October 27, 2016

DEPARTMENT OF THE TREASURY
CC:PA:LPD:PR (REG-163113-02)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, DC 20044

By: Certified Mail

Re: Comments Regarding Proposed Treasury Regulation (REG. 163113-02) (to be used also as an Outline of Topics to be Discussed at the Public Hearing Scheduled for December 1, 2016.)

Dear Sir/Madam:

This letter is being sent to you on behalf of the National Association of Certified Valuators and Analysts® (also referred to herein as "NACVA®") regarding Proposed Treasury Regulations affecting Internal Revenue Code §2704.[1]

In summary, it is the position of NACVA that these proposals ignore economic realities and would, if finalized in their present form, work to artificially inflate values for a specific targeted group of taxpayers and not others (and therefore lead to taxation of citizens without uniformity). Further, these proposed regulations would negatively impact small business owners, family owned businesses, and family farms with the ultimate effect of putting many of those enterprises out of business.

INTRODUCTION

The following comments and outline are respectfully submitted for consideration by Treasury and the Internal Revenue Service (hereafter, the "IRS") in compliance with those instructions set forth in the Proposed Treasury Regulations titled, Estate, Gift, and Generation-skipping Transfer Taxes; Restrictions on Liquidation of an Interest, (REG. 163113-02), (hereafter, the "proposed regulations"), as released by Treasury on August 2, 2016, and as published in the Federal Register on August 4, 2016. The information set forth in these comments and the outline of those topics to be addressed at the public hearing scheduled for December 1, 2016, was developed as a result of careful consideration of the proposed regulations as they are currently drafted and the profound effect that these proposed regulations will have on future valuations of all business entities, and most significantly, small businesses, family owned businesses and family farms, making the transfer of these businesses and farms to junior generation family members significantly more costly in terms of transfer taxes, and likely leading to the closure and sale of many of these businesses and farms.

[1] All references herein to the Internal Revenue Code, the Code, or IRC is intended to reference Title 26 of the United States Code and the Internal Revenue Code of 1986, as amended, unless otherwise noted.

NACVA ORGANIZATION

NACVA, headquartered in Salt Lake City, Utah, is a global, professional association that delivers training and certification in a number of financial consulting fields, including specifically, business valuation, but also including financial litigation, expert witnessing, forensic accounting, fraud risk management, mergers and acquisitions, business and intellectual property damages, fair value, healthcare valuation and consulting, and exit strategies. Founded in 1991 and celebrating 25 years of service to the accounting and financial consulting profession, NACVA has trained nearly 30,000 CPAs and other valuation and financial consulting professionals, and certified over 13,000 in the fields of business valuation, financial forensics, and related specialty services serving the legal, business, and regulatory communities. NACVA has also trained a great many engineers and valuators within the Internal Revenue Service.[2]

NACVA'S POSITIONS ON THE PROPOSED REGULATIONS[3]

The proposed regulations are in complete opposition with generally accepted valuation practices, historical company sales' transaction data, and the Uniform Standards for Professional Appraisal Practice (USPAP), the American Institute of Certified Public Accountants' Statement on Standards for Valuation Services, VS Section 100, as well as the professional standards developed and promulgated by NACVA and adopted by our more than 7,000 members. The proposed regulations will result in valuation outcomes which will have no direct relationship to market reality and will instead be based upon a constructed definition of value which has never existed and has no historical basis in tax statute, judicial findings, and, importantly, economic and finance principles. The proposed regulations will force all business valuators to change from using methodologies based upon generally accepted valuation principles to methodologies which lack any reasonable market basis or economic foundation.

1. <u>The Term "Minimum Value" Should Not Replace Fair Market Value</u>

Fair market value has been the definition of value for estate and gift cases for nearly 100 years. The Treasury Department has defined this term in Treasury Regulations §20.2031-1 (b) and §25.2512-1. Under these regulations,

> "Fair market value" is defined as: "The amount at which a property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts."

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[2] NACVA has nearly 7,000 members worldwide and operates international chapters in Africa, Canada, Europe, the Middle East, Taiwan, and the United States all supporting the globally recognized Certified Valuation Analyst® (CVA®) designation. NACVA is a member of the Institute for Credentialing Excellence™ (ICE™). NACVA's CVA designation is the *only* valuation credential accredited by the National Commission for Certifying Agencies® (NCCA®), the accreditation body of ICE. Other professional certifications offered by NACVA include: the Master Analyst in Financial Forensics™ (MAFF®) and the Accredited in Business Appraisal Review™ (ABAR™) designation with approximately 80% of NACVA's membership holding one of the Association's three credentials. NACVA's membership comprises some of the most intelligent, dynamic, and innovative people in the financial/accounting community. Throughout the past quarter century, NACVA has supported business valuation and financial litigation training for the American Institute of Certified Public Accountants, Internal Revenue Service, National Judicial College, and the Securities and Exchange Commission.

[3] Within the discipline of business valuation, NACVA has developed and provides training on a number of topics, including numerous courses relating to estate, gift, and generation-skipping tax matters. This high level of involvement in estate, gift, and generation-skipping tax matters uniquely qualifies this organization to offer comprehensive and meaningful commentary on the proposed regulations. This submission was prepared by a technical committee comprised of approximately 15 of the most experienced members of NACVA; including a number of its finest instructors who served on the technical committee responsible for this project.

Valuation is, in part, a subjective determination. However, the traditional standard of fair market value leads to a valuation process that makes the determination of value more scientific and based on market reality because transactions between buyers and sellers occur millions of times every day in the stock market. This is true whether the parties are related or unrelated.

For example, non-controlling shares of companies are traded daily on the New York Stock Exchange. In the United States alone, over 1,000 mergers and acquisitions were announced in August 2016, where acquiring a controlling interest was the objective. Numerous studies have consistently shown that publicly traded stock on an Exchange is sold at a discount for lack of control. This discounting arises because an individual purchasing a share of publicly traded stock is most often purchasing a non-controlling interest in that company, and correspondingly does not have the right to force the company to pay dividends, force liquidation, etc. Under the definition of fair market value, the impact upon value based upon non-controlling versus controlling interests can be tested and measured, and the results are both consistent and economically sound.

Further, other studies have shown that restricted shares of publicly traded companies and shares of companies prior to trading on a public stock market sell for a discount for lack of marketability. These third-party empirical studies provide ample and conclusive evidence that marketability affects the price an investor is willing to pay and, as such, reflects economic reality in the marketplace.

It is the position of NACVA that fair market value, as traditionally defined in the Treasury regulations and as set forth above, is that standard of value that is most appropriate in the determination of value to be used under Treasury Regulations for Estate and Gift Tax purposes. Its use is not based upon some artificially modified definition outside of sound economic theory, but rather, based upon time-tested valuation principles and practices which are consistent with data based on market evidence.

2. <u>The IRS has Consistently Supported Valuation Discounts</u>

The IRS has consistently recognized that valuation discounts are appropriate in valuing non-controlling interests in closely held businesses. Two such recent examples are the IRS Job Aids relating to "Discount for Lack of Marketability Job Aid for IRS Valuation Professionals" dated September 25, 2009, and "Valuation of Non-Controlling Interests in Business Entities Electing to be Treated as S Corporations for Federal Tax Purposes" dated October 29, 2014. The commentary within each of these Job Aids clearly articulate the need and reasoning for a discount for lack of marketability and a non-controlling interest as reflected by market data and accepted by all of the major business valuation credentialing organizations (NACVA, AICPA, ASA, IBA) as directed under the provisions of Revenue Ruling 59-60.[4]

Valuators/appraisers, accountants, attorneys, and the IRS have consistently utilized the definition of fair market value. The definition applies in a number of applications, including litigation, financial accounting, family disputes, and estate planning. In determinations of fair market value for purposes of valuing privately held enterprises and equity ownership interests therein for both income tax and estate and gift tax purposes, investment risks attendant to a lack of control and a lack of marketability have long been accepted considerations by the business valuation community, the IRS, and courts.

Furthermore, it is promulgated in Revenue Ruling 59-60, which was released by the IRS nearly 60 years ago, and requires the appraiser to employ *fair market value* in order to value closely held stocks and bonds. ARM 34 was issued in 1920 by the IRS for the purpose of determining the lost *fair market value* of breweries and distilleries as a result of prohibition. Other revenue rulings involving

[4] Revenue Ruling 59-60, C.B. 19589-1, p. 237.

the definition of fair market value include Revenue Rulings 54-77, 65-192, 79-49, 87-124, 88-49, 93-12, 2001-49, 2008-35. These consistent revenue rulings, which are supported in case law by federal and state courts, have laid a basis and groundwork for which members of NACVA, and the valuation profession at large, can perform valuations with consistent results.

3. Fair Market Value Assumes a Hypothetical Buyer

Inherent in the definition of fair market value is the assumption that the seller, as well as the buyer, are both hypothetical individuals who are, based upon the economics, attempting to obtain the best price for their situation. At no point has the definition of fair market value been formally altered, or interpreted, to assume that in a family controlled business, a particular buyer and/or particular seller should be considered. While the IRS has attempted, several times, to argue that treatment of family controlled businesses should be different, the courts have consistently held that there is no family attribution and that under the definition of fair market value, we are to assume that both the buyer and seller are hypothetical.

A consistent position was laid out by the IRS in Revenue Ruling 93-12[5] as a result of past court case decisions, in which the IRS held that minority interests in family owned businesses should be valued subject to a valuation discount as stated in Section 25-2512(f) of the Internal Revenue Code. This logic was followed in the court cases of *Bright, Propstra, Andrews, and Lee.*[6] This revenue ruling (93-12) revoked Revenue Ruling 81-253[7] and stated that: "A minority discount will not be disallowed solely because a transferred interest, when aggregated with interests held by family members, would be part of a controlling interest."

Further affirmation of this position is set out in the Estate of Davis. In *Davis v. Commissioner*, 110 TC 530 (1998) the Court notes:

> "The willing buyer and the willing seller are hypothetical persons, rather than specific individuals or entities, and the individual characteristics of these hypothetical persons are not necessarily the same as the individual characteristics of the actual seller or the actual buyer."

Further citations include *Estate of Curry v. United States,* 706 F.2d 1424, 1428, 1431 (7th Cir. 1983); *Estate of Bright v. United States,* 658 F.2d 999, 1005-1006 (5th Cir. 1981). *Curry* further stated: "The hypothetical willing buyer and the hypothetical willing seller are presumed to be dedicated to achieving the maximum economic advantage." *Estate of Curry v. United States, supra* at 1428; *Estate of Newhouse v. Commissioner,* 94 T.C. 193, 218 (1990).

4. Families Do Not Act in Accord

Many valuation assignments where members of NACVA are engaged concern family owned businesses in which family members do not act in harmony and accord. In many cases, family members are more likely to be in discord. Under the new artificial definition of value in the proposed regulations, the IRS makes a presumptive assertion that *all* members of a family owned business will act in the best interest of the family in their decisions and not act with contradictory agenda. There is absolutely no support for this position.

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[5] Revenue Ruling 93-12, 1993-1 C.B., p. 202.
[6] *Estate of Bright v. Commissioner*, 658 F. 2d, 999 (5th Cir. 1981) at 1001.
Estate of Popstra v. United States, 680 F2d 1248 (9th Cir. 1982).
Estate of Andrews v. Commissioner, 79 T.C. 938 (1982).
Estate of Lee v. Commissioner, 69 T.C. 860 (1978).
[7] Revenue Ruling 83-253, 1981-2 C.B., p187.

As can be illustrated by one simple, but common example, in the proposed regulations, a husband and wife together are assumed to be a family group. What the provisions of the proposed regulations fail to recognize is the fact that the divorce rate in the United States is over 50%. This is *prima facie* evidence that the majority of families do not act in accord.

5. <u>The Six Month Put Right Has No Basis in Market Reality</u>

In the proposed regulations, the IRS has instructed the valuator/appraiser to “assume” that the transferee has the right to “Put” back their interest to the company within six months of the date of valuation. Market data clearly shows that the time it takes to liquidate one’s interest in a closely held company typically takes substantially longer than six months. In *Champion*, the court stated: “In the case of unlisted stock…the price at which sales of stock are made in arm's-length transactions in an open market is the best evidence of its value.” *Champion v. Commissioner,* 303 F.2d 887, 893 (5th Cir. 1962), reversing and remanding T.C. Memo. 1960-51. To our point, history demonstrates that obtaining an “arm’s-length transaction could take much longer than six months.” Numerous studies have consistently shown that sales of interests in closely held companies (especially minority interests), often take years to liquidate. This lack of marketability is a substantial risk factor for any holder of a non-controlling, non-marketable equity interest. This risk is absolutely rooted in economic realty and should be fully reflected in the valuation of that interest.

One of the three primary approaches to business valuation is the Market Approach. This approach, advocated under Revenue ruling 59-60, allows members of the business valuation profession, and the users of business valuations (including the IRS), to incorporate “actual” transaction data into the valuation process, thereby bringing a direct assessment of market activity into that process. If members of NACVA are to use the multiples of transactions in the open market as one of the accepted valuation methodologies, these multiples must be recognized as being based upon liquid publicly traded companies, and as such, must be subsequently discounted to reflect the practical challenges and costs associated with selling an interest in a privately owned enterprise. To do otherwise is to inappropriately determine value.

6. <u>The Term “Minimum Value” Results in an Artificially High Outcome</u>

The claim being made in the proposed regulations that taxpayers are transferring assets at an artificially low value is not only false, but contradicts nearly 100 years of American case law, regulations, transaction data, market studies, and valuation methodologies.

The proposed regulations require valuators to employ a new definition of value which is referred to therein as “minimum value.” Further, the proposed regulations require valuators to simultaneously employ generally accepted appraisal methodologies. However, the term minimum value does not currently exist within the International Glossary of Business Valuation Terms,[8] or any business valuation principles, treatises, or governing professional standards; and attempts to establish a new standard of value which is not “generally accepted” nor could it be for a variety of reasons. For this reason, generally accepted appraisal principles and the proposed regulations are inconsistent on their face and contradictory to each other.

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[8] The International Glossary of Business Valuation Terms, as adopted by the American Institute of Certified Public Accountants, American Society of Appraisers, Canadian Institute of Chartered Business Valuators, National Association of Certified Valuation Analysts (prior to current name change) and the Institute of Business Appraisers, 2000.

Further, the result of applying minimum value results in an "artificially high" valuation, but creating "real" tax increases and an unreasonable tax burden to a targeted group. Minimum value is based upon a flawed definition of value with no basis in market transactions or market reality. For example, shares of stock in a public company, such as General Motors, can be purchased or sold online, and nowhere is it asked if the purchaser or seller are related to other shareholders—such relationships are not even remotely a consideration in determining transaction price. However, and as noted earlier, the value of these shares reflect a built-in discount for lack of control. That is market reality.

It is the position of NACVA that fair market value in estate and gift tax contexts should continue to apply in the valuation of all businesses, whether family controlled or not. Any other definition of value will result in an improper outcome thereby artificially increasing value on the estate, gift, and generation-skipping tax obligations on the transfers of these interests. Contrary to IRS inference, and, in fact, quite the opposite, fair market value *does not* artificially lower the value of assets between related parties. It should also be noted that credentialed members of NACVA are trained in *proper* valuation methodologies based on a widely accepted body of knowledge to determine fair market value in a wide variety of applications and matters, including estate, gift, and generation-skipping tax. In every other application, the proposed changes advocated by Treasury and the IRS in the proposed regulations would be dismissed for failure to reflect market norms.

7. NACVA Disagrees with the Proposed Regulations' New Definitions of Control

We note that the proposed regulations expand the historical definition of control in two primary ways:

The **first** of these relates to an expansion of the definition of the term "attribution," as that term is currently defined in Treasury Regulation 25.2701-6, Indirect holding of interests. Under subparagraph (a)(1) of that regulation:

> "…an individual is treated as holding an equity interest to the extent the interest is held indirectly through a corporation, partnership, estate, trust, or other entity…"

The proposed regulation, in Section 25.2704-2, Transfers subject to applicable restrictions, under subparagraph (d) Attribution provides:

> "An individual, the individual's estate, and members of the individual's family are treated as holding any interest held indirectly by such person through a corporation, partnership, trust, or other entity under the rules contained in Treasury Regulation 25.2701-6, Indirect holding of interests."

The definition of the term "member of the family" is currently defined in Treasury Regulation Section 25.2702-2(a)(1) as:

> "With respect to any individual, member of the family means the individual's spouse, any ancestor or lineal descendant of the individual or the individual's spouse, any brother or sister of the individual, and any spouse of the foregoing."

Thus, the proposed regulation expands the family attribution rules to include all "indirect" interests held by a transferor in consideration of determining control. It is the position of NACVA that separate legal entities such as those set forth in Treasury Regulation 25.2701-6(a)(1), including corporations, partnerships, estates, trusts, or other entities (presumably limited liability companies), have been created under a state law where the intent is to allow for a separate legal existence of an operational or investment activity carried on for the purpose of making a profit. Ownership interests, both direct or indirect, as they might apply to a specific member, should not be expanded to include family members being attributed indirect ownership as that attribution completely dismisses the legal and economic standing of that member in that entity; as well as the legal protections offered by the creation of that specific entity. At the same time, such attribution would create a fictitious ownership structure, circumventing rules of convention for voting and control both under the governing documents and the state law under which the entity was created.

The **second** way in which the proposed regulations expand the definition of control is by lowering the threshold for control with changes in the proposed regulation to Treasury Regulation Section 25.2701-2(b)(5)(iv) Other business entities, to at least 50% of either the capital or profits interests of the entity or arrangement, *or* ownership of any equity interest with the ability to cause the full or partial liquidation of the entity or arrangement.

NACVA views the expansion of the definition of control to include "at least" 50% ownership as both technically, and practically, incorrect. *More* than 50% ownership provides one the ability and power to direct the management and policies of the company; and has been the traditional (and legal) threshold of control throughout the business valuation industry and in *all* professional standards. The definition of at least 50% ownership is an inappropriate and technically incorrect position promulgated within the proposed regulations disrespecting equity owners' rights provided in a legal reality in each specific state of creation.

While the determination of whether the attribute of control exists in the ownership of any business enterprise, the determination most often rests on the state law in which the entity was formed. To reduce control to "at least 50%" ownership from "more than 50%" is to essentially say that two fractional interests of voting stock or equity in an entity each have equal control does not make economic sense and again, results in the creation of an artificial value. Attributing control to two separate 50% ownership interests is clearly devoid of supportable rationale.

8. Under these Proposed Regulations, NACVA Members may be Limited in their Ability to Perform Qualified Appraisals

The proposed regulations conflict with Treasury's definition of a "qualified appraisal":

> IRC Section 170(f)(11)(E)(i), paraphrased, provides that the term "qualified appraisal" means an appraisal that is (1) treated as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and (2) conducted by a qualified appraiser in accordance with generally accepted appraisal standards and regulations or other guidance prescribed by the Secretary. An appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards within the meaning of Code Section 170(f)(11)(E)(i)(ii) if, for example, the appraisal is consistent with the substance and principles of the "USPAP", as developed by the Appraisal Standards Board of the Appraisal Foundation. (Note that the Appraisal Foundation created these standards at the request of the United States Congress.)

In the 2016-2017 Edition of The Appraisal Foundation's Uniform Standards of Professional Appraisal Practice, Standards Rule 9-4(d) states:

> "An appraiser must, when necessary for credible assignment results, analyze the effect on value, if any, of the extent to which the interest appraised contains elements of ownership control and is marketable and/or liquid."

In the comment section it further states:

> "An appraiser must analyze factors such as holding period, interim benefits, and the difficulty and cost of marketing the subject interest. Equity interests in a business enterprise are not necessarily worth the pro rata share of the business enterprise interest value as a whole. Also, the value of the business enterprise is not necessarily a direct mathematical extension of the value of the fractional interests. The degree of control, marketability and/or liquidity, or lack thereof, depends on a broad variety of facts and circumstances that must be analyzed when applicable."

All of the industry's major valuation organizations recognize the applicability of valuation discounts and have long done so. For instance, The Professional Standards of (NACVA) Section IV Development Standard H, Fundamental Analysis, state: "For a conclusion of value, the member must obtain and analyze applicable information, as available, to accomplish the assignment, including, (8) Size of interest to be valued and its control, liquidity and marketability characteristics."

Statements on Standards for Valuation Services Section 100.40, published by the American Institute of Certified Public Accountants, 2015 states: "During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a pre-adjusted value. Examples of valuation adjustments for a valuation of a business, business ownership interest, or security include a discount for lack of marketability or liquidity and a discount for lack of control."

The proposed regulations fail to consider the economic reality of investor risk associated with holding a fractional equity ownership interest in a privately held company that carries neither the attribute of control or marketability. As such, the proposed regulations fail to consider the economic reality of valuation discounts. These discounts, very often, take into consideration other issues apart from those enunciated in the proposed regulations, specifically for the lapse of voting rights and restrictions. A listing (not all inclusive) of those additional elements that warrant consideration of discounts include:

1. Appoint or change management,
2. Decide on compensation levels,
3. Enter into binding contracts,
4. Decide on the amounts of dividends or distributions,
5. Determine capital expenditures,
6. Change the capital structure,
7. Determine policy, including changing the directions of the business, and
8. Block any of the above actions.

A discount for lack of marketability or liquidity is commonly applied to reflect the lack of a recognized market to sell the interest, and the fact that some ownership interests are not readily transferable. Failure to consider or recognize valuation discounts will result in a value that is not determined in accordance with generally accepted appraisal standards, and ultimately be considered "hypothetical" as defined in the USPAP.

9. <u>The Proposed Regulations Force Valuators to Perform Hypothetical Appraisals</u>

Business valuators that issue business valuation reports under the proposed assumption that any holder can demand liquidation of his/her interest at any time at minimum value and receive cash or property pro rata to the interest, would be required to disclose the nature of such an assumption as a qualifying assumption and limiting condition. Further, in accordance with business valuation standards, the business valuator would be required to state that these valuations are "hypothetical" in nature, which is not consistent with the standard of value defined as fair market value. Thus, the proposed regulation requires the business valuator to arrive at a fair market value of interests under hypothetical assumptions that are known to be untrue, in conflict with governing legal documents and state law, and possibly, may even be commercially unviable.

According to the fair market determinations of value under the proposed regulations, "…if an interest in a corporation or a partnership (an entity), whether domestic or foreign, is transferred to or for the benefit of a member of the transferor's family, and the transferor and/or members of the transferor's family control the entity immediately before the transfer, any restriction described in paragraph (b) of this section[9] is disregarded, and the transferred interest is valued as provided in paragraph (f) of this section."[10]

Consequently, the business valuator in the process of valuing the equity ownership interest would refer to paragraph (f) of the proposed regulations in performing the valuation which provides the business valuator the following guidance:

> "If a restriction is disregarded under this section, the fair market value of the transferred interest is determined under generally applicable valuation principles as if the disregarded restriction does not exist in the governing documents, local law, or otherwise."[11]

Again, as noted above, the foregoing guidance provides that the value of the transferred interest is to be determined under the fair market value standard and employing generally applicable valuation principles. However, the business valuator in his/her determination of fair market value is to assume that all disregarded restrictions do not exist in the governing documents or anywhere else, such as under state law. However, these disregarded restrictions are absolutely real and legally binding on the holders of such equity interests in the family entity, thus forcing the business valuator to make "hypothetical" assumptions and render a hypothetical appraisal, which is *not* fair market value.

Note further that the proposed regulations do not make the same assertions with respect to equity ownership interests held by equity holders outside the familial equity owner group. It is difficult to understand in the proposed regulations how these provisions and restrictions can be considered in the valuation of one identical interest held by a non-family member, while disregarded by a family member. NACVA views this inconsistency as ill-conceived requiring the hypothetical findings noted above and lacking any relationship with market realities.

10. <u>It will be Impossible to Comply with USPAP and Any Other Industry Standards and Simultaneously Comply with the Proposed Regulations.</u>

According to USPAP, a "Hypothetical" appraisal or a "Hypothetical Condition" is defined as:

> A condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis. Hypothetical conditions are contrary to known facts about the physical, legal, or economic characteristics of the subject property; or about conditions

[9] Proposed Regulation Section 25.2704-3(b) Disregarded restrictions means a restriction that is a limitation on the ability to redeem or liquidate an interest in an entity that is described in any one or more of paragraphs (b)(1)(i) through (iv) of this section, if the restriction, in whole or in part, either lapses after the transfer or can be removed by the transferor or any member of the transferor's family (subject to paragraph (b)(4) of this section), either alone or collectively.
[10] Proposed Regulation Section 25.2704-3(a).
[11] Proposed Regulation Section 25.2704-3(f).

> external to the property, such as market conditions or trends, or about the integrity of data used in an analysis.[12]

In addition, USPAP defines an "Extraordinary Assumption" as:

> An assumption directly related to a specific assignment, as of the effective date of the assignment results, which, if found to be false, could alter the appraiser's opinions or conclusions. Extraordinary assumptions presume as fact otherwise uncertain information about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis.[13]

The difference between whether a condition is hypothetical or extraordinary rests on what the appraiser knows about the condition in question. If an appraiser cannot verify a certain condition that is critical to the valuation, but which the appraiser has a reasonable basis to accept as true, then the condition is an extraordinary assumption. Alternatively, if the appraiser is asked to use a condition he/she knows to be false, but which is necessary for the analysis, a hypothetical condition applies.[14]

It appears that the assumption delineated in the proposed regulations about disregarded restrictions would not be an extraordinary assumption, but rather, a hypothetical condition because such conditions under the proposed regulations are known to be false and contrary to fact as evidenced by the governing documents and state law. Further, according to USPAP, any such appraisal report would require that the value be clearly labeled as hypothetical, the purpose of such appraisal is stated, and the conditions assumed are set forth in the report.

Similarly, the AICPA Statement of Standards for Valuation Services ("SSVS") has incorporated in Appendix C—Glossary of Additional Terms, a "hypothetical condition," as: "that which is or may be contrary to what exists, but is *supposed* [emphasis added] for the purpose of analysis".[15] Further, the business valuation report is required to disclose any hypothetical conditions used in the valuation engagement including the basis for their use.[16]

Finally, NACVA's professional standards also require that "hypothetical conditions" be disclosed in the business valuation report, with reasons for their inclusion. NACVA does not define hypothetical conditions.[17]

Based upon the foregoing comments observations and discussions, it would seem reasonable that business valuations rendered for gift and estate tax purposes under the proposed regulations would require that such opinions or estimates of value be labeled as hypothetical determinations, not fair market value.

[12] USPAP 2016-2017 Edition, Page 3.
[13] *Ibid*.
[14] USPAP 2016-2107 Edition, Page 307.
[15] "Appendix C – Glossary of Additional Terms," SSVS VS Section 100 (AICPA).
[16] SSVS VS Section 100.22.
[17] NACVA Professional Standards, V – Reporting Standards, Paragraph C.

SUMMARY AND REQUESTED REVISIONS

Based upon the forgoing discussion, NACVA, on behalf of its national membership of 7,000 business valuators and analysts, hereby respectfully recommend and request that the proposed regulations be **withdrawn** in their entirety. It is our position that the proposed regulations, as currently drafted, contain too many problematic provisions to effectively cure all defects by virtue of specific provision modifications within those proposed rules. Moreover, dependent upon which of the provisions within the proposed regulations are deemed appropriate for modification by Treasury and the IRS, those changes advanced will still require consideration in view of the entire set of proposed rules. As such, we believe the clear and appropriate action at this time is to withdraw the rules as currently proposed.

Though not our most desired resolution to the proposed regulations, should Treasury and the IRS decide not to withdraw the proposed rules as currently drafted, NACVA secondarily recommends and requests the following revisions to the proposed regulations be given careful consideration:

1. That the existing definition of fair market value be retained and that the term minimum value not be adopted in the final regulations.
2. That the assumed six month repurchase obligation be excluded from the final regulations since it is not based in any way upon market reality.
3. That the standard of value for estates and gifts continue under the definition of fair market value, with appropriate discounts for lack of control and marketability where appropriate.
4. That the definition of control be redefined to comply with business valuation and legal principles as "more than 50%" instead of "at least 50%."
5. That these proposed regulations be consistent with *Stare Decisis* and the liturgy of prior United States case law.
6. That under no circumstances, should these proposed regulations apply to businesses whose income is derived from operations as opposed to simply the holding of assets.

Thank you for affording the below signatories to this comment letter, on behalf of the entire membership of our organization, an opportunity to voice our concerns and thoughts relating to those provisions included in the proposed regulations.

Respectfully Submitted,

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