations is scheduled for December 1st. The Treasury has



announced that most of these new rules would not be effective before thirty (30) days after the regulations become final. Hence, it is likely they will take effect sometime early next year, making it necessary to complete any discount-related planning as soon as possible. The conventional wisdom of tax attorneys is that the Internal Revenue Service will likely push to finalize the new regulations sooner rather than later,

before President-elect Trump is sworn into office.

IV. Make informed decisions

If you own a business, or you think the proposed regulations under Section 2704 will affect you, we encourage you to speak with a licensed attorney who understands advanced tax planning, specifically in the estate planning

field. Remember that there are many issues to address, so make sure you are fully informed of what options are available, and what planning may still be available, for you and those close to you.

Advanced tax planning can maximize the control you have over your assets, ensure the person you select will handles your affairs upon your death or incapacity, protect privacy, and usually pays for itself

based on the minimization of taxes. If you would like a copy of any prior articles written by our law firm, please contact our offices. ■

For further info or to schedule an appointment regarding any issues raised in this article, please contact the Morello Law Group, P.C., Gerald M. Morello, Jr., Esq., and/or Robert E. Emmitt, Esq. at 734-281-6464 or morello@morellolawgroup.com

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EDUCATION

B.S.A., with High Honors in Finance and Managerial Economics, University of Michigan – Dearborn; J.D., Higgins Scholar and Notre Dame Law School Scholar, Notre Dame Law School; M.B.A., with Honors, University of Notre Dame Graduate Business School.

AREAS OF PRACTICE

Estate Planning; Tax Planning; Wills; Trusts and Estates; Probate and Trust Administration; Business Law; and Business Planning.

CAREER

Mr. Morello has personally developed or supervised over 7,500 Estate Plans over the past twenty-three years. He is a frequent speaker on estate and business planning; selected as Downriver's Estate and Business Planning Attorney; selected as one of Detroit's top estate planning lawyers by DBusiness Magazine; awarded the Five Star Estate Planning Attorney in 2014, 2015 and 2016; and awarded the Martindale-Hubbell Client Distinction Award in 2015; and he was awarded the 2016 Northville Record People's Choice Award for Best Attorney.

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CAREER

While in law school, Mr. Emmitt was a member of Law Review and served as a Title Editor. Mr. Emmitt was also elected and served as president of his law school class, and he served on the Student Bar Association's Board of Governors. Some of Mr. Emmitt's academic accomplishments include receiving Book Awards in Estates and Trusts, Estate and Gift Tax, Remedies, and Torts. He is a member of the Young Lawyers Section of the Michigan Bar, and sections involving Elder Law, Probate and Estate Planning, Disability Rights, and Real Property Law.