SHELLEY DRURY, CPA, CVA, ABV, CFF

DIRECTOR OF LITIGATION AND VALUATION SERVICES

VALUATION DISCOUNTS FOR GIFT AND ESTATE TAX SAVINGS

HOW GETTING A VALUATION NOW CAN SAVE YOU LATER

ANNUAL GIFTING OF MINORITY OWNERSHIP INTERESTS

As a valuation expert, I am often called upon by clients, estate planning attorneys, and other CPAs to provide my opinion as to discounts applicable to gifts of minority interests in Limited Liability Companies (LLCs) and Family Limited Partnerships (FLPs).

LLCs and FLPs often hold real estate (commonly referred to as “holding companies”) and are frequently used as an estate planning tool to transfer wealth from one generation to the next. This is done by making annual gifts of minority ownership interests.

These entities are controlled by operating agreements with varying degrees of restrictions, allowing the gifter to retain control of the entity and the assets while transferring value to the next generation.

STANDARD OF VALUE

The standard of value for gift and estate tax purposes is “fair market value,” which is generally defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts.

VALUATION DISCOUNTS

When gifts of minority interests are made in an LLC or FLP, valuation discounts are allowed by the Internal Revenue Service in determining the fair market value of the gifted interest. Accordingly, the values of minority ownership interests in these entities are lower than outright ownership in the assets held by the entity because of the restrictions contained in the operating agreement. The most common valuation discounts are discounts for lack of marketability and lack of control. These discounts typically range from 25% to 45% depending on a number of factors.

THE VALUATION

An opinion relative to the appropriate size of the discounts should be determined by a skilled valuation analyst, and based on the following:

- an analysis of the assets held by the entity and the condition thereof
- the size of the interest being gifted
- restrictions outlined in the operating agreement

The restrictions usually significantly limit the power of minority interest holders to vote, participate in management, replace the manager(s), force distributions, liquidate assets, and transfer or sell their ownership interest.

The IRS allows an annual exclusion gift of

$15,000

(nontaxable) per person, per gift.

Many clients choose to make annual nontaxable gifts of $15,000 per recipient. Others make larger single or multiple gifts of minority ownership interests.

EXAMPLE:

THE BENEFITS OF HAVING A GOOD ESTATE PLAN

SCENARIO 1

Mom and Dad own an apartment building outright, valued at $1,000,000, with no debt against the property. They want to gift the property equally to their 4 children. They both make gifts of 12.5% to each of their children (a total of 100% ownership interest among 8 individual gifts of 12.5%). Under this scenario, **the gifts would be subject to gift tax with 8 gifts valued at $125,000 each**. In total, **the fair market value of the gifts is $1,000,000**.

SCENARIO 2

Mom and Dad own the same apartment building with no debt against the property, but instead of owning the building outright, they place it in an FLP. An operating agreement is drafted by an attorney, placing significant restrictions on the rights of minority partners. Mom and Dad each make gifts of 12.5% in the FLP to each of their 4 children, gifting a total of 100% in the FLP. Based on these restrictions in the operating agreement, the valuation expert performs an analysis and determines that a combined discount of 38%, for lack of marketability and lack of control, is appropriate to be applied to individual gifts of 12.5% in the FLP. Under this scenario, **the gifts would be subject to gift tax with 8 gifts valued at $77,500 each**. In total, **the fair market value of the gifts under Scenario 2 is $620,000**, which is $380,000 less than the fair market value of the gifts in Scenario 1, significantly reducing potential gift tax and future estate tax liability. This allows Mom & Dad to execute their estate plan in less time.

WHY NOW?

If you already have an LLC or FLP in place and want to make gifts, now is the perfect time to get a valuation as to the appropriate discounts applicable to gifts of minority interest.

Valuations are generally valid for six months, so to get one now allows clients to make gifts in two calendar years (December 31, 2019 **and** January 1, 2020) while only incurring the cost of a single valuation, and saving thousands of dollars in associated professional fees.

SHELLEY DRURY, CPA, CVA, ABV, CFF

ABOUT US

Our 20+ years of experience, combined with specialty credentials, ensure our preparedness and accuracy in making assumptions and adjustments - available only from an exceptionally qualified team, and supported by the resources of a full-service CPA firm.

BUSINESS VALUATION

For businesses of all sizes, we prepare business valuations for marital dissolution, buy/sell agreements, business loss claims, estate planning, gift and estate taxation, admission or buy-out of shareholders, and financing purposes.

FORENSIC ACCOUNTING

For businesses or individuals, when money goes missing, we conduct fraud investigation and detection via discreet analysis of internal controls, accounting records, and staff interviews. Our prepared loss reports can be used in the event of an insurance claim or prosecution.

ECONOMIC LOSS CALC

Typically resulting from violation of non-compete agreements, fire damages, theft loss, easement issues related to access and unfulfilled contracts - we have testified multiple times in personal and business economic loss cases.

Valuation services are extremely specialized, and few CPAs are credentialed to prepare the necessary reports. Our team has extensive training, significant experience, and a keen eye for detail. Contact us today to get started on the valuation process for your year-end gifting!

1102 BROADWAY, SUITE 400
TACOMA, WA 98402

THE DOTY GROUP P.S.
CERTIFIED PUBLIC ACCOUNTANTS

(253) 830-5450
SDRURY@DOTYGROUPCPAS.COM