

FAIR VALUE™

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VALUATION DISCOUNTS- CAN YOU EXPLAIN YOURS? NEW IRS GIFT TAX FORM RAISES THE RISKS

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“We’ll take a 30% minority discount on the gift tax return instead of having a formal valuation. It may never get audited, and if it does 30% is a safe discount that’s within the ‘house limits’ of the IRS.”

Not Anymore- The Rules Have Changed. On its new form 709 (U.S. Gift Tax Return), the IRS is upping the ante on valuation discounts, making it clear that taxpayers can no longer count on luck or so called “standard discounts” to carry the day. Instead, taxpayers will have to provide solid and objective support for the validity of any valuation discounts used. Here’s what the form’s new instructions say:



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“Valuation Discounts- If the value of any gift you report in either Part 1 or Part 2 of Schedule A reflects a discount for lack of marketability, a minority interest, a fractional interest in real estate, blockage, market absorption, or for any other reason, answer “Yes” to the question at the top of Schedule A. Also, attach an explanation giving the factual basis for the claimed discounts and the amount of the discounts taken.”

In short, the IRS wants to know two things:

1. Did you take a discount? If you did

they’ll know to focus their attentions on you.

2. If you took a discount, is it legitimate and supported?

The Implications. The change in the form should not discourage clients from taking valuation discounts if they are reasonable and supported by the facts. However, the facts will have to be explained in a way that can withstand scrutiny. In other words, it is no longer enough to wing it, even when it comes to explaining the rationale for the discounts. If the IRS does not later accept the client’s rationale, attorneys could be exposing themselves to malpractice claims from their clients. The best advice is to have a professional business valuation prepared which provides unbiased market-based support for the value reached. A qualified business valuator uses current market data and accepted approaches which the IRS staff of valuers will know how to review for legitimacy and which will have a much better chance of being accepted. ♦

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