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UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

PUBLIC HEARING ON PROPOSED REGULATIONS "ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES; RESTRICTIONS ON LIQUIDATION OF AN INTEREST"

[REG-163113-02]

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PROCEEDINGS

(10:00 a.m.)

MS. CHYR: Good morning. It's 10:00. Welcome to the public hearing on proposed regulations under Section 2704 regarding restrictions on liquidation of an interest.

A Notice of Proposed Rulemaking as well as a Notice of Public Hearing was published in the Federal Register on August 4, 2016. To date, we have received a number of electronic comments with 37 requests to speak today.

I'm Charlotte Chyr, Special Counsel to the Associate Chief Counsel, Passthroughs and Special Industries.

On the Government's Panel this morning, at the end of the table, is Cathy Hughes, Attorney-Advisor with the Department of Treasury. Next to her is John MacEachen, Senior Trial Attorney, drafter of the proposed regulations, and an attorney in the Estate and Gift Tax Branch, and to my immediate left is Leslie Finlow, Supervisory Reviewer for the proposed regulations, also in the Estate and Gift Tax Branch.

A bit about today's hearing format. Building Security has informed us that all visitors must be escorted while in the building, both during breaks and to exit the building.

There will be three 15 minute breaks. One break will be from 11:30 to 11:45. The second, from 1:15 to 1:30. The third, from 3:00 to 3:15, and then the hearing will resume at 3:15.

Today's hearing will be conducted pursuant to the Statement of Procedural Rules at 26 CFR Part 601. Each speaker or group of speakers will have 10 minutes to present comments.

There is a timer and a light indicator at the top of the podium. When the light turns green, you may begin to speak. When the light turns yellow, it is a warning that you have 3 minutes to conclude your comments. When the light is red, your time is over.

We thank you in advance for your cooperation, as we will be sticklers with the 10-minute time rule.

Security and building management have informed us that we must all vacate this auditorium at 5:00. There are 37 speakers for today's hearing, and Treasury and the IRS want to hear everyone's comments so that we can provide meaningful guidance.

So, please approach the podium promptly when it is your turn to speak, and note that the other speakers waiting their turn may have comments that you agree with. Your input in this rulemaking process is essential. To ensure that we get through all of the speakers today, we will limit our questions at the end of your 10-minute comment period.

Also, just a reminder, tonight is the National Tree lighting ceremony. Street closures, we are told that some of them will begin at 2:30, and some may also begin at 4:30. If you have a flight that departs early this afternoon, you may want to take that into consideration.

With that, I'd like to welcome the first speaker, Justin Ransome, with the American Institute of CPAs. Please come to the podium.

MR. RANSOME: Thank you. Good morning. My name is Justin Ransome. I'm a partner at Ernst & Young. My testimony today is on behalf of the American Institute of Certified Public Accountants, the national professional association representing more than 418,000 members in 143 countries.

I'd like to acknowledge that the AICPA has not yet submitted its written comments regarding these proposed regulations as we are in the process of finalizing them and expect to have them in the near future. My testimony today is indicative of the substantive issues that we address in our comments.

While our comments address many issues with the proposed regulations, my testimony will focus on three major areas we believe Treasury and the IRS need to address in the final regulations.

One, the put right in the -3 proposed regulations. Two, the three-year look back rule in the -1 proposed regulations, and three, the rules for determining control of an entity.

Let me start by stating that the AICPA is concerned that the proposed regulations under Section 2704 are overly broad and general in nature. We request that once Treasury and the IRS have considered the over 9,000 comment letters it has already received, and knowing it will receive at least one more from the AICPA, that they withdraw the current proposed regulations and re-propose them with another comment period before these regulations are finalized, with the effective date extended until the regulations are finalized.

We also request that Treasury and the IRS provide an exception from the proposed regulations, particularly the -3 proposed regulations, for family-owned businesses that carry on a trade or business, as Treasury and the IRS have interpreted that term for purposes of section 162 of the Internal Revenue Code.

Now, I'd like to turn to the three major topics that my testimony addresses. First, I'd like to address what I will refer to as the put right set forth in the -3 proposed regulations and referred to in the -2 proposed regulations.

Under the exceptions to the disregarded restrictions contained in the -3 proposed regulations, it states that "any restriction that otherwise would constitute a disregarded restriction under this section will be considered a disregarded restriction of each holder of an interest in the entity as a put right."

The proposed regulations explain that a put right is a right enforceable under applicable local law to receive from the entity or its holders on liquidation or redemption of the holder's interest within six months after the date the holder gives notice of the holder's intent to withdraw cash and/or property with a value that is at least equal to the minimum value of the interest determined as of the date of the liquidation or redemption.

Many of the members have interpreted the aforementioned language to mean that if there is a transfer of interest in a family-owned business to a family member, the value of the transferred interest is to be determined as if it included a put right at minimum value because any restriction on the right to withdraw that is more restrictive than the put right set forth in the proposed regulations is disregarded.

We also understand this is a common interpretation among many other practitioners in the estate planning community.

We understand that on many occasions after the proposed regulations are published, representatives from Treasury and the IRS have stated that such an interpretation is incorrect and overly broad. However, if this is a common interpretation among many practitioners in the estate planning community as it is currently drafted, we think it is quite possible that IRS agents may form such an interpretation of this put right as well.

We recommend that Treasury and the IRS remove this put right language from the final regulations as we disagree with its impact as many are interpreting it. If this recommendation is not accepted, we recommend that Treasury and the IRS clarify and provide in the final regulations more specifics as to when this put right applies, including several examples.

Next, I'd like to address what I referred to as the three-year rule contained in the -1 proposed regulations. The current -1 regulations define a liquidation right as the right or ability to compel the entity to acquire all or part of the holder's equity interest in the entity, whether or not this would cause the entity to liquidate.

It further provides that a lapse of the liquidation right occurs when an exercisable liquidation right is restricted or eliminated. However, this rule generally does not apply if the rights with respect to the transferred interest are

not restricted or eliminated. As a result of this exception, an interest holder who has the aggregate voting power to compel the entity to acquire the holder's interest makes an inter vivos transfer of the minority interest that results in the loss of the interest holder's ability to compel the entity to acquire his or her interest, the interest is not treated as a lapse.

The proposed regulations amend this exception to provide that the exception regarding transfers of interest that do not result in the restriction or elimination of rights associated with the transferred interest are limited to transfers that occur more than three-years before the transferor's death.

The AICPA's concern is that including the value of the lapse of an interest in the decedent's gross estate after their interest was transferred amounts to the inclusion of a phantom asset in the decedent's gross estate.

While Sections 2035 through 2043 all include provisions for the inclusion of value of certain assets in the decedent's gross estate, there is nothing in Section 2704 that would require such an inclusion if such asset was not otherwise a part of the decedent's estate.

Although we recognize the power given to Treasury and the IRS by Section 2704 to apply it similar to voting and liquidation rights, we ask that Treasury and the IRS reconsider whether they should use this power to create phantom assets in a decedent's gross estate when the statute does not call for such.

We also believe that the change is unnecessary given that a transfer of an interest in a family controlled entity to another member of the family is subject to the disregarded restriction provisions provided in the -3 regulations, specifically the put right to which I previously referred.

In other words, if the transfer was subject to the -3 regulations at the time of transfer, it is unnecessary to have the three-year rule. That is, of course, if our current interpretation of the put right is what was intended by Treasury and the IRS.

Finally, if this three-year rule becomes part of the final regulations, we ask that it only affect transfers that occur after the date of the final regulations are published. The proposed regulations provide that the amendments to the -1 regulations apply to lapses of rights created after October 8, 1990, occurring on or after the date these regulations are published as final regulations in the Federal Register.

Specifically included is a three-year look back rule. The AICPA is concerned that Treasury and the IRS may apply the three-year look back rule to transfers that occur three years prior to the effective date of the final regulations. If the three-year look back rule were to apply to such transfers, it would unfairly treat taxpayers who made transfers believing Treasury and the IRS would not subject such transfers to the new 2704 regulations.

In other words, we believe that none of the regulations should have retroactive effect, and it appears that as currently drafted, the proposed

regulations would have a retroactive effect for transfers caught by the three-year rule.

We further ask that Treasury and the IRS provide examples as to the three-year rule and inclusion of such transfers in a decedent's estate. Pursuant to Section 2704(a)(2), the amount of the transfer is calculated as the access of the fair market value of all interests held by the individual immediately prior to the lapse over the fair market value of these interests after the lapse.

The AICPA is not clear how Section 2704(a)(2) would apply to a transfer that is subject to the three-year rule. The first question that arises is the proper date to apply Section 2704(a)(2). One, the date of transfer, or two, the date of death.

As the purpose of 2704 is to measure the decline in value due to a transfer, we recommend that the final regulations provide that the date of transfer is the proper date to apply Section 2704(a)(2).

To use the date of death values would allow appreciation and depreciation to enter into the calculation, which is clearly not contemplated by Section 2704(a)(2).

The second question that arises is how the taxpayer should calculate the decrease in the lapse. The examples in the current regulations and as amended by the proposed regulations do not contain an example regarding the calculation of the amount subject to gift or estate tax under Section 2704(a)(2). We will have an example in our written comments that highlight our confusion.

Finally, I would like to address a couple of the rules for determining control of an entity. The proposed regulations as drafted result in uncertainty over the determination of which members of the family are included in assessing control of an entity.

Section 2704 applies that the transferor or members of the transferor's family control an entity. Section 2704(c)(2) defines the term "member of the family" to include (1) the individual's spouse; (2) any ancestor or lineal descendant of the individual; (3) any brother or sister of the individual; and (4) the spouse of any individual described in categories (2) or (3).

Section 2704(c)(1) provides "control" has the meaning given to such term under Section 2701(b)(2). This section provides a definition of "control," but also provides for more description of the family member and the definition provided by Section 2704(c)(2).

Specifically, Section 2701(b)(2) delineates an applicable family member as any lineal descendant or any parent of the transferor or the transferor's spouse. Similarly, the -3 regulations refer to such, too.

Several of our members noted that the expanded definition above may result in the potential inclusion of the transferor's nieces and nephews under the definition of "entity control." However, such an expansion appears to exceed the intended scope of Section 2704.

Therefore, we recommend that the final regulations clarify that "member of the family" does not include lineal descendants of any parent of the transferor or their spouse.

And with 20 seconds left to go, the AICPA appreciates the opportunity to comment today, and we hope that Treasury and the IRS will consider these thoughts as they consider what to do next with the regulations, and we look forward to working with Treasury and the IRS on this issue.

And I have six seconds for questions. (Laughter)

MS. HUGHES: Questions actually don't count, but thank you very much. To put your mind at rest, as we have said publicly before, there is no intended put right, and we will absolutely make that clear in the final regulations. We also will make it clear that there is no retroactive effect on the three-year rule.

MR. RANSOME: Thank you.

MS. CHYR: Thank you. Our next speaker is Michelle Gallagher with the American Institute of CPAs.

MS. GALLAGHER: Good morning. My name is Michelle Gallagher. I am a certified public accountant, CPA, accredited in business valuation, ABV, and certified in financial forensics, CFF. I own and operate the valuation and forensics accounting firm of Gallagher Valuation and Forensics in Lansing, Michigan.

My testimony today is on behalf of the American Institute of Certified Public Accountants. I am the current chair of the ABV Credential Committee.

As some background, in 2007, the AICPA issued detailed professional standards for business valuation conclusions and calculations for all types of engagements, including gift and estate matters. All AICPA members must comply with these standards. These standards are codified by AICPA's VS Section 100, and are considered generally accepted valuation principles for CPA business appraisers.

My comments today will focus on valuation related issues from a business appraiser's perspective. Specifically, our concerns on how the proposed regulations do not follow generally accepted valuation principles, as they redefine three important valuation concepts -- fair market value, number one. Number two, control, and number three, marketability.

Let's first discuss fair market value. The definition of "fair market value" used universally by business appraisers assumes both a hypothetical willing buyer and seller dealing at arm's-length. Under the new proposed regulations, there's no longer a presumption of a hypothetical party or an arm's-length transaction.

Included in AICPA's VS 100 standards is an international glossary of business valuation terms. The international glossary has been adopted and approved by a number of professional business valuation organizations, including the AICPA, and many, many others.

According to the international glossary, the definition of "fair market value" is as follows: "The price expressed in terms of cash equivalence at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's-length in an open unrestricted market when neither is under any compulsion to buy or sell, when both have reasonable knowledge of all the relevant facts."

This definition is consistent with Treasury Reg 2031-1(b), which the courts have consistently relied on for decades, as well as Revenue Ruling 5960, and a number of other Treasury and IRS references.

As stated in the proposed regs, 2704-3(f), if a restriction is disregarded under this section, the fair market value of the transferred interest is determined under generally accepted valuation principles, as if the disregarded restriction does not exist in the governing documents.

In other words, Treasury and the IRS are asking business appraisers to rely on some new concept or definition of "fair market value," which appears more like what we call as business appraisers "investment value."

"Investment value" is defined by our international glossary as "the value to a particular investor based on individual investment requirements and expectations."

At recent presentations by Treasury and IRS representatives, I have heard them reference the proposed regulations as nothing more than subtraction issue, like going to the butcher shop and trimming off the fat. So, let's go to that butcher shop and compare the concept of fair market value.

When the butcher trims off the fat, that piece of meat is now customized and unique to that very customer. When determining the fair market value of an interest in a company, we use market data, such as publicly traded companies, M&A transactions, publicly held real estate partnership transactions, closed-end funds, and many other market data.

Think of this market data we use as similar to that untrimmed piece of meat at the butcher shop. When the fat is trimmed away, a unique piece of meat has been created for that customer with no comparison to the market, so it has its own value to that customer.

For any non-meat eaters in the room, another example is a Snickers bar. If you take the peanuts out of a Snickers bar, what do you have? You have something different, something with different taste, a different market, and a different value to the consumer. It's not a Snickers bar anymore.

The proposed regulations are asking us to value that unique piece of meat from the butcher and that unique Snickers bar with no market data to support it, which means it is not fair market value. It's investment value.

By changing or bifurcating the definition of "fair market value," business appraisers will be required to perform different valuations using different methodologies for assets affected by the proposed rules.

The proposed regulations are also creating a significant burden on the taxpayer who will have an asset with two different values and two different basis amounts to track, a basis for income tax and a basis for estate tax. Taxpayers will have an additional burden of needing to file adequate disclosure requirements indicating gift tax returns are being filed with contrary positions.

Now, let's turn to control. Another concern we have with the proposed regulations is how they redefine "control." Under the proposed regulations, all family members, those with controlling interests and non-controlling interests alike, are assumed to work together, which is not reality.

I work with family-owned businesses all the time, and I can truly attest to this. I bet everyone in this room can think of at least one family member they would never go into business with. I know I can. (Laughter)

The fact is issues of family control and attribution were litigated for years resulting in the IRS acquiescence of this position with the issuance of Revenue Ruling 9312. The definition of "control" in the proposed regulations is in direct conflict with Revenue Ruling 9312.

Further, the proposed regulations provide stringent requirements before ownership interests held by unrelated parties are even relevant, which is not commercially reasonable.

Under generally accepted valuation principles, an adjustment for lack of control is often used to compensate for the inability of a minority interest holder to control any company decisions. Available market data broadly supports that the fair market value of a non-controlling interest, even in an asset holding company, is worth less than its pro rata value. The proposed regulations require business appraisers to ignore this market data.

In addition to ignoring certain unrelated third party owners and market data, under the proposed regulations, business appraisers are required to ignore governing documents and local law when certain restrictions exist. These requirements will force business appraisers to make hypothetical assumptions that are contrary to fact or unlikely to occur, and again, are not consistent with the definition of "fair market value."

Finally, I'd like to discuss marketability. Marketability is the ability to quickly convert an ownership interest to cash with minimal cost and maximum certainty about the price that is received. Under generally accepted valuation principles, an adjustment for lack of marketability is often used to compensate for the difficulty of selling an interest in a closely held company that is not traded on any exchange.

The proposed regulation includes what appears to tax and valuation experts as a mandatory put right, although I'm thankful to hear that is going to be at least clarified for us. In our minds as valuation experts, a put right is commonly defined as a right to sell a security at a specific price within a specific time period.

With the proposed regulations requiring assumptions relating to liquidating an interest at a minimal value in cash within six months, we can easily see how many experts are interpreting this as a deemed put right.

These deemed put rights would also appear to override all other provisions and create an immediate market for the interest holder, and the marketability adjustment may no longer be applicable.

Other provisions in the proposed regulations related to marketability that are not commercially reasonable include the following: Disregarding limitations on the ability of an interest holder to compel a liquidation is not realistic because such limitations are placed in company agreements all the time to facilitate the operation of the entity and to achieve their business purpose.

Limitation on interest holders' redemption on liquidation to at least minimum value in cash are unreasonable because closely held businesses are typically illiquid, and it could result in a forced liquidation of the entity. In the real world, there are no guaranteed minimum values for any investment, at least that I know of.

Limitations of the deferral of the full redemption payment to no more than six months is unreasonable because such terms are generally not offered by closely held businesses, as such terms would likely put them out of business.

If the proposed regulations are not revised to address this perceived put right and these commercially unreasonable provisions, business appraisers will need alternative methods and guidance for determining marketability adjustments which are warranted.

In conclusion, the AICPA urges Treasury and the IRS to withdraw the proposed regulations. If that is not pursued, Treasury and IRS should take into consideration these points we have raised and issue new clarified proposed regulations for public comment.

Treasury and IRS should also apply the regulations only to family-owned entities that hold passive investments and not to family-owned businesses that carry on a trade or business.

MS. CHYR: Thank you, Ms. Gallagher.

MS. GALLAGHER: Thank you for the opportunity to testify today.

MS. CHYR: Our next speaker is Stefan Tucker for The Real Estate Roundtable.

MR. TUCKER: Good morning. I'm Stefan Tucker. I represent The Real Estate Roundtable. I'm a partner in the firm of Venable, LLP, and I also teach business planning at the University of Michigan Law School, so this is my career in representing real estate people and entrepreneurs.

I'm pleased to be here. I started my career exactly years ago in this building when it headquartered the U.S.

Tax Court, where I was the Attorney Advisor. It's nice to be back again and not see the ugly green walls anymore.

(Laughter) I'm going to deal with five points today. One is the overall adverse impact of the proposed regulations on family-owned businesses, which we believe are the heart and soul of this U.S. economy. Number two, the invalidity of the bright line test of the three-year rule. Three, the invalidity of the extension of Section 2701 and 2704(b) to "business entities," other than a corporation or a partnership. Next, the proposed rules as to the disregarded restrictions under the proposed regulations.

By the way, the definition of the word "bank" being excluded from fiduciary of a trust under Section 267(b), the issue we have is with the words "publicly traded," and then lastly, the puzzling proposed regulations as to the applicable restrictions under -2(b)(4) and disregarded restrictions under 2704-3.

We have deep concerns with these proposed regulations, and we have noted them in our submission to the Treasury and to the Internal Revenue Service. We really believe that family owned businesses are unique.

That's my specialty, family-owned businesses, and my specialty, frankly, is dysfunctional families, and I heard the prior speaker talk about one person. I could assure you that most families have more than one person, and every time a client of mine says my kids will always get along, I must remind them that Cain and Abel were brothers. (Laughter) So, we have to deal with that.

We believe that we are going to be impeding and perhaps even eliminating family business situations, and we would point out, as we do in our comments, that 50 percent of family businesses last through the second generation, and only 5 to 10 percent last through the third generation, and the families want to continue the businesses, and this is impeding even further the ability to transfer to future generations.

There were 5.33 million family-owned businesses under the Census Bureau determination in 2012, including more than one million family owned businesses in real estate and the construction industry. This is going to have a tremendous adverse impact.

They go beyond egregious abuses, and we understand there are some, although actually in my practice we don't think that has occurred at all, but we see that most of it is not egregious, and you are doing things that really impact.

We would like to point out some very key elements and asking you to withdraw, and if you are going to have these regulations, revise them substantially.

The first one I'm going to talk about is the bright line test, the three-year rule. It's not allowed. This is a legislative regulation. This is not a regular regulation that would have been allowed under 2704(b)(4) on the authority as to the ultimate reduction in value of the interest that went to the transferee.

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We understand that 2035 eliminated in contemplation of death and went to the three-year rule, but that was Congress, and that was signed off on by the President. We believe this needs to be withdrawn.

The second one is the extension of the concept of a corporation or partnership, which is very clear under 2704. You have a corporation or partnership. It is not that you said that an LLC that defaults into being taxed as a partnership is a partnership, you added "all other business entities," and we don't know what that means, and we think it creates a lot of problems for people as to what it is. It says "corporation or partnership."

If you want to wedge in "business entities," we believe you need to do that with legislation, not with these proposed regulations.

We then get to the subject of disregarded restrictions. We see here a lot of problems because we don't think the understanding is that family-owned businesses have dysfunctions.

People try to preserve it, as the prior speaker said, you have discounts for minority interests for lack of control because that really is something that offsets the value, but here you are amalgamating a family, if it's more than 50 percent, together, where there really is no reason to do that.

As the person said, 9312 had that kind of concept, taking into account each separate interest and not amalgamating, even though it was to family members. All of a sudden, you have done that. That is something that is very unrealistic in our view, and very much not in accord with the real world of family-owned small to medium businesses, and it is very disruptive to even think about this happening.

We will go a step further. We cannot believe that you actually amalgamated people who are in the families together.

I mean, you have a charity, you have a third party who came in because he or she produced money, and you're putting them together to say unless they come together as 20 percent, then it's not going to be looked at at all as somebody who is independent.

I can assure you that we have many, many "family businesses" which have third parties in them, sometimes to their chagrin, that really, really do not have any control but they have real issues because the people running the business, whether it's a corporation or a partnership, have fiduciary responsibilities.

There are things that are sued about all the time because of breaches of fiduciary responsibility, and we believe this really needs to be articulated and more carefully looked at.

For example, we have members in real estate, so we have people who are part of the family, but they are guaranteeing debt, they are liable for what we call "bad boy X," and therefore, they have different positions, and how you amalgamate those positions where they could have the liability against what

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everybody else is doing throws us. It just simply brings together things that we believe should not be brought together into one package.

You need to recognize the world of small business, the world of family business. These don't seem to recognize that at all.

The next thing we have is the applicable restrictions. Very interesting to see a bank that was privately owned would not effectively be excluded from the fiduciary rule under 267(b).

I'd like to read to you about a case, and I won't identify the publicly traded bank. It says "A bankruptcy court slapped this bank with a $2.3 million punitive damages award for deliberately charging unjustified fees and costs and misapplying mortgage payments made by a bankruptcy debtor."

The bank hid from both the borrower and the court any information about how it was applying the money paid, so these charges couldn't be challenged. Finally, after years of litigation, the bank admitted that these actions were part of its normal course of business, and yet it refused to refund over charges it collected from the countless borrowers who had gone under, so to speak, and had all these bankruptcy issues, saying they should have known better.

That's a publicly traded bank. The ones we work with, the trust companies, aren't publicly traded, and they are very reliable and they are governed by state law, and we don't understand why it just said "publicly traded banks."

The next concept is you have effectively said that restrictions which are more than the state law should be ignored. Our clients do it every day. They need to govern the business, and they need to hold the business together, and again, our concern is you are simply not focused on the real world of small business.

We are more than glad to help. We are more than glad to work with you, The Real Estate Roundtable is more than glad to work with you, because you need to focus better on what are applicable restrictions and what are disregarded restrictions, and we would urge that you look at all this, and you certainly need to withdraw and revise the regulations at this time, and we would reiterate what other people have said.

One, it can't be retroactive, and it needs to be clear that it takes into account the real world, not the hypothetical world, for the small business.

Thank you.

MS. CHYR: Thank you, Mr. Tucker.

MS. FINLOW: Excuse me. You did submit comments?

MR. TUCKER: Yes.

MS. CHYR: Our next speaker is Mr. Robert Weinstock of the Strategic Valuation Group.

MR. WEINSTOCK: Good morning, everyone. My name is Robert Weinstock. I'm from Calabasas, California, and I'm here today to ask you to withdraw these confusing and burdensome regulations.

In California, I'm a business appraiser, I'm an attorney, and I'm a volunteer Superior Court Judge. I understand the IRS' frustration. The IRS believes that taxpayers are transferring assets at artificially low values and feels valuation discounts are essentially a loophole. A "loophole" is defined as "an inadequacy in an obligation which can be evaded."

Fair market value and its valuation discounts are not based upon evading taxes. They're based upon actual transactions and actual market data. Every day, millions of stocks change hands at market value. Some of these are between related parties, but all are at market value.

According to the proposed regs, the term "minimum value" is defined as the "pro rata interest in fair market value of all assets less liabilities."

As I will discuss in a minute, minimum value not only overvalues these assets, but as I will show you, it can make certain valuations nearly impossible.

These new rules make several assumptions, that all families get along, that all family members will act exactly the same in decision making, and that the decedents are assumed to be able to sell back their interest to an entity, and the entity has enough cash to buy back the interest, and finally, that the definition of "fair market value" artificially lowers the value of an asset.

As I mentioned, I'm an appraiser, an attorney, and a volunteer Superior Court Judge. No matter what hat I'm wearing, families do not get along.

In Calabasas, California, we are home to a large number of celebrities and wealthy dysfunctional families. (Laughter) For the past 25 years, I've made the majority of my living from families suing each other. My clients have spent hundreds of thousands of dollars trying to get back at mom's favorite child.

We have one famous family in Calabasas, and it's the Kardashians. (Laughter) If you think that all families get along, I suggest you think about the Kardashians. (Laughter) Between Kris, Robert, Bruce, Caitlyn, Kim, Khloe, and other family members, I think you get the message, they don't all get along. Yes, I do see them at lunch very frequently.

Yes, people do use estate planning to reduce their estate tax, but people also use income tax planning. This could include getting married on December 31 to file a joint tax return, donating clothing in December, and planning is planning, whether it is aggressive or not.

Let me give you some hypothetical situations where these proposed regs could be a problem. Suppose dad gives 10 percent of a closely held business to a son and 10 percent to the Red Cross. According to the proposed regs, the gift to the son would be at minimum value and the gift to the Red Cross would be at fair market value.

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Alice Walton and her family owns 51 percent of Wal-Mart. They are the largest family-owned business in the United States. Wal-Mart stock trades every day at $70 per share. If Alice gifts 1,000 shares to her kids, how do we value that? Alice is part of a family group that would fall under Section 2704.

We would need to value this transfer based upon minimum value. So, to do so, we could either look at Exchange prices on Yahoo! or under minimum value, we would have to value every asset under fair market value less every liability.

Wal-Mart has 12,000 locations in 28 countries, so if you can imagine the fees and time involved in complying with that, it would be very troublesome.

Imagine the problems now for CPAs. They will have basis adjustments for family members, basis adjustments for non-family members in the same company.

Imagine dad gifts a business to a son in 2006. The IRS audits the gift in 2007, and one week later, dad dies. Under the three-year rule, the IRS just wasted time doing the gift tax audit because the asset is now part of the estate.

Assume son sues dad for the value of the business and after a lengthy trial, the judge determines fair market value of the stock. Dad dies. Can they use the value that the judge came up with or now do they have to value dad's interest using minimum value?

As an attorney, I recommend a lot of my clients place their real property inside of corporations for asset protection purposes. Does this now make their real property a business interest subject to 2704, or is it still real property? Do clients have to make a choice between asset protection and gift and estate laws?

A couple more hypotheticals. What if dad and his brothers each own 20 percent of a piece of real estate as tenants in common? As part of their income tax reporting, they file a partnership tax return. Is that a business or is that real estate? Does dad get the 20 percent discount for the fractional interest on death? It's not clear.

Attorneys have already written their clients that they will have to rewrite their estate plans if these 2704 regs go forward. As an attorney, we're thrilled. (Laughter) Attorneys have already sent letters to their clients saying they figured out ways around these regs, and appraisers have figured that out, too.

Last hypothetical since I have three minutes and four seconds. I didn't write this one, it's a crazy hypothetical from Steve Oceans, an attorney in Nevada. Mom and dad own a business. Dad gives one percent of the business to his cousin. Mom and dad now own 99 percent of the business. Dad finds out he has cancer. Mom and dad file for divorce for the purpose of getting valuation discounts. On dad's death, he owns 49.5 percent, subject to all valuation discounts. On mom's death, same thing.

So, if you don't think that smart lawyers aren't going to figure out ways around these regs, then I think you have something coming.

In conclusion, I hope you can see some of the problems with these regs, and they may not be worth the relatively small amount of money that they generate for the government since so few people are even subject to this tax, especially in light of the new Administration, they may be even not as relevant.

So, I hope you withdraw these regulations, and I thank you.

MS. CHYR: Thank you, Mr. Weinstock. Our next speaker is Robert Branca of Branded Management Group.

MR. BRANCA: Good morning. My name is Robert Branca. I'm here in my capacity as a Dunkin' Donuts franchise owner, as the Chairman of the Dunkin' Brands Government Affairs Committee, the Vice Chairman of the Coalition of Franchisee Associations, and representing the International Franchise Association.

These proposed regs are particularly punitive to franchise businesses, which are largely family businesses that offer a unique path to the American dream for countless people. Unlike non-franchise businesses, the value of a franchise is much more limited and cannot be measured as the IRS has repeatedly attempted to do so, so as to inflate its value.

Courts have routinely struck down these attempts for a good reason. There are legitimate fact based discounts on valuation. The most commonly used measures of valuation, such as a multiple of EBITDA, a factor of cash flow, simply do not translate to franchises. Franchises have uniquely pressing needs to legitimately use the discounting factors that the IRS seeks to eliminate.

Why are franchise businesses different and why do they have unique needs for the discounting allowed by the current long-standing rules?

Franchises are time limited businesses by nature. The business exists only for a limited term of years with no guarantee of renewal. This means as each minute ticks by after the signing of a franchise agreement, the business is worth less.

It also means that the value of a franchise at the end of its term is zero as a going concern. All that is left might be used equipment, but there will definitely be a non-compete covenant preventing a former franchisee from continuing in that same business even under a different name. The value is actually less than zero. This is clearly a less marketable business as each day passes.

Franchise business sales have a unique factor not present in other business transactions, a third party, the franchisor. Franchise agreements give franchise powers that influence sales of franchise businesses that weigh on valuations that simply are not factors in other businesses.

What are these factors? Franchisors typically possess the power to not only apply not unsubstantial fees on transfer, fees that are not deductions in prices in other businesses.

The franchisor can also deny any transfer, sale, or gift outright for any reason or no reason. Franchisors also typically possess a right of first refusal to step into

the shoes of any transferee. Again, this is a unique factor limiting both control and marketability.

Transferees often price the uncertainty created by these rights into the purchase price, knowing that the time and money spent on due diligence, negotiation, and experts can be completely lost.

I personally encountered such a situation and have observed many others.

However, perhaps the most discounting factor in valuation of an interest in a franchise is the severely limited pool of buyers. Only an approved franchisee of the system is even eligible to buy at all. This is a tiny universe of potential transferees, and a franchisor can deny anyone approval to be a franchise, even a franchisee's child or spouse, a more clearer lack of marketability and control it would be difficult to find elsewhere in the business world.

These rights are not always used correctly, and they can pit franchisees against each other in vying for territory and growth, and prevent a franchisee from transferring business interests as any seller or grantor outside of franchising can do at will.

However, the proposed rules do not recognize these discounting factors at all, and the Service has routinely attacked discounts in valuation of gifts to children who seek to continue in a family business in which they grew up.

Franchise businesses typically have substantial obligations that non-franchise businesses do not have. They are not only the royalties paid off the top line, but extensive and expensive remodeling obligations. These required remodels are often done on real estate that the franchisee does not own.

Perhaps the most visible example of this requirement has been the wave of McDonald's locations that have undergone massive renovations, including many raising and rebuilding. When you acquire an interest in a franchise, whether by purchase or gift, you are inheriting the obligation to perform these remodels, typically every five years. That obligation is on top of all the other periodic required equipment and upgrades necessary to prepare new products or perform new services.

Non-franchise businesses are not compelled to make these investments, and cannot be forced to in cases where there is no expected return on investment.

Franchise businesses, even where the renewal term is granted after a transfer, cannot be assured of what the new royalty costs or other contractual terms of the business will be. This is because franchises routinely require the franchisee to sign the then current franchise agreement. Royalty rate increases and remodel obligations can be more costly, and the transferee has no certainty at the time of transfer what mandatory business conditions will be.

A franchise business faces a monumental risk in addition to these others. Rent and loan obligations aside, a non-franchise business owner can lose only a maximum of his or her investment. A franchisee can lose everything, as they are often obligated to pay liquidated damages based on royalties that the franchisor

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did not collect if the franchisee ceases before the term has expired or fails to perform a requirement under the franchise agreement, even though a franchisee is forced out of business and getting nothing, he or she takes their loan obligations with them.

Indeed, a non-franchise business has no obligation to a franchisor upon default that could compel forfeiture of the entire business. Where a franchise default occurs, the franchisor can step in and take the business often for no payment at all and resell it and retain the proceeds.

These not unsubstantial risks are natural factors that limit the marketability of an interest in a franchise. Valuation discounts for these factors are entirely justified, yet the IRS has routinely refused to accept them and now seeks to eliminate them without the necessary review.

So, why is the over $10 million exemption from estate tax not adequate for a franchise business? A typical quick service franchise requires a high initial capital investment in land, buildings, and equipment, as well as the continuing remodel investments already discussed.

The money for that initial investment usually comes from entire life savings, liquidated IRAs, college funds, and mortgages on the family home, essentially everything that a family has is required to even get into the business.

The value of these brick-and-mortar and equipment assets can quickly consume the amount of the exemption, particularly as real estate values appreciate. More importantly, a typical franchise throws off nowhere near its brick-and-mortar value in cash flow, and a franchisee's entire family typically all live off that cash flow, leaving only a minimum capital reserve, which is used for those remodels.

There is simply not that much money left after everyone takes their wages from profits, if there are any profits. Children are simply not left in a position where they have the cash to pay a large death tax after factoring in the value of the brick-and-mortar assets that eat up the exclusion amount. That expected amount was what was producing their middle class incomes, not massive cash flows or retained capital.

With that, I will conclude.

MS. CHYR: Thank you, Mr. Branca. Our next speaker is Dick Patten, American Business Defense Council.

MR PATTEN: Thank you. And good morning. I am the President of the American Business Defense Council. We represent family businesses, farms, and ranches throughout the nation. I, myself, come from five generations of family business owners and entrepreneurs.

Throughout America, family businesses, farms, and ranches are the bedrock of America's economy. They provide 72 percent of America's jobs in a jobs-thirsty nation. They are the anchors of their communities. Yet the proposed rule changes under Section 2704, singularly hurts family businesses, farms, and

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ranches. This is not good for them, or for their families, or for our economy, or for America.

The minority family business evaluation discount has been in place for a very long time, and it accurately reflects market valuation. To eliminate established valuation methods would force artificially high revaluations on families for estate tax purposes. In fact these discounts play a more important role in helping family business survive the tragedy of family death, and the rigor of estate taxes (inaudible) companies almost inevitably. Individual minority shares of closely-held family businesses, farms and ranches, ought not to be valued as a direct percentage of the whole, as if you're counting shares of a New York Stock Exchange company.

Here is a personal example from my own family. My grandparents founded what was to become a successful title insurance company in Montana in the early 1920s. My grandfather died in 1948, when my grandmother passed away in 1972, her estate distributed 48 percent of the family business to my father, 48 percent to his older brother, and 4 percent to the older brother's wife. With the majority ownership in their collective hands, my uncle and aunt shut my father out of the family business. He never received a single dollar of his share of family business profits.

My father couldn't even get his brother to provide annual financial statements. In other words, my father's 48 percent of the family business wasn't worth anything. Yet, if the proposed rules under Section 2704 were in place, my father's taxable share of the business would have been a fully-monetized 48 percent of the full value of the business. Now, while my family's example is admittedly at the far end of the family dysfunction curve, I think you see my point.

Not only do these violate established market valuations, no economic impact statement has been filed by the IRS, thus violating its own precedence. Furthermore, the IRS has failed to conduct an analysis under the Regulatory Flexibility Act to study how these proposed rule changes to Section 2704 Regulations, will impact small business. The IRS claims that any impact of its rules will only be felt by individuals and not by businesses.

This position ignores the economic realities of family-owned-and-operated businesses. Often families running these businesses have no other source of income or assets. Any impact of the rule will be borne directly by those businesses as families struggle to adjust to the IRS changes. The IRS also claims that any impact of its rule, is a result of the statute, and not its regulation. This position ignores that Congress has not made any changes to Section 2704, and the IRS is taking it upon itself to change long-settled valuation rules.

Therefore, the source of the impact of these rules is the IRS and not the statute. The American Business Defense Council petitions the IRS to conduct the Requisite Regulatory Flexibility Act Study, publish that study in the Federal Register, and allow for public comment on that study, so that the IRS can better understand the true impact of its proposed rule. The proposed rules will result in many businesses, up to a 100 percent increase in estate taxes levied. A radical

change of this magnitude should be considered by Congress prior to any administrative action. Thank you.

MS. CHYR: Thank you, Mr. Patten.

MS. HUGHES: Mr. Patten, I can assure you that we will make it very clear that these regulations are not intended to eliminate minority discounts. We will make that very clear, if it wasn't already. But thank you, for pointing out how important (inaudible) how business is to the country. It's important for all of us to remember that. Thank you.

MR. PATTEN: Thank you.

MS. CHYR: The next speaker is Stephanie Loomis-Price, with the American College of Trust and Estate Council.

MS. LOOMIS-PRICE: Good morning. I'm here on behalf of the American College of Trust and Estate Council. I'm a shareholder at Winstead PC in Houston. And I intend to address three issues; control, a very big word, at 2704-2E, and 2704-3F, the impact of ignoring applicable restrictions and disregarded restrictions, and then under 2704-3B4I, interests held by non-family members.

Mr. Ransome earlier this morning mentioned the problem with the word family, and the definition that is used in 2704, but the cross-reference to the definition of family in 2701.

I struggled with those words trying to figure out how to make clear what the problem is, and here is what I've come up with. 2704 defines for purposes of 2704, in (a)(2), family as the individual's spouse, ancestor or descendant, or of the spouse, ancestor or descendant of the spouse. Or, the spouse of ancestors or descendants' siblings, or the spouse of siblings. It does not include descendants of siblings; straightforward, yet, the existing Reg. 252704-1A2I, and proposed Reg. 252704-2C, and 252704-3C, refer to the definition of controlled entity, and existing 252701-2B5, which incorporates a definition of family that does include descendants of siblings. In other words, nieces of nephews.

And that difference will make a difference in how we plan, it actually ends up making a difference in who dies first, and whether or not a spouse and children and nieces and nephews, that timing difference will make a difference in whether or not these proposed regulations apply. And there's an easy fix. Congress defines family for purposed of 2704,in 2704, the easy fix is that the cross-reference to the 2701, family definition should exclude (i)(1). Such that only those provisions addressing control, ii, iii and i(4), in 252701(2)(b)(5) are applicable to 2704.

Next looking at attribution, and so, Cathy, you are the person I know best on the panel, so you are my intended audience here. Three proposed Regs refer us to an existing Reg. Proposed Reg 2704-1A2I, 2704-2D and 2704 3D, all refer us to existing Reg, 252701-6, to determine whether attribution applies. And attribution is simply whether an individual is to be treated as owning an interest in an entity, owned by another entity or trust or estate, in which an individual has an

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interest. That attribution concept has several problems, and the proposed Reg is very broad, 2701-6 is very, very broad.

Why is that a problem? Under 2701-6, a grantor or the grantor trust will be deemed to have owned an interest regardless of whether that grantor has a beneficial interest in the trust, or a right to control voting interests in the trust. An aged income beneficiary of the trust, who has no interest in the principle of the trust is deemed to be an owner. All 10 cousins who are discretionary beneficiaries of a trust are all deemed to own all of the interests held by the trust all at the same time, which results in attribution of 100 percent of the same entity interest 10 times over.

And if this trust were our grantor trust, mentioned above, grandfather grantor is also deemed to be a 100 percent owner of 100 percent of the interest owned by the trust, resulting in 11 times 100 percent. And what about our 95-year-old income beneficiary? She is attributed with 100 percent ownership at the same time as each of the trust's remainder beneficiaries. Regulation 252701-6 contains fixes for multiple attributions, but those fixes don't really address the issues that arise under 2704, because 2701 is different.

So, proposed Regs 2704-1A2I-2D-3D should contain their own set of trust and estate attributions rules rather than trying to piggyback on to the attribution rules that we find in 2701, that don't really apply to our situations, thereby deleting the cross-reference to Reg. 252701-6, we have extensive proposed language in our comments, several pages for your consideration that might assist in addressing that issue.

Next I turn to the impact of ignoring applicable and disregarded restrictions, you and we, and people all over the country have been discussing at length the concept of a deemed put, and having studied the proposed Regs it is clear to me that there is no deemed put. But it's not clear to a lot of people. Given the furor that exists over what the words mean, and what silence means, it is clear that clarification is needed, if nothing else.

I'll give a quick example, we ignore liquidation restrictions and silence is what results, as we understand Treasury intended. So, what about a difficult or recalcitrant general partner, who, when I come to him and say, I'm ready to redeem my interest, what can you give me? He says, nothing, I don't like you, you are not my favorite child, or favorite niece or nephew.

How do we take that into account? The appraiser might think, difficult general partner discount, we've seen those before, but what if the family could draw an agreement that the general partner can't unreasonably deny a request for redemption, but they don't? Some commentators have said, that in and of itself, that action would be a restriction that would have to be disregarded, that action that is in action in putting a provision in the governing agreement, that forces the GP to take into consideration a reasonable request.

Or, as some further have circularly reasoned, the family has the power to remove the general partner, and choose not to, that general partner who refuses

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to redeem, who could be removed by the family, that failure to remove in and of itself is a restriction that would have to be disregarded. Which, if all of these things were restrictions, and I'm not saying I agree that they are, but if they were, you can see how commentators have fought circularly and end up at the only possible result from silence, is a deemed put. Again, I don't necessarily agree, but you can see where the logic gets us.

MS. HUGHES: Thank you for explaining it.

MS. LOOMIS-PRICE: And the real concern for those of us who are in the courtroom, is not what Treasury intended, or intends if these proposed Regs were promulgated as initially proposed. But what a judge might read into them, or understand, and if people are smart as the people in this room and various people in ACTEC and other organizations, who still think that there's a deemed put, it is entirely possible that a judge, even though Treasury didn't intend for there to be one, could read it into it as well.

And then we are stuck with case law that says there is a deemed put. That also raises the question of valuation impact, we've heard some of this from Ms. Gallagher, and I'm sure you'll hear more from other appraisers in the room today, but we will need guidance on how to appraise. I have about 40 seconds to address interests held by non-family members. It is easiest described as this. We all know what the lion looks like, we all know what an eagle looks like, but when you put them together it's really hard to understand what a griffin looks like. Not my turn, Mickey Davis, but this rule, this three-year rule, is a griffin. There is no business, there is no person, there is no member or entity that looks like this, and so we are finding it very difficult to put this three-year rule into reality. And so there are all sorts of issues that I now no longer have time to address.

MS. CHYR: Thank you, Ms. Loomis-Price.

SPEAKER: Thanks (crosstalk)

MS. CHYR: The next speaker is Ronald Aucutt, with the American College of Trust and Estate Council.

MR. AUCUTT: Thank you very much. I am Ronald Aucutt, a Partner in the Tysons Corner Office of the Law Firm of McGuire Woods. I am not representing the American College of Trust Estate Council as such, I'm here in my own capacity, but I worked on the ACTEC comments, I support it entirely and I affirm everything that Ms. Loomis-Price has just said.

Specifically, this confusion over the effect of disregarding a restriction has produced the biggest commotion I've ever seen. Including the deemed put notion, and that narrative. A lot of people have told you already and a lot of people are ready to tell you later today about the facts of family life, and the facts of business life. These facts of life justify adjustments. Sometimes called discounts, sometimes substantial discounts in the valuation of interests in entities especially family-owned business.

Now, these people are right about those discounts of course. Those discounts are real, and the justifications for those discounts are real, and the fear of some

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of you, that has been expressed about the effect of these proposed regulations is real too, and it's understandable, it's just based on a false narrative, I'm sorry to say, but began even before these proposed regulations were published, about the overreaching of these proposed regulations and the drastic effect that they will have.

And I want to apologize on behalf of my profession for not doing more, and doing it sooner, and doing it more clearly to deal with that false narrative. But the advice is understandable, that the advice has been given in good faith, it's just based on that narrative above the government outreach, and that was circulated even before the proposed regulations were published. And that narrative has missed the point that these proposed regulations would ignore something that is limited to a provision.

A provision, words on a page, words in a governing document, words that seek artificially to add to discounts, that those real facts of business life of course already support. Appraisers are going to be asked to ignore those specialized restrictive words, and that's all. You know, not the asterisk, nor any of the facts of business life, the business plan, the business environment, the market data, the unpredictability, the competition, the illiquidity and the need for capital. All of these things that justify discounts, sometimes substantial discounts, appraisers will still respect, there is no new standard, a fair market value, and appraisers in the audience; I apologize to you, too, for the false narrative, that has been so confusing.

And by the way, as I construe these proposed regulations, then there is no doubt that they are within the authority that Congress granted in 1990. Now, as for you my friend, my written comments remind you about words, too, like minimum value and assumptions, and otherwise, and so on, those words have fanned the fire, and you need to fix that. And even once you have, you need to listen carefully at what you are going to hear later today, for example, about a special case in California, under California law, where even if all of the unclarity is removed and the ambiguity is removed, these regulations still might result, inadvertently, in creation of a deemed put under those special circumstances.

Now, you would like me, or Ms. Loomis-Price, or others to tell you how to reword the proposed regulations to fix them. I'd love to do that. I can't. I don't see all the cases you do, so I don't know what it is that has prompted these particular regulations in this way, because there really aren't that many specifics in the proposed regulations, I can't tell what you are (inaudible), and the critics are right about that.

Now I know people are going to tell you some already have, it's just, withdraw these regulations. Some will say, withdraw and republish. Now, oftentimes people suggest that just to push you, because they just don't like the estate tax of something like that. I understand that, I don't like to be a part of that group. I don't like to join that chorus, but today, I'm afraid, I have to.

I see no other way that I can help you. Or that others can help you recommend what to do to clarify these regulations and help them to accomplish

their purpose until I know a little bit more about what the purpose is. And it may well be that you'll find, I'm not guaranteeing this, but you might find that the choice to define disregarded restrictions with reference to the effect, and not their components in their nature, is going to make it impossible to deal with these ambiguities, this unclarity might be inevitable, and a different construct might be necessary, which it seems to me would almost compel a re-proposing of the regulations with that construct, then I'll be able to help you. And so were many members of ACTEC. You'll have to tell us about what you are trying to do, before we can tell you how to do it better.

Now if we can do that together, I'm positive, and I promise the taxpayers in this audience that the final regulations can actually bring clarity that will save compliance cost, of cost in litigation, limit the uncertain shadow of case-by-case fact-bound, and sometimes even judge-specific determination. And even if some transfer tax values, in some cases, are greater as a result the uncertainty and clarity can be worth it, and can be welcomed, that's the way this process should work.

Now, these facts of business life it justified the way interests in (inaudible) are valued, to me they mean that active trades and businesses which will not be affected much by these proposed regulations, if at all. Certainly active trades in businesses are not the target, as some have said or seem to think. Well, then, very little impact of these regulations would be sacrificed and lots of public acceptance could be preserved if there's simply an exception for active trades and businesses, and I know it's hard to define.

An active trade or business in a way, for example, that can't exploited the stuff parts of assets into it, and all this kind of thing. The proposed regulations that points, refer to Section 6166(c) admitted, that businesses should get some special break. But Section 6166 is a mess, it's a mess largely because it can't be amended. It can't be amended because of reform scores as a huge revenue loss because of the rigid cash basis in revenue estimated, tax defers, loss, even though it's only deferred and the interest is charged. So here is the tip; lead, take the lead. You are not drafting regulations to implement Section 6166, you are drafting an exception to regulations under Section 2704, and then drafting that exception, no one is going to blame you if you overreach a little bit.

You decide what roles what you want, you decide how to define an active business, you define how to deal with real estate businesses, you decide how to handle farms, and so forth, just write the exception, who knows, Congress might even like what you do and pick it up some day, for Section 6166. And another thing that needs to be addressed, is the idea that family members, usually younger generation family members, who just inherited an interest, who got it by gift, and it's been a minority interest, and they have never controlled the entity, they had nothing to do with creating the restriction.

But they should, nevertheless, face the state, or gift tax consequences as if they were responsible for creating what the regulations called disregarded restrictions, how can that be fair, and an exception has to be created for that.

And by the way, this entity that has existed for a generation or more, probably isn't the (inaudible), it's just to get past an estate tax audit, or that you all probably view as the likely target.

Finally some effective date issues. If death occurs within three years, the lapse of a voting or liquidation right is three days elapse, occurring on the transfer's date of death, and the effective date provisions say this applies to lapses, occurring after the date the regulation is finalized. Thank you for saying, you get it, and you are going to fix that, that's good. Now, that's the general effective date provision that I read. The new disregarded restriction regulations in Dash 3 would be effective 30 days later, because of the Administrative Procedure Act.

Now I don't know if just having its own number makes the regulation substantive, and using an old number means it isn't, but in this environment, we are going to have controversy over that, there will be arguments about what is substantive, and what isn't. So as the ACTEC comments, and my comments propose, the controversy can be avoided just by making everything effective 30 days later.

And why not, even if there were no controversy, who what's to deal with two sets of effective dates for a long time? Say, these regulations are finalized two years from now; is there a reason to have actions taken 337 months after the statute was enacted, treated differently than actions taken 338 months after? I think not. An effective date 30 days after will lose nothing except all this exasperation. Believe me when I say that ACTEC Members, including me, are able and willing to help you achieve a final product that provides the kind of clarity and certainty, and thereby compliance, clarification --

MS. CHYR: Mr. Aucutt?

MR. AUCUTT: -- simplification and relief that we are all looking for. Thank you.

MS. CHYR: Thank you. Our next speaker is Brian Reardon with the S Corporation Association.

MR. REARDON: I am Brian Reardon. I'm a former Special Assistant to the President of the United States, serving on the National Economic Council. During my time at the NEC, I oversaw the tax portfolio and helped to craft and get enacted into law the 2003 Jobs and Growth Act, as well as the 2004 American Jobs Creation Act. I am here today as the president of the S Corporation Association. A trade association representing the interests of America's 4.5 million S Corporations. S Corporations are in every state; they're in every industry; they employ one in four American workers. And they form the economic cornerstone of thousands of communities across the country.

They also tend to be family-owned enterprises, which puts them right in the cross-hairs of the rules promulgated under Section 2704. S Corp submitted extensive comments opposing these rules back on October 17th. Key points raised by those comments include the following: The proposed rules are an

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attempt to broadly apply a general family attribution rule to family businesses that are passed on from one generation to the next. In doing so, they would largely eliminate the consideration of control and perhaps to a lesser degree, marketability when value in the business is for estate tax purposes. This would result in estate tax increase on family-owned businesses of 30 percent or more over what an identical non-family business would pay.

As one of my board members points out, the estate tax for closely held businesses means that every generation, the business has to buy back a significant portion of the business. And if this rule goes through as we read it, that would significantly increase that price tag and it would mean that there would be fewer and fewer family businesses that are able to survive from one generation to the next.

This broad application of the family attribution is wholly inconsistent with Congressional intent when enacting 2704. Chapter 14 was intended to be a series of targeted provisions and of particularly -- particular perceived abuses. It was not intended to be a general family attribution rule. Since we submitted these comments, there's been lively debate about as to the true scope of these proposed rules. With few exceptions, the tax community is adamant that the rules are broad and would largely eliminate discounts for control and marketability for family controlled businesses.

Treasury is just as adamant and I've heard from Cathy directly that the rules are narrow and leave most of those discounts intact. I'm not sure I've ever seen broader disconnect between what Treasury says they intended and what the tax community says is written on the piece of paper and I think it's important to review exactly why the business community is so alarmed. I see three underlines sources of our concern. The breadth and aggressive nature of some of the enforcing provisions; the limited usefulness of the mitigating -- some of the mitigating provisions -- where am I here? And finally, the failure in my mind of the inherent logic of the regulations if you read them with a narrow view in mind. So, in terms of aggressiveness, we make clear in our comments that the proposed rules go well beyond the underlying statute in several instances. The rules disregard all transfers made within three years of death of a business owner. The rules ignore the plain language of 2704 by creating a safe -- or which created a safe harbor for non-mandatory default state law restrictions and the rules disregard interests held by non-related parties when (inaudible) whether a family controls the business.

None of these provisions are authorized under 2704 and yet, here they are. And this aggressive nature of these provisions is consistent with the business community's broad interpretation of the rules, not the narrow one. The second flight is what I consider to be the lack of usefulness of some of the mitigating provisions. For example, the rules provide that non-family interests can be considered for purposes of determining control, but only if they're on a (inaudible) rights meet the following criteria. They have to be held for at least three years. The interests must represent at least 10 percent of the business. All the non-family interests must total at least 20 percent of the business and each non-

family interest has to have a put right. No business is going to give a minority owner these rights. This just simply not going to happen, particularly the put right, which means that no non-family interests will count towards determining control under the rule. The provision is effectively useless.

That same analysis applies to another safe harbor in the rules. Under the proposed rules, a family business can avoid having any disregarded restrictions if every interest holder in the business has a put right to receive from the business within six months of notification, cash or cash equivalent equal to the minimum value of the interest. No business could possibly operate under such an ownership structure, so the safe harbor is simply not useful.

Including provisions which purport to provide relief from the rules, but which in fact, are not useful, in my mind, suggest a very aggressive approach on the part of Treasury. And finally, there's the issue of the implied put right. The private sector argues that the rules only make sense if Treasury assumes that every minority interest in a family business has an implied put right, as defined above and any effort to limit or remove that put right would be a disregard and restriction which should be ignored for valuation purposes.

Treasury, and we've heard this today from Cathy and others, is adamant that no put right exists. But in our reading, the rule doesn't make sense without the implied put right. I'll give you an example. The first example in the rule, in that example, minority stakes in a partnership are passed from a parent to two children. The partnership agreement prohibits withdrawal by a limited partner. But that limitation could be removed by the approval of all the partners. So, another proposed rule is limitation on withdrawal is a disregard to restriction and therefore, the minority interest should be valued as if the limitation does not exist.

The rule goes into great length to describe how the interest should be valued, but if no put right exists, even without the limitation on withdrawal, you would still have a minority interest in the partnership that would be valued taking lack of control and lack of marketability in account. The value of the interest would therefore, be the same with or without the limitation. So, if there's no implied put right, what's the point? Why go through this entire exercise just to come up with the same valuation? That's why -- and I think this is the core of the business community's confusion. Looking forward, it's clear that these rules need to be withdrawn. Some people are suggesting withdrawing them or re-proposing that. We would support that.

Over 28,000 comments have been received by Treasury during the comment period and with few exceptions, they were all opposed. That's an extraordinary output -- pouring of opposition by the business community and we're hopeful that Treasury is responsive. It's also clear that Congress needs to rewrite 2704. Family attribution is a fatally flawed concept, whether it's applied broadly per our reading of these rules ordinarily as written into the underlying 2704 statute. That's corporation association intends to continue to work with stakeholders, Treasury and the tax writers to achieve both of these goals. And we appreciate the willingness of our Treasury and the tax writers to listen to our concerns. We -- I

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very much appreciate the opportunity to address this group and I will give you back your two minutes and 30 seconds. Thank you.

MS. CHYR: Thank you Mr. Reardon. We will now have a break until 11:40, and we'll start with Mr. Palmer Schoening.

(Recess)

MS. CHYR: Hello everyone. Could you all take your seats. It is a little past 11:40 right now. The next speaker on the list is Palmer Schoening with Family Business Coalition.

MR. SCHOENING: Thanks for the opportunity to speak today about how the proposed 2704 regulations affect family-owned and operated businesses across the country. My name is Palmer Schoening. I am chairman of the Family Business Coalition, a collection of industry groups, associations and organizations that meet monthly to discuss tax policy as it relates to family owned and operated businesses. Over 120 organizations jointly representing millions of businesses joined our September 22 coalition letter to treasury calling for a trial of these regs. Upon treasury proposing these changes to Section 2704 our team hosted several briefings with some of the country's top estate planning experts, some of which you'll hear from today, about how these rules will affect privately owned businesses. There are certainly varying interpretations among estate planners, appraisers, and the tax community at large but one thing the group agrees on is that the vagueness of these regulations if implemented as currently written will give the IRS broad authority to interpret them in a number of different ways. This confusion among tax professionals alone is a sufficient reason to call for withdraw of the regulations.

So my brief statement I'll discuss some complications these regulations could cause in succession planning for family businesses, why treasury should have conducted a regulatory flexibility analysis, review some recent legislative history on the issue and I'll conclude by recommending as the Family Business Coalition did in our submitted comments that these regulations be withdrawn permanently.

Our coalition seeks to make like easier on family businesses by lowering their tax burden and protecting them from harmful regulations. We take this task seriously and we take pride in the fact that our members help to create the majority of jobs in the country. Indeed, family businesses create 66 percent of all new jobs according to Harvard Business Review. Also, family businesses sponsor the local little league baseball team or help to build the new wing at the local children's hospital. Communities depend on healthy small businesses. I've personally called many of them in this category and I asked how these regulations would affect them. Their first thoughts were not about their profit margins. They were all chiefly concerned with the workers and the family members that have worked by their sides to help build these successful businesses. I recorded some of these responses that I received over the phone and email regarding how these proposed regulations would change their behavior and I'll share a few of the here. "These regulations will force us to cut

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back on giving raises to workers, philanthropic projects in the community or both." That is from a third generation farmer in Sheffield, Iowa and that business has 14 family members that have some type of an ownership stake in the business. "If we didn't allocate so much money to a estate planning and life insurance we could use the money to hire more workers or operate our equipment. These regulations will leave us even less money to take care of our workers." That is from a second generation HVAC distributor which started in 1973 with seven employees and now employs over 100 workers in Illinois. "There is simply not enough cash on hand to pay our state planners $10,000 every time the government decides to issue a new regulation. We can only tighten our belts so much without having to cut salaries to stay afloat." And lastly, from an estate planner in Birmingham, Alabama, he told me "we love complexity, we love more rules and regulations because it means more billable hours but we also have our clients best interest at heart and these regulations will hurt the bottom line". None of the businesses that I spoke with, and as far as I can tell none that filed comments are using the valuation discounts to artificially lower their tax bill or abusing the valuation discounts.

The overwhelming majority of businesses use these valuation discounts, minority and lack of marketability, legitimately to more fairly value their businesses while gifting or upon the death of the business owner. As an example, consider a wholly owned family business in which the owner controls 51 percent of the stock and the children control some combination of the minority shares. As anyone who has tried to sell part of a local distribution company knows the market for selling minority shares of that business is not the same as it is for shelling shares of Apple stock, for example. The value of the shares in the business is depended on the market, the specifics of the business and the lack of control the new buyer would have in the business. As such, the value should be adjusted to reflect those realities which is why the regulations we're discussing were inactive in the first place. These protections have been law for over two decades and family businesses have arranged their succession plans accordingly to avail themselves of these protections. Business valuations already subject to scrutiny by the IRS on a state and (inaudible).

Changing the rules in the middle of the game by ending this predictable structure increases uncertainty and, as I discovered talking to these business owners over the past four months, can be quite costly. A brief survey of our members indicates that they pay between $400 and $900 per hour for estate planning, some actually pay more than that. These businesses include distributors, forest land owners, manufacturers, franchisees, and businesses from almost every other sector of the economy. Many of them have still not had the opportunity to even revisit their estate plans nor to sit down with their accountants to ascertain the effect on their businesses. For this reason, on October 4 the Family Business Coalition requested a 90 day delay on the comment period so family-owned businesses could have more time to understand how the proposed regulations may affect their succession plans. We have yet to receive a formal/informal responses request. The layered request was echoed by several of our member associations and also by the Small

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Business Administration Office of Advocacy. Given that these proposed rules by definition affect family businesses we were surprised that the Treasury Department did not conduct a proper regulatory flexibility analysis as called for in the Regulatory Flexibility Act. The justification for not conducting the analysis as I think was mentioned earlier is that these regulations technically affected individuals and not businesses. It is no impact certification the Treasury Department did not make what we consider a factual basis statement to justify not conducting regulatory flexibility analysis. In fact, these regulations almost surgically target the valuation of family-owned and closely held businesses.

It is clear from the nearly 10,000 comments filed and then just anecdotally from business owners who flew here on their own nickel to testify today that the 2704 regulations without question affect businesses and accordingly a proper analysis of the small entity should be conducted. This observation was also echoed by a number of other business association and by the Small Business Administration Office of Advocacy.

The recent legislative history and congressional intent on this issue is instruct of unwanted tax changes of this scope should be left to an act of congress. In 2012 the President's fiscal year 2013 budget sought to "modify rules on valuation discounts". According to the President's budget modifying the rules on valuation discounts would raise $18 billion over 10 years. This line item disappeared from the President's budget request to Congress in subsequent years leading many to speculate that the administration Treasury Department would eventually issue regulations to the same effect and indeed the proposed regulations reflect the same changes as the President's budget request. It appears what would have previously required congressional approval is now affectively being legislated by regulation that concerns our members.

With respect to increasing the estate tax burden on family businesses Congress has moved to quite the opposite taking a number of steps to reduce or repeal the estate tax altogether. HR 1105 legislation to repeal the estate tax sponsored by Congressman Kevin Brady, a Republican from Texas, and Congressman Sanford Bishop, a Democrat from Georgia, passed the House on a bipartisan basis 240 to 179 in April of last year. Members of the Senate Finance Committee and House Ways and Means Committee wrote to Treasury on September 29 and November 3 respectively requesting that the regulations be withdrawn. In addition, Warren Davidson and Senator Rubio have offered bicameral legislation to nullify the regulations through the appropriations process. In just 13 days Mr. Davidson's bill already counts over 100 co-sponsors in the House. Simply put the spirit of these regulations is not (inaudible) with the will of Congress. We have other concerns and I believe a lot of them have been addressed so I won't address them. They include the three-year bright line test, (inaudible) in the regulations which still seems to be an open question. I was happy to hear that addressed at the beginning of this hearing and Brian has me worried about it again. The willing buyer/seller test in lieu of that family attribution and more that I expect to be adequately addressed here today. But for these reasons and more that we submitted in our comments to Treasury, the Family

Business Coalition requests that these regulations be withdrawn permanently. At a minimum, the Treasury Department should afford family businesses more time to meet with their estate planners to see how these changes will affect their businesses. The Treasury Department should also conduct a proper economic analysis on how these regulations affect private businesses. We look forward to working with the Treasury Department this year and in the next administration to maintain a predictable set of rules for family businesses and leave them otherwise free to do what they do best, create the majority of jobs in the country and strengthen the communities that they're part of. Thanks for your time and for taking these concerns into consideration.

MS. CHYR: Thank you for your comments, Mr. Schoening. Next speaker is Mr. John Porter, Baker Botts.

MR. PORTER: Good afternoon. I'm John Porter, I'm a partner in the law firm of Baker Botts. I'm also a fellow of the American College Trust and Estate Council although I'm not speaking on behalf of ACTEC today nor did I participate in the comments. I did assist the S corporation association in the preparation of its comments and I adopt those fully as if they were my own. I have served as lead counsel for numerous tax payers in cases involving transfer tax issues. Specifically including cases involving evaluation of interest and family controlled entities. I was lead counsel for Bain and Mildred Kerr in the *Kerr* case, both in the tax court and in the 5th circuit. Our firm Baker Botts handled the Harrison case but it was a little bit before my time. I'd like to say it was back when I had a full head of hair but that is not true. I've also handled a number of cases throughout the country on issues of first impression in the transfer tax area. Davis, Vanguard, Petter, McCord, Gelky, Black, Christiansen, Steinberg, Holman and others and handle audits around the country. I feel like I'm uniquely situated to testify from the tax payer's perspective with respect to how chapter 14 issues have been handled through the years and some of the concerns we had with respect to the proposed regulations.

My concerns principally are with respect to the breadth of the proposed regulations. As I read them, the proposed regulations undermine the subtle principle that property is valued for transfer tax purposes at fair market value. By ignoring restrictions on liquidation and withdraw that commonly exist in closely held businesses, whether or not those businesses are family controlled and I strongly believe that the proposed regulations artificially limit the hypothetical willing buyer, willing seller test to non-family transfers by imposing a general family attribution rule.

The legislative history of Chapter 14 clearly establishes that it was intended to deal with a targeted set of rules and not as been discussed today intended to affect minority discounts or other discounts available under the present law. It is also clear in repealing 2036(c) and enacting Chapter 14 that Congress did not want to impose general family attribution rules. But I have significant concerns, and I'll focus first on 2704(b) on the proposed regulations about the extension of those applicable regulations and the language to ignore restrictions on liquidation and with withdraw in the context of family controlled entities. These types of

restrictions, restrictions on liquidation and withdraw, exist in these entities for a variety of non-tax purposes. Whether they're family entities or non-family entities and they have a substantial impact on the value of those interests in the real world. Reasons for including them vary from case to case. They include the desire to continue the business without being forced to liquidate assets or incur borrowing costs to pay the exiting owner. And under what terms a non-controlling interest owner has the right to withdraw or liquidate her interest depends on the purposes for which the entity was created, the continuity needs and the liquidity constraints of the company and a variety of other specific reasons to each entity that are different in every case.

I believe Congress recognized this concern when it enacted 2704 which is why the rule making authority granted in 2704(b) allows the Treasury to promulgate regulations addressing other restrictions in a family controlled entity but the language in 2704(b) is critical. Only if such restriction has the effect of reducing the value of the transferred interest for purposes of the subtitle but does not ultimately reduce the value of such interest to the transferee. That is pretty specific language and very different from the language which grants rule making authority under 2704(a).

In other words, Congress in authorizing the Treasury to adopt regulations said that you could disregard restrictions that reduce value for transfer purposes but only if those reduce value in the hands of the transferee. It is a specific particularized test. Congress recognized when it granted this authority that abuses may exist but required a particularized comparison of the effect of the restriction on liquidation or withdraw on the value of interest for transfer tax purposes to the value of the interest in the hands of the transferee before that restriction may be disregarded. My view is that this is very similar to the device test that is enacted in 2703(b)2. It is an easy fix, quite frankly. The proposed regulations could simply provide that we're going to ignore restrictions on liquidation and withdraw that have the effect of reducing the value of the transferred interest for purposes of the subtitle but does not ultimately reduce the value of such interest to the transferee, it is frankly an easy fix as opposed to an across the board analysis or across the board family attribution test.

Another concern that I have relates to the breadth and we've talked about this a lot. Whether or not there is an assumed put right, whether or not frankly what hasn't been talked about do we assume a liquidation right exists if we ignore the restrictions and if so what is its effect on fair market value. I would implore you and Kathy, I know you've said repeatedly, that a put right, we're not intending to assume a put right exists. I would make it clear that we also don't assume a liquidation right exists if a liquidation restriction is ignored.

The reason I say that is because what I see in the field, what I see litigating these cases dealing with examining agents across the country and I've seen it in the 2703 context where somebody will take a statute that may be not necessarily vague but 2703 is not the clearest statute in terms of what it applies to and we've seen examining agents and Internal Revenue Service engineers take the position that with respect to withdraw rights we could ignore those bells and whistles you

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talked about. We could ignore restrictions, a number of votes, and we can assume that the shareholder has the right to withdraw at (inaudible) value and I'm scratching my head and I say no if you're going to ignore a restriction on withdraw or a provision on withdraw in the agreement you have to ignore it all. You can't just pick and choose those that you ignore but I've seen that in a number of cases. What I would implore you to do is make sure if these are going to go final that the provisions are clear in their application and the examples are clear in their application.

The question though that comes into my mind is if we're not assuming a put right or a liquidation right then what are we really accomplishing through these proposed regulations? And I'll give you an example. If we assume that a liquidation right or a put right that exists in the agreement, so it is a restriction on liquidation is ignored and maybe that put right has the withdraw right has the ability to withdraw and receive a note at fair market value for a note with an AFR interest rate, I've got an exit vehicle. If we ignore that though under the proposed regulations, if we ignore it, we ignore the state law provisions that allow withdraw and there is no put right assumed, I have no exit vehicle. I'm no appraiser but my experience is unless that entity is making significant distributions, having an exit vehicle is more valuable than not having an exit vehicle. So the concern I have is, are we really accomplishing anything in the context of these regulations if they don't assume a put right? We've gone through a lot of exercise. There is a lot of people who have raised serious concerns about the proposals but at the end of the day is there anything to be accomplished if the point is just simply to ignore the bels and whistles and I'm not sure that there is.

I'm going to briefly address concerns I have under 2704(a). The proposed three-year claw back rule under 2704(a) creates a minimum holding period for interests in family controlled entities. While the rule making authority under 2704(a)3 is different than 2704(b)4 I simply don't believe that it grants the authority to impose effectively a holding period. It does allow the Treasury to address rights similar to voting or liquidation rights. What might that be? It might be elapsing withdraw right, it might be elapsing put right. If the concern and I've heard one of the concerns is death bed transfers and it is clear from the Murphy and Frank cases cited in the proposed regulations that that's a concern. If death bed transfers are a concern, three years is too long. One year, I know ACTEC proposed one year. I have concerns about that because you're still going to capture people who may die unexpectedly who are not engaging in death bed transfers. My view would be that the better approach if this was going to be allowed would be the approach for using the annuity tables with respect to the actuarily tables for the private annuity, a greater than 50 per cent chance of surviving one year. Thank you.

MS. CHYR: Thank you, Mr. Porter. Our next speaker is Keith Schiller with Schiller Law Group.

MR. SCHILLER: Thank you. We are now at high noon. I am not opposed to the Federal Estate Tax. By way of overall background, I've been an attorney 42 years primarily taxation, estate planning, and business succession. I am the

author of the B&A textbook Art of the Estate Tax Return. I have taught accountants, attorneys, since 1985 Federal Estate Tax. I've had the pleasure to work with Treasury in other matters dealing with the Federal Estate Tax. I've also taught with the IRS for most years since 1997.

Had the proposed regs excluded family business enterprise I would not be here today. I would not have spent very much time opposing these proposed regulations. However, the purpose and policy of the proposals as are announced in the notice I feel trivialized the impact of these regulations on family business. After all, the Federal Estate Tax is a burden on the business owners and in turn the entity. The entity is the source from which the taxes come. Whether it is through added dividends or distributions or redemptions, bonuses, one way or the other the entity has to be the source and Congress recognizes the importance of the entity as that source. You have IRC section 303 in which there is special consideration for how redemptions are handled. Those are funds coming out of the entity. 6166, 2032(a) all have special recognition of the impact on the entity. I recognize that you are rightfully displeased with how there are excessive discounts on certain investment entities. I would urge you to focus on that and to approach the act of business with a more embracive and positive approach than I see in the proposed regs and I'm going to go through some very particular examples.

John Porter's Holman case I feel has where he was the counsel I feel is a great help to you because entities which are formed without a substantial and legitimate non tax purpose will not have valuation discounts respected. So I think this narrows the area in which there may be an issue. What I ask is that you separate out trade or business and the assets used in that enterprise. Some of that may be in a separate holding company where there is real property, intellectual property or some cash included. What I would then hear as well you could then pack that with far too much investment type assets. I think there is a major difference between considering packing and entity with major investment assets that don't have a substantial connection to the business purpose than to draw to fine of a line in narrowing what an active trade or business is. So I would ask you take this from an approach which is more positive not only to the operating entity itself but to the entities which are affiliated with that operating entity. I'm assuming that this would be substantial through the evidence.

When I read the regulations, a case came to my mind and in large part motivated me. It is the case of a family auto dealership which is a franchise in the central valley. The father and son together own 95 percent. A long term key employee owns five percent. What happened? The father and son had a general partnership which owned the real property used in the business and had cash that was used to help finance flooring so that rather than going to the bank to get loan the funds could be internally generated. Let's say that within three years of death that general partnership is converted to an LLC. Now let's see what will happen. First of all, the five percent ownership interest by the outsider long time will not count because it is only a five percent interest. Second, the conversion of the general partnership to the LLC even with no voting right change will mean

that the general partnership interest will be valued. What does that mean? Under state law, general partnership interest have no minority interest discount upon death. This is the impact of the Revised Uniform Partnership Act. If you look at the comments and I have this in my comment, that is the impact. So now when you move from a general partnership to an LLC within three years now you're valuing the LLC interest as though it is a general partnership and the minority interest discount is lost, the lack of marketability discount will be greatly reduced.

Let me go to the next example and this is the one dealing with California law. Let us assume that the LLC existed as of the moment of death and we'll forget about the three-year rule. I'm going to show you where under the most benign interpretation of the proposed regs you will have either an elimination or a great reduction of the minority interest discount and a substantial reduction of the lack of marketability discount with an LLC applying California law. California law is not unique. This is what happens. Under California law on death the interest becomes a non-voting (inaudible) interest. That would be a disregarded restriction. However, the voting right would be assumed to then exist and you would be valuing the estates interest as though it was a member. Members have the right to file for the dissolution determination of the entity and they can do so if it is necessary to protect their interests. How will their interests need to be protected? Here is how. Under the proposal even the most benign, narrow construction and I'm not talking about the put I'm talking about assuming that it does not apply per se this is what will happen. Our decedents estate will be valued as though they have the right to compel the termination of the entity. That will then mean that they could go to court and if they can show that it is needed to protect their interest and I believe they would be able to do that because their interest is being valued under the estate tax for more than it is economically worth than they'll be paid for. The only way they're made whole of the interest is to have that interest valued as though they were a member and their rights respected as though they are a member including the right to have the partnership terminated. That is indirectly a put whether in whole or part you'll have either an elimination or reduction of the minority interest discount.

I would also point out that our client has an S corporation. If we have any situation in which the other shareholder is bought out at a price different than the family member if there is a redemption you will have then a second class of stock and the S election terminated. I would point out that in the relief for the closely held business even when you get to promissory notes it is not very significant. First of all, the valuation of the entity is excessive because only certain deductions will be allowed. The use of a secured promissory note is not going to work as a viable requirement. Why is that? Once the interest is redeemed it no longer exists. That would then mean a hard money loan. If there is going to be a loan where there is collateral and it is hard assets the banks will typically not allow that. So if you cannot use the redeemed interest because it no longer exists, if the banks or other finance requirements would also prevent a junior financing you then get into a guarantee. The problem with a guarantee is to show that it is adequate you have to have a financial statement and business owners in the family are not going to want to be sharing financial statements. So what relief

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you have and by the way I have comments which are 58 pages, I have 37 comments in all, there is also a supplement where I have that LLC item added. I'm sorry for the 37 comments. I know Wilson had 14 and Moses only had 10 so this is a lot. What I would do is to urge that you rewrite these, if you wish to carry them forward than I would do so where there is another chance to have common (inaudible). Franchise agreements, by the way, in the example of my client, the auto manufacturer loans the client no money. The restrictions in the franchise agreement would not count because there is no loan. Yet as you heard from the gentleman with franchises it would have a very big impact, thank you.

MS. CHYR: Thank you, Mr. Schiller. Our next speaker is Clarene Law, business person.

MS. LAW: Hi there. I think I'm what you're talking about here. Fourth generation family business from Jackson Hole, Wyoming, former state legislator and I really appreciate the opportunity to be here today to testify. I started out Elk Country Motels as a 28-year old back in 1962. My funding came from my mother and my dad. She was a housewife and he was a blue collar construction worker. They had very little money, but had a lot of pride. They trusted me, their 28-year old daughter with the only $10,000 they'd saved in a lifetime, which enabled us to purchase a 17 unit property, 12 old cabins with 10 shower stalls, some rooms above the office, an office which we still use today in Jackson Hole. We're not fourth generation.

Since its inception, all Elk Country Motels has been a family operation. My mother and my dad and all of my children have worked and continue to work in our businesses while their children did much of the same while entertaining high school and college in their vacant time. Some of them have now graduated and looking forward to coming home. Who wouldn't want to come home to Jackson Hole, Wyoming to these family businesses?

My entire family has sacrificed to make these businesses successful. Sometimes it meant sleeping on the floor while their mother rented their beds in a growing community and sometimes it meant working all summer making beds and cleaning bathrooms while their friends were at summer camps. Now, we're 50 years later, our small businesses have grown and they've provided my extended family and our loyal employees with a stable living. Today, we manage 450 rooms in Jackson and employ over a hundred people.

Now, continuing this family business is of the utmost importance to me. I have high hopes of passing it on to my children and my grandchildren and I feel we can only accomplish my wish for succession with favorable tax consideration which acknowledges legacy businesses such as ours. All my children have college degrees. My daughter's here with me today, a lawyer, and operating a small property in Jackson Hole, Wyoming. Two of the three children and their spouses came back to manage these hotels and I must not destroy their dreams of continuing this family legacy. These children are now in their 50s and can dedicate their lives and efforts towards building and expanding their heritage. All

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have contributed heavily in public service and are the vibrancy and the very fiber or our community.

My husband and I would like to convey our interests through gifting and selling our respective interest to children who wish to continue the business, the business that they've worked and sacrifice to build. And I'll end it that upon reading 2704, I was confused and a bit frightened. Much of that has been explained here today, but under those proposed rules in Section 2704, they have the potential to severely disrupt the plans that are so dear to my heart. Ownership of County Motels and other limited liability companies is divided between my three children, my husband and our trust, all minority interests. The IRS application of family attribution could result in all these interests being valued as if they were controlling, preventing the use of legitimate valuation discounts and leading to estate tax increases that the next generation would have to bear.

And this could force my descendants to sell the business in order to pay the taxes. After 55 years of operation, this family would like to say in business and not just sell out to corporate America. It's just not my business the rules would hurt. Our neighbors face the same challenges. Jackson, Wyoming is nearing the escalation property values largely driven by investors, investment fund purchasers. Teton County has seen assessed valuations escalate sharply in recent years with commercial real estate leading the charge. You know, in Wyoming, assessors are charged with taxing current market value largely driven by comparative sales, not net income. I should have changed that while I was in the legislature.

This approach often results in valuations that far exceed the income the property can generate without estate taxes. Meanwhile, our state board awaits equalization is ordering a significant increase in assessed values for Teton County's commercial properties. There's no relief test, so again, assessed valuations do not reflect earning capability. Well, you know, perhaps a hedge fund can easily pay these inflated prices, but small, closely held businesses such as ours, simply cannot. The estate tax forces many family businesses like ours to buy back a large part of the business every generation, plus an additional strain on the business is simply not felt by the public and companies with whom I complete -- compete.

They don't have to face the burden, but I do. Ranch land, particularly in Wyoming is under the same pressure. It would be virtually impossible to pass heritage ranches that we all love on to generations should an orderly discount speak compromise. Just like our small business, our ranchers want to remain on their lands, pass their heritage on to their children. Well, they could always make the decision to sell at some point in the future and I guess ride off into the sunset. They shouldn't be compelled to do so by a tax code. That obviously would be bad for our family business and ranches and also be bad for our communities.

Hedge funds and absentee owners may have lots of money, but they seldom serve the community. Family ownership is not only better for the management of the company, it's also better for the communities in which they reside. When I

make a decision to hire and invest, I literally have to live with the consequences. Make or break. My husband and I, along with our children and their spouses, have had the opportunity to build the American dream. We think future generations ought to have the same opportunity. You know, thanks for allowing me to tell my story. It's really nice to kind of (inaudible) with faces here and I'm honored by democracy and the ability to raise these concerns at this hearing. Thank you very much.

MS. FINLOW: Thank you.

MS. CHYR: Thank you Ms. Law. (Applause) Our next speaker is Carol Warley, Texas Society CPAs.

MS. WARLEY: Thank you for the opportunity to testify on a very important matter that is concerning to taxpayers as we can see and tax professionals. I'm Carol Warley, a partner with RMS US LLP. I've been a licensed Texas CPA for almost 37 years and licensed as an attorney for four years. My primary expertise is in individual income tax, estate tax, gift tax, generations giving tax, charitable planning, and fiduciary income tax. I'm a current member of and past chair of the Texas Society of CPAs Federal Tax Policy Committee.

I speak today on behalf of that committee, as well as TSCPA's business valuation, forensic and litigation services committee. The Texas Society of CPAs is a non-profit voluntary professional organization representing more than 26,000 members. Our committees have been authorized by the TSCPA to speak out on behalf of its members. I'm not speaking out on behalf of and my comments do not reflect necessarily the view of RSM US LLP. Treasury's authorization of regulations in a current form -- for decades, Texas families have followed the law and taken legitimate valuation discounts to help preserve family ranches, farms, oil and mineral interests, and other businesses.

In many cases, these properties have remained in families for generations and formed part of our rich Texas history and heritage. We respectfully believe that the broad proposed regulations Treasury's issued conflict with a large body of case law and ignore the impact of state law. When Congress enacted Section 2704 in 1990, it offered restrictions on the regulatory authority, granted, Treasury. Tax preparers have appropriately applied the provisions of existing regulations to reduce valuations. These valuation adjustments have been approved by case law, much of which originated in Texas in the Fifth Circuit. To the extent the proposed regulations have disregarded restrictions that create a astute put rights, mandate the use of minimum value, assume cash redemptions within six months and ignore certain unrelated parties unless their percentage ownership exceeds a given percentage, we believe they're creating a fiction rather than disregarding existing restrictions as authorized under Section 2704(b)(4).

The IRS has repeatedly championed legislation to overturn the longstanding body of case law, but Congress has declined to enact additional restrictions. In the absence of legislation, Treasury should not promulgate regulations conflicting with well-established case law.

The Three-Year Look Back Rule -- the final regulation should clarify, as other commentators have indicated that the Three-Year Look Back Rule is not retroactive and grandfathering transactions that took place in good faith reliance on existing law prior to the effective date of the final regulations. Case law has recognized the impact of ownership by unrelated parties based on facts and circumstances without imposing a three-year ownership requirement. The proposed regulations would ignore existing case law and force a harsh result. The existing regulations provide an exception to the inclusion of the value of lapsed liquidation rights and gross estate without requiring that death must occur more than three years after the transfer.

The proposed regulations would require inclusion of gross estate of a phantom value which we think could result in the result of the valuation of the interests in excess of what the valuation would have been without any valuation discounts if death occurs within three years -- an equally harsh result. Section 10-2035 provides for a three-year rule where the value of the asset would be included in the decedent's gross estate under Section 2036, 2037, 2038 or 2042. We believe a statutory authority granted under Section 2704 to issue regulations provides authority to disregard certain restrictions, but does not provide the authority to add provisions which do not, in fact, exist, such as expansion of the Three Year Rule in Section 2035.

We understand Treasury's desire to provide for a bright line test in applying Section 2704(a), but case law has established the facts and circumstances test. We recognize Treasury's concern about a transfer in contemplation of death by terminally ill or elderly transferors, but is not appropriate, particularly in circumstances where there is an unanticipated death. If the Three Year Rule is retained in final regulations, there should be an exception for an accidental or other unanticipated death. The post regulations ignore the economic reality. The proposed regulations ignore economic reality of discounts for minority interests, lack of control, lack of marketability and other valuation concepts that legitimately reduce the value of an asset.

The courts have long respected and accepted these discounts as reflecting economic reality. The proposed regulations discards concepts of fair market value and willing buyer and willing seller and disregard restrictions that have true economic meaning in terms of valuation. Economic realities and not tax fixes dictate that minority interests often cannot be sold without a discount, but depending on the circumstances, can be substantial. The proposed regulations ignore genuine relationships among family members who often have divergent interests as we've heard today and timing of cash needs fairing levels of passion for the business and so forth.

Families, we all agree, do not often get along well, particularly, for more distant generations. And there are instances, as we know, of family members suing others in an effort to get money out of businesses or having to accept a substantial discount at buyout. The proposed regulations to find a controlling interest of family-owned interest of 50 percent or more of any family ownership of -- or an interest of any interest of a general partner that can cause liquidation of

the entity. A 50 percent interest is a super minority interest that cannot do anything without the unity and approval of the other 50 percent interest. As a result, a 50 percent interest does not have the prerogatives of control for controlling interests.

The definition of control of 50 percent or more disregards the fact that interests of less than super minority majority do not have full operational control, such as making major decisions in the business. Clarification regarding income tax basis -- the final regulation should clarify that if an asset is valued for estate tax purposes under Section 2704, the basis for the beneficiary should be the same for income tax purposes under Section 1014(f) -- the use of the minimum value standard. The proposed regulations replace the well-defined fair market value concept with the new and previously unknown concept -- minimum value. Ignoring the true fair market value of these property interests could result in defective estate tax rates well in excess of the statutory 40 percent rate. The proposed regulations advance a new theory for valuing inter-family estate and gift tax transfers. The proposed regulations do not clearly state how this new standard is to be applied. Applying the proposed regulations appear, in our view, to substantially reduce or altogether disregard valuation discounts. This ignores the long standing precedent of decades of court cases, appraisal education and experience, academic research and economic realities.

In effect, the value for purposes of Section 2704 will not equal fair market value, thus, creating a myriad of problems for those involved in transactions where the parties expect to receive fair market value. The assumed put right -- the proposed regulations provide, in our view, an unrealistic put right to every interest holder. The assumption that each member of the family or entity would have unlimited put rights to the entity as a fictional assumption that contradicts reality. It would not be negotiated in an arms-length transaction. This assumption is an impossible scenario in the real world that conflicts with the business purposes of family entities. Business owners may decide or liquidate businesses rather than continue as a family-owned entity going concern. This last outcome would be highly destructive especially in smaller businesses.

In conclusion, we appreciate the opportunity to speak today and we respectfully asks the Treasury withdrawal or significantly revise these overreaching proposed regulations to prevent harsh results that are contrary to a long-standing body of existing law. Thank you.

MS. CHYR: Thank you, Ms. Warley. The next speaker is Kevin Kester with National Cattlemen's Beef Association.

MR. KESTER: Good afternoon. My name is Kevin Kester. I'm a rancher from Park Hill, California and I have some favorable news. My comments can be closer to the five minutes instead of 10. So, on behalf of the National Cattlemen's Beef Association, thank you for your interests in my comments regarding the IRS proposed rule to restrict the valuation of interests in family-owned businesses for estate, gift and generation skipping transfer tax interests. I appreciate the opportunity to share with you, the National Cattlemen's Beef Association's

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position on the estate tax and the detrimental effect and impact the proposed regulations will have on family ranches and farms, such as my own.

We are a multi-generational family ranching operation. My family has ranched in California since 1864 and I represent the fifth generation of California ranchers in my family. We have an 18-month old granddaughter who is now representing the seventh generation. I am here today to help future generations have the best opportunity to stay in business. Having dealt with the state tax, I can assure you it is not an easy fix to sell the estate of a loved one while coping with the questions of how to pay the estate tax; trying to figure out will we have to sell off parts of the ranch, farm or business; will we be forced to take out a loan to pay the tax even if we could get a loan; will we be forced to lay off employees? Those are tough questions I've had to face and been through and many, many livestock producers have to answer when confronted with estate tax.

So, in its present form, the estate tax is a primary obstacle to keeping family-owned ranches and farms intact and viable during generational transfers. Ranching is a debt intensive business. Beef producers largely operate on a land-rich, cash-poor business model. A rancher's and farmer's biggest asset typically is the land. Making U.S. Agriculture, specifically ranches, especially vulnerable to the estate tax. As a result, many families are unable to keep their estates intact. Our ranch is like most other small family-owned businesses. They can be challenging to make a payroll, compliant with numerous federal and state regulations and paying bills, loans and taxes.

When my grandfather passed away, we struggled. We struggled to keep the ranch intact. We struggled more than 10 years to pay off the estate tax debt. Employees were let go. We did not make investments into the business. Deferred maintenance was excessive. We needed to hire folks, but we could not. The debt hanging over our heads for 10 years cost us dearly. Besides the stresses on our family, we could not grow our business. To create an economically viable operation, we tried to do all the right things. I have invested to grow the family business and have worked to increase the value of our operation through investments that allow us to contribute to our local economy.

As cattlemen, we are caretakers. The most important part of my family's livelihood is the health and safety of our cattle along with the well-being of our employees and the land which we live and work. Every day, my family works alongside employees because every hand in the operation has a shared responsibility to look after not only our animals, but the natural resources so critical to our industry and to our country. We have increased the value of our ranching operation through a range of improvements from genetics to conservation efforts. Significant investments and environmental stewardship projects have improved our water quality, wildlife habitat, and ranch management.

Estate planning is an expense, produces or forced to utilize to preserve the economic viability of the ranching or farming operations. Producers like myself are utilizing legitimate valuation discounts as a means of maintaining family

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ownership. The great benefit of these discounts, which accurately reflect the actual market value of minority ownerships in closely held businesses is that they reduce the tax burden at death, allowing agricultural operations to maintain family ownership from one generation producers to the next. So, the lack of marketability and the lack of controlled discounts be eliminated, the significant number of ranchers and farmers will face an even greater tax burden during the difficult task of transferring minority interests to the next generation.

Having dealt with the estate tax, which is not so fondly referred to in my family as the death tax, there is no doubt in my opinion the proposed rules will up end succession plans, halt planned expansion and growth and result in grave, grave many agricultural operations, liquidating assets in order to simply survive from one generation to the next. In fact, I'm in the process of succession planning with our next generation and these proposed regulations would have a very significant -- in fact, a huge detrimental impact on our plans. The proposed regulations under Section 2704 will have a profoundly negative impact on the business climate for ranchers and farmers. Ultimately, just decentivizing the next generation of producers from carrying on family businesses. As such, the National Cattlemen's Beef Association respectfully requests that the IRS formally withdraw the proposed rule. Thank you for the opportunity to speak to you. If you have any questions, I'm happy to answer them.

MS. FINLOW: Thank you for your time.

MS. CHYR: Thank you, Mr. Kester. The next speaker is Robert Grossman, National Association of Certified Valuators and Analysts.

MR. GROSSMAN: Good afternoon. My name is Robert Grossman. I am a partner in the accounting firm of Grossman, Yanick and Ford in Pittsburgh, Pennsylvania. I am a certified public accountant with a Masters degree in taxation, and I carry all four major business valuation organization -- the accreditations.

Today, I'm here to appear on behalf of the National Association of Certified Valuators and Analysts, and on behalf of that organization, I would like to take this opportunity to thank the panel and the IRS and Treasury for allowing our members to express their concerns through this forum. I'd especially like to thank Cathy Hughes -- who I've not met until this morning -- but whose name I will tell you has come up at least 30 times in the last three months as I discussed these regulations and other rules around the country with other practitioners and so forth.

The other thing I may have to do as a result of this session today is reconsider my position that when I look at the four of you having to focus so clearly on everybody's comments, to reconsider the notion with my wife that there's nothing worse than watching two Hallmark Christmas movies back to back. Maybe there is.

NACVA is a global professional organization that delivers training and certification and a number of financial consulting disciplines, including primarily

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and historically business valuation. Founded more than a quarter of a year ago, NACVA has trained nearly 30,000 certified public accountants and other financial professionals, and we have credentialed more than 13,000 professionals in the fields of business valuation and other services. Within the context of that training, we have also trained many of the engineers and valuation specialists within the Internal Revenue Service.

My comments this morning were developed by a special task force and a team of NACVA's most experienced national membership. The findings of that committee and the comments submitted here in today reflect the comments and observations and concerns of our national membership as well. The findings of that task force undertaking and the committee's work over the last several months will be provided by myself, Mr. Mark Hanson of Green Bay, Wisconsin and Mr. Peter Agrapides of Salt Lake City, Utah. Each of us is longtime instructors for NACVA and all heavily experienced business valuators. We are honored to present those findings to you today. I would further note for the committee's knowledge that Mr. Robert Weinstock who spoke earlier this morning in Calabasas, California, also had a significant role in conjunction with our comments.

Our comments today are primarily business valuation oriented. It is NACVA's primary concern and consideration with respect to these rules and regulations as is proposed, that in many ways they operate in direct opposition to the business valuation body of knowledge that is encompassed and threaded throughout all of the professional organizations -- professional standards -- through preeminent and prominent technical literature that has been promulgated over the last three or four decades. It is also through historical Treasury and IRS rulings, and pronouncements including regulations that are out and permanent as of today, and in many ways the proposed regulations do not reflect -- as it has been mentioned numerous times today -- economic realities in the marketplace.

The proposed Treasury regulations seemingly work first and foremost to modify the traditional and historical standard of value -- fair market value. That has been gone in to detail today. I'm not going to repeat the definition and so forth, but it is obviously well-founded within Internal Revenue Service, literature, the Internal Revenue Code's supporting Treasury regulations, etc. I would also note, however, for the panel's discussion, that that same terminology has been accepted carte blanche through the International glossary of business valuation terminology, a cohesive product that was produced by all of the major valuation organizations and has been adopted by them as of 2001.

So how do they change this and where does the effect of fair market value come into play on this instance? Well, the proposed regulations, you know, take a look in numerous places on changing and modifying that traditional definition. One way is to deem foot that has been talked about and the term minimum value which comes out of it, which tends to value of the equity ownership's interest by virtue of looking at the pro rata portion of the underlying assets and certain debt obligations that would be deductible in certain circumstances for that particular equity interest.

As has been pointed out earlier, and I won't use the committee's time to go through -- the panel's time to go through all the details of that. I would suggest also that we agree and concur that that type of definition -- minimum value -- does not coincide in any way with fair market value unless it were by mere coincidence. So it is a clearly artificial market premise. It ignores market realities and economic realities, and equity ownership that -- attributes that are created by the entity's governing documents as well as state law.

Another way which it affects attribute -- the definition of fair market value is through this new family attribution rules and the expansion of the attribution rules. Interestingly in a 37 year career, one of the very early assignments I worked on was with a partner -- one is a young buck at Ernest and Young -- and we were fighting the service and the contest over revenue rule 81253 and it's interesting to note that here I am, 36 years later, and we're still having the same discussions. So in some ways, I don't know that we've moved as far ahead as we might have all liked. The standard of value -- of fair market value has long been predicated on an objective test wherein hypothetical buyers and sellers are at the heart of a hypothetical transaction, of course. It has not been interpreted in the courts and is not intended to be interpreted as a personalized transaction fundamentally based on the holder of the asset as it is supposed to be on the asset itself. So the proposed family attribution rules struck down by the courts again numerous times -- again works to create an artificial standard of value which NACVA does not concur with.

Third, the imposition of a blanket dismissal valuation discounts based on family attribution assumes that all family organizations run in harmony. We've spoken with that at length as well, and I know the folks in the audience as well as the panel don't need to hear that again. But it is a fact that has been brought forward several times, that there are numerous -- and almost everyone in the room can attest -- situations in which family relationships are not of the familiar evidential type that we would expect, and that there's infighting and difficulties in running those businesses constantly.

The inability to apply valuation discounts for lack of control, lack of marketability, NACVA reviews as inappropriate. As such a result fails to recognize the economic realities associated with a lack of either of these attributes. Certainly the business of business valuation is risk assessment and risk analysis. A equity ownership interest failing to have total control, or failing to have perfect liquidity and marketability carries with it additional investment risk which needs to be compensated. And whether that is done in the context of the business valuation discount, or in the context of some other element of the process it is economically sound and should be considered in conjunction with that. A failure to eliminate that carte blanche is going to put us in a situation where the valuation committee is unable to establish fair market value when those attributes are not available or not attended to that subject equity interest.

Finally, the utilization of discounts for lack of control as well as the lack of marketability has long been recognized as a legitimate measure of the investment risk associated with these attributes. As I've said, Treasury's

acceptance of this in the past -- most recently viewed through the job aids -- specifically the job aid for discounts for lack of market ability in 2009, and the 2014 job aid talking about the valuation of non-controlling interests in S Corporations, so they're there, as well.

So in conclusion, I would say that it's the position of NACVA that the new rules as concluded in the proposed regs represent a new standard of value created only for a specific targeted group of equity owners and to that extent it seems somewhat onerous and errant. As such, a new standard appears to be arbitrary. More importantly, it does not incorporate market realities that business valuation community are bound to comply with by virtue of their professional standards.

On behalf of NACVA, I respectfully request that the proposed regulations be permanently withdrawn as well as in total. If that is not possible, then at a minimum we ask that they be withdrawn in their current form and re-released in a modified form at a later date with such modifications as might be necessary to maintain fair market value as that appropriate standard of value in the estate and gift tax regime. Again with the appropriate commentary detached to allow for communications from the -- from the compliance community. And with that, I thank you for your time and your attention this afternoon. Thank you.

MS. CHYR: Thank you, Mr. Grossman. The next speaker is Samantha Joshion with New York Law School. Seeing she may not be here at the moment, we'll move to the next speaker. Will Frazier with the American Society of Appraisers. There was a change in the list. It is Will Frazier, not John Russell.

MR. FRAZIER: Ladies and gentleman of the panel, it's my pleasure to speak to you today. My name is William Frazier. I'm an accredited senior member with the American Society of Appraisers. I'm here today representing the American Society of Appraisers which was formed in 1939. It's a multi-disciplinary professional appraisal organization which teaches and tests credentials, individual professional appraisers in all of the appraisal disciplines and has nearly 5,000 members nationwide.

In addition, ASA is one of the eight major appraisal societies that founded the Appraisal Foundation in 1987. The Foundation authors, the Uniform Standards of Professional Appraisal of Practice or USPAP which the IRS has generally endorsed as a guideline in evaluations performed for estate and gift tax purposes.

While we have provided comprehensive written comments outlining our concerns with the proposal, I will focus today on the key areas that led us to urge the IRS to either withdraw the current proposal or to withdraw and re-propose the proposal. I would note that the American Society of Farm Managers and Rural Appraisals joined us in our letter.

The ASA objects to the proposed regulations as currently written because they create a large, and heretofore, unexamined valuation issues. Many of these cannot be resolved by observing the marketplace or referencing empirical studies

which is the stuff of appraisal. Instead, they leave us with large insoluble problems which can only be dealt with with great measures of speculation and subjectivity. Time and time again the Federal Appellate Courts have warned us against engaging in speculation when it comes to valuation. Yet, the proposal would have appraisers doing exactly that.

While the proposed regulations actually say very little about this, the elephant in the living room is what to do about valuation discounts as applied to family holding entities holding relatively safe and liquid assets. Sections 27-01 through 27-04 of the Internal Revenue Code were enacted to prevent the reduction of taxes through the use of estate freezes and other techniques designed to reduce the value of the transferors' taxable estate and discount the value of the taxable transfer to the beneficiaries of the transferor without reducing the economic benefit to the beneficiaries.

It is our belief that the proposed regs do, indeed, reduce the economic benefit. Further, given the motivation for Chapter 14 why are operating businesses covered by these proposed regulations? Today's norm for determining valuation discounts is supported by a long history of U.S. Tax Court, Federal District Court and Appellate Court decisions, as well as the IRS's own rulings. Revenue ruling 93-12, for one.

We've heard some Treasury spokespersons indicate that the proposed regs are not designed to eliminate valuation discounts and that the regs should have only modest impact. We at the ASA do not see how that interpretation comports with what is implied and expressed by the proposal. It may be, as my mother used to tell me, it's not what you say. It's how you say it.

The document is, at best, unclear. Many different valuation outcomes could stem from a wide range of interpretations of Treasury's intent in issuing the proposal. A great fear is that IRS agents auditing returns will later be attempting to interpret these regulations with little or no guidance and wide individual discretion. The predictable result will be chaos.

Underpinning much of our concern is the perception of what valuation discounts are, and more specifically, what they are not. Discounts are not, as some would contend to mean, for certain tax payers to avoid paying taxes that would otherwise be owed on the business interest that was passed as a gift. Instead, it might be more helpful to look at discounts as adjustments to account for economic risks that reflect real value, as our previous speaker mentioned.

At the heart of the Treasury's foundation for proposing the changes to 27-04 is a continued pursuit of the notion of family attribution. A notion has been rejected by the courts, specifically, probably most famously in the Bright decision. But under the current proposal the service would reinstitute by regulatory fiat that which has been rejected by the courts, and more specifically, the service itself exceeded this argument in Revenue Ruling 93-12 where it stated that discounts for lack of control cannot be denied simply because interests are passed from one family member to another.

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Perhaps the biggest challenge we see to the understanding interpretation of the proposal's use of the term fair market value. The definition of value is intended to represent an actual or hypothetical sales transaction in a free and open market between unrelated parties. Fair market value is viewed in the contents as the hypothetical sale transaction. The wording of the proposal makes it clear that the transfer is viewed from the standpoint of liquidation.

In fact, the proposal uses the term liquidate or liquidation over 120 times, and the term sell or sale only four times. When liquidations occur they are usually auctions or surrenders of property for a present price. Fair market value assumes a negotiated transaction occurring in a free marketplace. Thus, while a value for estate or gift tax purposes is supposed to be governed by fair market value the proposed changes, the structure of the transfer such that even an altered definition of fair market value is no longer possible.

What we are now contemplating is the value at which the partnership might redeem the interest being transferred. Thus, another central tenant of fair market value definition is violated. The willing buyer is not the unrelated, hypothetical third-party, but it is the family. The proposal by reinstituting family attribution assumes the partners act in concert and that they, in effect, are one person. How then can a withdrawing partner negotiate with the partnership over the value of the interest since he or she is an indistinguishable part of the partnership? One cannot negotiate with oneself. There's either family attribution or there's not.

While there are many practical impacts that would come from the implementation of this proposal almost all family-owned businesses would be forced to obtain multiple opinions of value for planning purposes. At a minimum, one where an interest is passed to a non-family, arms-length party who could contend to use appropriate discounts, and another for intra-family transfers or discounts would either no longer be available or at least greatly reduced.

Mr. Schoening earlier asked for more time to consider these regulations. But as Mr. Aucutt noted earlier, the regulations are rife with a lack of clarity and I'm not sure what an additional amount of time -- what good that would do us at this point in time. So what the ASA would respectfully request that the Treasury either withdraw these regulations or at least re-propose the regulations and give us a chance to respond to a proposal that is more clear. Thank you very much.

MS. CHYR: Thank you, Mr. Frazier. Our next speaker is MarK Hanson with the National Association of Certified Valuators and Analysts.

MR. HANSON: Thank you very much and thanks for the opportunity to make this presentation. Bob has introduced me. I won't get into any more of that. But what I did want to talk about was we've heard family attribution. We've heard deemed puts or assumed puts. We've heard minimum value. In the valuation community which I am part of there's been a lot of concerns and we automatically think there goes discounts. There goes minority discounts. There goes the marketability discounts.

I was glad to hear this morning that, perhaps, minority discounts are not that much of an issue as we've interpreted it or these put rights that seem to relate a little bit to marketability discounts. Well, we're interested in hearing more, I guess is the bottom line. But what I want to do is drill down a little more into this issue on discounts and how they relate to valuations.

The current proposed regs seem to -- there seems to be a disconnect between the proposed regs and the Treasury's own definition of a qualified appraisal. I'll walk you through that or thought process. The current regulations provide that the term qualified appraisal means an appraisal that is, number one, treated as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and two, 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 if, for example, the appraisal is consistent with the substance and principles of USPAP or the Uniform Standards of Professional Appraisal Practice as developed by the Appraisal Standards Board or the Appraisal Foundation. Our previous speaker spoke of USPAP.

The 2016-17 edition of USPAP published by the Appraisal Foundation states in Rule 9.4D, for those scoring at home, an appraiser must, when necessary for credible assignment results, analyze the effect on value, if any, of the extent to which an interest appraised contains elements of ownership control and is marketable or liquid. The comment further goes on, it says, an appraiser must analyze factors such as holding period, interim benefits, and the difficult and cost of marketing these subject interest. Equity interests in a business enterprise are not necessarily worth the pro rata share of the business enterprise interest taken as a whole.

Also, the value of the business enterprise is not necessarily a direct mathematical extension of the value of a fractional interest. The degree of control, marketability, or liquidity, or the lack thereof depends on a broad variety of facts and circumstances that must be analyzed when applicable. All of the major BV organizations in the U.S. recognize the applicability of valuation discounts and have long done so.

The proposed regulations fail to consider the economic reality of investor risk associated with holding a fractional interest in a private held company that carries neither the attribute of control or marketability. As such, the proposed regs fail to consider the economic reality of the valuation discounts. This discounts, very often, taken into consideration other issues apart from those outlined in the proposed regs, specifically for the lapse of voting rights and restrictions.

Those additional elements that were in consideration, for instance, for minority discounts, are the ability to appoint or change management, decide on compensation levels, enter into contract, decide dividends or distributions, determine capital expenditures, determine policy, including the changing direction of the business, or block any of these transactions. A discount for lack

of marketability or liquidity is commonly applied to reflect the lack of 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 USPAP.

USPAP defines hypothetical 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 external to the property such as market conditions or trends. NACVA, AICPA, ASA all have similar definitions with respect to this hypothetical condition under this newly minimum value or that premise of value.

So business valuators that issue business evaluation reports under the proposed assumption that a holder can demand a put of his or her interest at any time at minimum value and receive cash or a pro rata amount for that interest would be required to disclose the nature of such assumptions 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 value of fair market value.

Thus, the proposed regulations require the business valuator to arrive at a value of interest under hypothetical conditions that are known to be untrue, in conflict with legal documents and state law, and possibly maybe even be commercially unviable. I have three minutes, 42 seconds left, and I thank you for your time.

MS. CHYR: Thank you, Mr. Hanson. Next speaker is Peter Agrapides of National Association of Certified Valuators and Analysts.

MR. AGRAPIDES: All right. Thank you for the opportunity to speak today. I'm a certified valuation analysis with NACVA, and I also am an adjunct professor of finance at the University of Utah. I've authored the course of the valuation of family limited partnerships for NACVA, so this was a particular concern to me going through the agreement or going through the proposed regulations.

I'm going to cover the following topics. I'm going to cover the six month put right, even though there was some commentary that that's going to be relinquished. I'm going to cover the term minimum value, and the new definitions of control. Then I'm going to go over the summary and conclusions of NACVA's position on the proposed regulations.

So with the six month put right, the six month put right contained in the proposed regulations ignores the time that it takes to liquidate an interest in a closely held company. Namely, when the valued interest is a minority interest. Court cases have cited the importance of looking to the open market for

transaction of stock made at arms-length, and we generally view those as the best evidence of market value.

Studies have shown that sales of interest in closely held companies, especially minority interests which is usually what we're valuing in estate planning or any transfer tax valuation, can take years to liquidate. The risk is rooted in economic reality and it should be reflected in the fair market value of the interest. We're still viewing fair market value as the standard of value that we're using for these types of valuations.

The six month put also renders the market approach ineffective unless valuation analysts are allowed to discount that value when using public company comparables to account for the challenges and costs associated with selling an interest in a privately owned enterprise, as opposed to using multiples based on liquid publicly traded securities. So getting, again, down to the proper level of values. So we're not viewing a discount as a loophole or a benefit for the tax payer. We're viewing it as parody or getting an apples to apples comparison of using imperfect market data from the public marketplace to value a privately held company.

So to do otherwise would inappropriately determine value, and the proposed regulations also render the population of true comparables infinitely small. As few, if any, companies in the marketplace have a similar six month put for all shareholders.

Next, the term minimum value. The term minimum value results in an artificially high outcome. The proposed regulations make the claim that tax payers are transferring assets at an artificially low value. Our position is that this is a false statement, and directly contradicts nearly 100 years of American case law, regulation, transaction data, market studies, and valuation methodologies.

The proposed regulations will force appraiser to employ a new definition of value, referred to as minimum value, while simultaneously adhering to generally accepted valuation methodologies. It should be noted that the term minimum value does not currently exist in the International Glossary of Business Valuation terms or in any business valuation principles or governing professional standards, and attempts to establish a standard of value that is not generally accepted at this time.

For this reason, generally accepted valuation principles and the proposed regulations as they're currently written are incongruent. Our position is that fair market value should continue to apply in the valuation of businesses for transfer tax purposes whether or not the entity is family controlled. Contrary to the position of the IRS and, in fact, quite to the opposite, fair market value does not artificially lower the value of assets between related parties.

I'll also note, as Bob Grossman touched at the beginning of his presentation, that NACVA's 7,000 credentialed members are trained in proper valuation methodologies based on widely accepted body of knowledge to determine fair

market value in a wide array of applications and matters, including estate, gift, and generation skipping tax.

Then finally, the last point, we disagree, NACVA disagrees with the proposed regulations definition of control. The proposed regulations expand the historical definition of control in two ways. The first of these relates to the expansion of the definition of the term attribution. The proposed regulation expands the family attribution rules to include all indirect interests held by a transfer in consideration of determining control.

It is our position that separate legal entities have been created under state law where the intent is to allow for separate legal existence of an operational or investment activity. Ownership interest, both direct and indirect, should not be expanded to include family members being attributed indirect ownership as that attribution completely dismissed the legal and economic standing of the member in that entity, as well as the legal protections offered by the creation of that specific entity. It should also be noted that the proposed attribution rules would create a fictitious ownership structure, some of that's been covered before in some of the basis inconsistency issues that would bring up.

The second matter in which the proposed regulations expand the definition of control is by lowering the threshold of control to at least 50 percent of either the capital or profits' interest of the entity or arrangement. Our position is that the expansion of the definition of control to include the prefix at least is both technically and practically incorrect.

In general, owning more than 50 percent of a business provides one with the ability and the power to direct the management of policies of the company. Further, this has been the traditional and legal threshold of control through the business valuation industry and all professional standards. The definition of at least 50 percent is inappropriate, as well as technically incorrect. It's an incorrect position promulgated within the proposed regulations which disrespects equity owners' rights provided in a legal reality within each specific state of creation.

So in closing, our summary and recommendations. Based upon the foregoing discussions, NACVA, on behalf of its membership of 7,000 plus valuators and analysts hereby respectfully recommends and requests that the proposed regulations be withdrawn in their entirety. It is our position that the proposed regulations as currently drafted contain too many problematic provision to effectively cure all defects by simply modifying the proposed regulations.

As such, I'll state it again, we believe that the clear and appropriate action at this time is to withdraw the rules as currently proposed. Though not our most desired resolution, should the Treasury and IRS decide against complete withdrawal of the proposed rules as currently drafted, NACVA secondarily recommends and requests the following revisions to the proposed regulations, and we request that each be given careful consideration.

We ask that if the regulations are rewritten that there's another open comment period and a chance for professionals and business people within the community

to review and comment on the regulations. Second, that the existing definition of fair market value be retained, and minimum value, and everything associated with minimum value not be adopted in the final regulations. That the assumed six month repurchase obligation be excluded from the final regulations since it's not based, in any way, in market reality, and you've already discussed that that will be removed.

That the standard of value for all transfer tax valuations continue under the definition of fair market value with appropriate discounts for lack of control and lack of marketability where appropriate, just as we do today. That the definition of control be redefined to comply with business valuation and legal principles as more than 50 percent instead of at least 50 percent. That these proposed regulations be consistent with the liturgy of prior United States case law, and number seven, that under no circumstances should these proposed regulations apply to businesses whose income is derived from operations as opposed to holding companies.

Then eight, given the complexity associated with the proposed regulations, we believe that the enactment period should be longer than 30 days, thus, ensuring all parties can get up to speed. I actually finished with ten seconds. I think that's the first time I've ever finished on time. Thank you for giving me the opportunity.

MS. CHYR: Thank you, Mr. Agrapides. We will have a break now until 1:25. We'll return at 1:25 and we'll start with Mr. Pomerleau.

(Recess)

MS. CHYR: Okay, our next speaker is Ernest Pomerleau with Squire Patton Boggs.

MR. P: Good afternoon, is everybody refreshed now? I am going to follow in the footsteps of Clarine who talked about family legacy and although she is from four generations and Kevin of the Cattlemen (sic) was seven; I am just three but I wanted to kind of put it in real time, if I could and kind of share with you the hurdles that family businesses have to deal with and why we have some concerns around some of the revisions that have been proposed here.

First of all, thank you. This is, as we have all noted, an honor to be here to be able to do this in the society. I am a Vermonter; I am second generation, trying hard to get a third generation and what I wanted to talk about -- you've heard about family businesses being half of the GDP and half of the employment base, well more than that depending on how you diagnose it but the part that I wanted to share -- I know you know it but we really feel strongly about it.

We are not national corporations. We are local corporations. We bring a sense of social fabric of philanthropy of engagement of communities. We are part of the community, we make the community and they make us.

A little perspective that I think is important. I am not going to go into details, this is just how I feel and I think it's important and you'll see how these reactions come out of handling business.

If I go to 10,000 feet, if I -- I am from Vermont so it's kind of unique, to say the least, we've got not only our federal income tax but we've got one of the highest state taxes so we are paying almost 50 percent in income tax. Then we have a third higher capital gains.

Now when we sell something and we get cash, we have IRS forms, we fill them out. We are not happy about it but they are easy. We send the check in, we are done. The sword of Damacles that faces family businesses is the estate tax; we call it the death tax. It's the sword of Damacles and in Vermont, it's not 40, it's 40 plus 16; it's 56 percent. That's a very high threshold for a family business that has already paid half of its income out and now has to pay another half.

The part that I wanted to share, and I know you know it but it's really an arbiceral (sic) component here, everybody thinks there is lots of cash in family businesses, right? You just take half the cash and you go away. As you heard from the Cattleman associations and you'll hear from real estate, we have huge debt.

We pay on equity, we pay on cattle, we pay on inventory, we pay on assets. That's really hard for us. That's why we are sensitized to any additional add-on supplemental issues that are going to burden our transition.

We, in fact, in light of all of this though have an impassioned program to sustain our success but to be able to pass it one to the next generation. A classic example, my father is 99, we pass on a whole bunch of stuff, we are working with the third generation. We started small, we are 10 times larger and we are very involved in our community. I have 10 siblings, it's an Irish French Catholic mother and father but -- so when you are looking at evaluations and you have 1/10th, that's really hard.

Valuations in the normal world and real estate, you valuate it on marketability, liquidity and control. So as we pass things on to the next generation to retain it, establishing market value in our perspective is very tricky. The way you've done it before has worked, it's fair, it's equitable and as you've heard from many people, it's very hard to do that so when we pass this along, we are asking you for the reconsideration.

There are tons of challenges that we are constantly facing in transferring and making our company successful but what you are hearing is that we are devoted to what we do. We are faced with some very significant guidelines that upon a transition of a family, we are faced with huge cost. I am here to just add my voice to other businesses in this room and in this country that complicate -- there are many complications in 2704 that go against that tide.

We have phenomenal hurdles to survive in family businesses as you heard the small amounts that do so we would ask you to withdraw these. We are faced with a lot of stuff as it is. Anyway, thank you for your time, I appreciate it.

MS. CHYR: Next are Celeste Lawton and Laurel Stephenson with the Tax Section of the State Bar of Texas.

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MS. LAWTON: Hi, my name is Celeste Lawton. My comments are being presented on behalf of the Tax Section of the State Bar of Texas.

My comments should not be construed as representing the position of the Board of Directors, the Executive Committee or the general membership of the State Bar of Texas. My comments are being made as a result of the approval of the committee on government submissions of the Tax Section of the State Bar of Texas and pursuant to the procedures of the council of the tax section, which is the governing body of that section.

No approval or disapproval of the general membership of the Tax Section of the State Bar of Texas has been obtained and the comments represent only the view of the members of the Tax Section who prepared them.

I would like to specifically address three features of the proposed regulations. First, the interaction of the proposed regulations with section 1014(f) of the Internal Revenue Code, second, the existence of a right, and third, clarification regarding the determination of minimum value.

First, with respect to the interaction of the proposed regulations of code section 1014(f).

Code section 1014(a) generally provides that the basis of property received from a decedent shall be the fair market value of the property at the decedent's death. It does not say that the basis of the asset is the value as finally determined by the estate tax purposes, it simply says that the basis cannot exceed the value as finally determined for estate tax purposes. Although this generally results in the value of property reported on estate tax return, setting the property spaces for income tax purposes, we have concerns regarding how the provisions of section 1014 of the proposed regulations interact. The proposed regulations expressly apply only for purposes of subtitle B relating to the estate, gift, and generation skipping transfer taxes and not for income tax purposes, thus it appears that the IRS could argue that for estate tax purposes, lapsing rights and liquidation restrictions are to be disregarded pursuant to Section 2704 in the proposed regulations for establishing the estate tax value of interest, but then for income tax purposes, those rights and restrictions are not to be disregarded for establishing the income tax basis.

This would result in the property having a lower basis for income tax purposes then it would have for estate tax purposes.

We believe the IRS and Treasury have no intention of taking this position, thus we respectfully request that the IRS and Treasury clarify that lapsing rights and liquidation restrictions disregard it pursuant to 2704 and the proposed regulations of establishing the estate tax value of an interest are also to be disregarded in establishing the income tax basis of that interest.

Next, with respect to the existence of a put right, as has been previously stated by many speakers, many practitioners believe -- have interpreted the regs to provide for a deed to put right.

Given the statements today by Ms. Hughes, I will not go into any discussion with respect to the put right but simply will state for the record that we appreciate the assurances given today that the put right will be addressed in the final regs if the regs go final.

We also request that -- stand by John Porter's request that there be assurances, that there is no liquidation right given as well.

With respect to the termination of minimum value, we'd like for regulations to clarify the manner in which minimum value for an interest in a family-controlled entity is to be determined.

The current definition of minimum value generally requires that the minimum value of an interest in a family-controlled corporation be determined by multiplying the fair market value of the interest by the underlying assets. So if my son and I hold a 50 percent each interest in a business that owned real estate, the minimum value of my interest would be 50 percent times the full fair market value of the underlying asset, whereas if instead, my son and I held that real estate outright, instead of in an entity, the value of my interest would be something less than 50 percent because it would have discounts for lack of control, lack of marketability.

It appears that in determining minimum value, owners are being penalized by putting their property in entities rather than holding the property outright and we respectfully request that the regulations remove this penalty and instead provide a look-through rule so that owners will be treated as holding a proportionate share in an underlying asset.

Finally, we would like clarity regarding how the minimum value of an interest of a parent entity holding an interest in a subsidiary with an operating business is determined, the -- I only have 30 seconds because I am sharing my time, but the preamble and proposed regulations initially suggest that when you determine the minimum value of an operating business that's held by a parent company, that you value it as a going concern, but the last sentence of -3B2 of the regs seems to provide that you look through the entity and now have to value the property and underlying entity so you're not valuing it out of growing concern anymore.

We would like the regulations to clarify and provide examples for how minimum values to be determined.

MS. STEPHENSON: Hi, my name is Laurel Stephenson, testifying today on behalf of the state bar and I should start by saying that all of the obligatory disclaimers that Celeste issued also apply to me and I would also like to thank the officials today here from Treasury and the IRS for again extending to me and to the others in the room this opportunity to convey concerns that all of us have debated for the past six weeks or however long we've been debating it, seems like six months because we know that you want to hear our input and we are definitely looking to give that input.

I am going to touch on a couple of points that have already been made by prior speakers but I think they are important points that cannot be

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overemphasized and I also suspect that the individuals in this room here who are testifying after me prefer that I use my allotted time. The first concern is the concern that Stephanie -- limits price raised on behalf of (inaudible) and that's the definition of which individuals count for purposes of control under 2704(b). One, it can be the individuals who constitute members of the transferor's family under 2704(c)4 and the 2702 reg that's referenced in the -2 and -3 regs.

Or, some have felt like the reference to the 2701 reg and the definition of the controlled entity and the individuals who are in turn referenced in that definition could be an expansion of the individuals whose interests count for purposes of determining whether or not we have the control that merits the application of 2704(b).

Like Stephanie, we believe that it's the narrower group, the transferor's family members to find 270 or C4 and feel like the fix is easy; it's just dropping out the reference to the first clause under the 2701 reg so clearly it's just reference for purposes -- what interest counts and what level of holding of those interests counts for purposes of getting to the control feature.

We are also concerned about the three-year inclusion window, which is probably not surprising. We understand and can appreciate the concern with deathbed objectives that might be present when somebody makes a gift to get out from a controlling interest inclusion for an estate but we feel like while bright line tests are nice, we would like a little bit more a tailored approach that really addresses the deathbed concerns and as John Porter had mentioned, we like the terminally ill standard that is 75/25.

We feel like that is a tested workable balanced approach that accommodates the deathbed concerns that Treasury and IRS have and are concerns that there could be a gift that is made without any kind of deathbed concerns but then the transferor meets with an untimely death.

We also appreciate your assurances that there will be clarifications coming in final regulations that transfers that occurred before the effective date will be swept up by the three years inclusion window; so we appreciate that.

We would also appreciate guidance with regard to how you value that phantom asset that is includible in the estate in the event that you do fall within the three-year inclusion window, if it is retained or if you have a terminally ill standard as the substitute. How do you value that phantom asset?

I hear opposing arguments made, whether you use date of gift because that's when the transfer actually occurs or do you use date of death because that's when the lapse is deemed to occur and the phantom asset is includible in the estate. So we'd appreciate guidance with regard to what is the appropriate valuation date and also guidance with regard to how this interacts with any applicable restrictions or disregarded restrictions that would be potentially in play under the -2 and -3 regulations.

And as always, we appreciate examples. So with that, I have a few minutes left but as I said, these points have all been beautifully made by people before

me so I just wanted to echo and convey the State Bar of Texas has concerns with more than what I have discussed today but those were the two primary concerns that I was going to present so thank you so much for your time.

MS. CHYR: Thank you. Our next speaker is Pete Sepp with National Taxpayers Union.

MR. SEPP: Well thank you for your stamina. You will certainly deserve a round of applause at the end of this. National Taxpayers Union is a non-profit citizen group that works primarily on tax administration issues. We are very proud to collaborate with Nina Olson and the National Taxpayer Advocate office on what taxpayers face when they file, when they encounter an estate, those kinds of issues.

Now I am certainly not smart enough to be a tax lawyer, I am not well-paid enough to have an estate but many of my members do. Many of my members are small business owners. They are very concerned about the tax compliance burdens they already face when they are alive, while they have workers functioning in their small businesses -- and there is an interesting statistic, a study conducted by the National Association of Manufacturers and they surveyed businesses, developed methodologies and determined that on a per worker basis, a firm with more than 50 employees has a per employee tax compliance cost figuring also estate tax planning burdens of about $1,518 a person.

Now the smaller business has a burden almost 50 percent higher per worker. There is an economy of scale here. It's a bad burden all around but it gets worse as the business gets smaller but the point to all of this is unfortunately, we have encountered, in our work, that the government's estimates of compliance costs and burdens of a particular rulemaking, law or other policy on the private sector are consistently underestimated.

A study our foundation conducted puts the annual tax compliance burden systemwide at $234.4 billion annually and that only accounts for about three quarters of the tax laws and statutes that we were able to identify. There is another quarter that we haven't even costed out yet. This has a direct bearing on the discussion today because we talk about the economics of this rule as having really no significant impact and you've heard testimony from folks who have said, "Well this does actually have a very significant impact at my own personal level." We need to think about the mathematics here and how, if we are off by even a few percentage points of our compliance estimates for this rule, it's going to have massive consequences out in the private sector.

One example, the section 385 rule that Treasury initially issued on corporate inversions -- OMB put the compliance cost to the private sector of that initially at $13 million and they started hearing testimony from companies, individual firms who put their own compliance burden at 10 times that amount just for one firm.

Now both sides can't necessarily be right here but I would contend that somewhere in the middle, there is an accurate estimate and the government's estimate is starting out way too low. We need to be very cautious about that in

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rulemaking. As for this particular rule, we would of course support shelving the entire thing.

What else could we do? I think there is an interesting recommendation here because obviously, this rule at issue is quite controversial. It has been litigated in *Kerr v. Commissioner*. There have been estate rulings regarding estate valuations. The president's budget, three of them actually have contained proposals centered around some of the principles in this rule.

There is congressional involvement. All of these things suggest to us that there ought to be a more collaborative process at work here than a simple rulemaking. All of these comments that we have heard are quite valuable but perhaps the best thing we could do would be to take a step back and consider a job aid.

This was a proposal that I have to credit a fellow who recently wrote an article. He is named Weston Kirk, writing in a gift and estate tax valuation insights and he suggested, why not have a more collaborative process between the preparation community, taxpayers, and others and try to clarify some of these issues before moving forward with the rulemaking.

He wrote that this procedure would provide clarity and understanding of the services stance without creating significant disputes between taxpayers, their advisors and the services agents, saving the service time and taxpayer money in attempting to pass and then properly enforce its regulations. We would suggest that is a smart policy for just about every complex, tax policymaking exercise but it's especially appropriate for this one.

We are going to set aside as much of the political considerations as we possibly can here. That is not quite the purpose of this proceeding but I still think this is practical guidance that my members and many folks here in the absence of completely shelving this rule would probably support.

Take some more deliberative steps forward to engage the community beyond these hearing processes, have more back and forth and see what the real issues are and how they might be resolved and to that end, National Taxpayers Union would be pleased to offer its assistance to you in any way that you see fit so I thank you.

MS. CHYR: Thank you, Mr. Sepp. Next speaker is Keith Miller with Coalition of Franchise Associations.

MR. MILLER: Well good afternoon now. My name is Keith Miller and I am a Subway franchise owner in Northern California with three locations which that means a couple of things that should put you at ease. Number one, I am not a lawyer, number two, I am not a CPA and I try to do things very quickly because in our business, speed matters so I will be out of here in less than five minutes.

I also assume everyone here wishes I was doing my day job at making sandwiches for you because everyone is probably starving by now so -- I am also a chairman of the Coalition of Franchisee Associations.

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We are the largest franchise owner organization in the country. Our membership of associations represents 41,000 franchisees, 86,000 locations employing about 1.4 million people.

We also work with the Family Business Coalition who you heard from earlier. We are here to speak in opposition of the proposed rule change, especially as they relate to the discounts on the gift tax. These discounts are especially warranted to franchise owners as they more accurately represent the true evaluation of our businesses.

While our ongoing business may be valued at one price, our ability to sell at that price is often severely impacted by the franchise business model.

You heard earlier from Rob Branca, who is our vice chair so I won't spend a lot of time repeating those same issues.

But first, I want to speak about some of the issues directly related to our model. Our businesses operate under a franchise agreement. That is an agreement for a set period of time. Well some systems offer ongoing renewals, many do not, meaning that business becomes less valuable every day and if renewals are offered, they often come with additional demands such as required expensive remodels that devalue our business. If you do wish to sell your business, the franchisor really controls your destiny as they must approve any transfer. This is except a little bit in California where we last year sponsored and passed some legislation that required disclosure of approval standards for transferring your business and if they don't approve a transfer, they have to give a reason. In most of the country, no reason has to be given and the standards don't have to be provided upfront so it's very easy for someone, whether it's the franchised company or in the case of Subway, a regional developer that also has to approve it.

There is nothing that requires them to tell you why they aren't approving it and you don't even know why they aren't. It may just be that they think the price is too high. So I want to be even more specific and give actual examples to how our marketability and the value of our franchise can be driven down.

Many obstacles to our ability to sell may not be included in our contract, the actual franchise agreement but may be inserted over time unilaterally in our operations manual during the life of that franchise and in this case, I'll give some specific examples in my own brand in Subway.

There are clauses that state that transfers cannot have multiple franchises on one contract or include conditional contracts, for example, the sale of one franchise is conditional in the sale of a second franchise or the real property related to that franchise.

It also has a clause in there that says you can only transfer one store at a time to a new franchise owner or up to three to existing franchise owners and they do limit us in this way.

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So these specific clauses negatively impact the value of our franchises. For example, if you own the property that your franchise is located on, you can't conditionally sell them both on the same contract.

Or if you own say 10 or 20 stores, you would have to break up your company to sell the individual units. I think you can clearly see that in total, a company of a large franchise owner, with all the overhead structure and efficiencies in place that are built into that larger company is more valuable than when broken into individual stores and without the real estate.

So I ask you, how can you properly value a company when you can't sell the company? While these examples are specific to Subway, many franchises follow similar policies so we would respectfully ask that you reconsider this rule change and I stayed under my five minutes.

MS. CHYR: Thank you, Mr. Miller. Our next speakers are Andrew Grossman and George Mooradian from the Family Business Estate Tax Coalition.

MR. GROSSMAN: Hi, I am Andrew Grossman, I apologize for my colleague, George Mooradian who is unable to attend today. I am a partner at the law firm Baker and Hostetler and I appear here today on behalf of the Family Business Estate Tax Coalition which is a grassroots coalition of over 50 national organizations representing family owner business associations dedicated to protecting all family-owned businesses from the estate tax.

The Coalition opposes the proposal that is the subject of today's hearing. These proposed regulations would discourage families from continuing to operate and grow their family businesses and for passing on those businesses to future generations.

In particular, they would force parents to sell off family businesses to outsiders so as to avoid their estates being taxed based on unrealistic valuations that far exceed the value of the business interest at issue. They would force too many sons and daughters to sell off family businesses or to take on debt just so they can pay tax bills based on those very same unrealistic valuations and they would undermine family business and as a result compromise economic growth, capital accumulation and job creation.

And these proposed regulations are not only bad policy but also unlawful because they contravene with the tax code. For all these reasons and the many others discussed in the coalition's 60 pages of comments, which I am sure you have studied very closely, we urge Treasury to withdraw this proposal.

But for the remainder of my remarks, I would like to focus on how specifically this proposal threatens family businesses and why it is completely illogical, to the point that any court would have to throw it out for failing to constitute recent decision making.

How assets are valued is the central question in calculating viability for gift and estate taxes. The traditional way that assets have always been valued is to estimate the price of an arms-length sale. In other words to determine what price the market would bear.

When that asset is a piece of a business, reality dictates the valuation be adjusted downward to account for lack of control, lack of marketability and any restrictions on controller liquidation rights.

These things aren't made-up accounting contrivances or legal fictions. Instead, they reflect the reality that any buyer in the marketplace values business interests less when they don't come with control rates, when they are difficult to resell or when control of sale is barred. This is all just common sense. The proposed regulations buck that common sense and they ignore reality. The first one retroactively imposes additional tax liability on the transfer of a business interest subject to restrictions on voting or liquidation if the giver dies within three years by simply deeming those restrictions to be lapsed.

The second denies a discount for transferred business interests that are subject to certain restrictions on liquidation. The third denies a discount for restrictions on liquidations under state law and the fourth denies a discount for restrictions that may turn on ownership stakes of family members.

In other words, here you have four specific scenarios where the economic reality is that restrictions will reduce the value of a transferred business interest and what the proposal would do is to disregard that reality.

Now this has real consequences for American businesses. Standard valuation discounts like these can reduce the state and gift tax liability by 30 percent or more and those discounts would continue to apply to businesses that are not family-owned and to transfers outside of the family. Only family businesses would pay the bill.

It's no exaggeration to say that this proposal singles out family-owned businesses for particular treatment and in some sense, punishment, by putting a big thumb or you might even say a fist on the scale when calculating tax liability for family-owned businesses.

This proposal would force the sale of family farms, would block the expansion of family owned manufacturers and would prevent parents from gradually turning over responsibility for running a family business to their children.

These unfair consequences are all too real. The Coalition's comments contain three case studies based on specific real-life examples that illustrate the devastating effects that this proposal would have on America's family-owned businesses, those are the facts.

But they are not the only ones that would suffer. Family businesses are responsible for more than half of employment in this country and they account for more than half of job creation.

They provide workers with greater job security than non-family firms. They offer greater leadership opportunities for women and minorities and they perform better than other businesses in times of economic slowdown.

As I said earlier, when you take aim at family businesses, jobs and economic growth also take a hit. Our comments surveyed the research on that point and it's

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overwhelming, but what astounds me is that Treasury apparently made no attempt to justify this radical shift in policy.

In fact, the proposal doesn't even acknowledge that there is this sort of massive shift in policy. It presents no evidence that taxpayers are abusing valuations under current law. It doesn't even attempt to estimate the impact that this proposal would have on business or the economy and it doesn't even address research suggesting that this proposal could very well reduce overall tax revenues and it disregards the fact that the proposal undermines and conflicts with another portion of the tax code, section 6166 that attempts to address the threat that the estate can pose to family businesses by authorizing deferrals in installment payments.

These are all things that Treasury simply has to consider before it can enact this type of sweeping change. So let me ask, does this proposal make any logical sense at all? Well, the agency that proposed it apparently has no answer to that vital question. It would depart from longstanding practice for well understood valuation standards and ultimately from economic reality without ever answering whether these specific changes provide any net benefit at all or whether the only thing that we get is pain.

The entire justification, so far as I can tell is the assertion that current law, which has been in place for years is somehow "substantially ineffective." Let me say that view is not one that is broadly shared. Congress, in fact, refused to adopt through legislation the very same policies as in this proposal even after years of goading by Treasury.

Of course, there is a reason that Treasury went first to Congress to make these changes. The reason is that it lacks the legal authority to carry them out on its own. Our view is that the proposal should not be finalized but it also should not be allowed to linger as a threat to America's family-owned businesses, to their owners and to all those who depend on them.

Treasury should recognize that these proposed regulations are fatally flawed and that they cannot be salvaged and on that basis, treasury should withdraw this proposal and with that, I will thank you for this consideration of this testimony as well as for the Coalition's comments.

MS. CHYR: Thank you, Mr. Grossman. The next speaker is Roger Hannay with Hannay Reels.

MR. HANNAY: I would like to thank the panel for your long suffering and attention after a long day. And as a reward I'm going to leave a booklet here that was published upon occasion of our 75th anniversary of the company for your later perusal. By the way, we're now in our 83rd year.

My comments are going to be less technically oriented as some of the others you've heard today. Mine will be more from the heart, along the lines of my friend Ernie earlier here from Vermont.

My name is Roger Hannay, I'm the Chairman and one of two third generation owners of Hannay Reels. That's a C corporation in the small village of Westerlo,

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Albany County, New York. We are a manufacturer of heavy duty steel, aluminum, stainless steel reels for hose and cable. As I said, now an 83-year-old company with worldwide sales. We have an informal motto, by the way, "built to last, delivered fast." (Laughter) We live by that every day.

We provide employment for 165 area residents. Some of them commute up to 40 miles because it is so rural. We have good paying jobs and fringe benefits, and we're the only major employer in this decidedly rural area.

We also have two fourth generation owners. My son Eric, as CEO and President, and his sister Elaine Gruener, as COO and Executive Vice President. They are managing the business day-to-day now, so I can go off and do things like this.

My grandfather, Clifford, accidentally -- and this is a true story -- accidentally started the company in 1933. He did that by helping a local oil deliveryman with a fabrication project which turned out to be a hose reel, of all things. If Clifford were to come back to life today, he would recognize the product but not the challenging legal and regulatory environment in which we operate.

Until now, we've been able to navigate the transfer of family ownership between generations by careful planning and use of appropriate valuation discounts at the time of death or departure of owners, thus maintaining our important jobs in this small village. All the time and energy we spend working on these plans could probably be better spent doing other things like building up our business and increasing our employment.

We fear that if the proposed changes to Section 2704 follow through, this may no longer be possible, thus putting in jeopardy the significant well-paying jobs, which they are. At that point, we might be forced to consider, painfully, some of the significant offers that we get to sell this business to non-family business bidders. And there would be no guarantee whatsoever that the jobs would remain here in this small town.

Therefore, we respectfully request that consideration at least be given to leaving the current provisions of Section 2704 intact. And I thank you for your time.

MS. CHYR: Thank you, Mr. Hannay. (Applause) Our next speaker is Jamie Richardson with White Castle Management Company.

MR. RICHARDSON: Thank you very much for the chance to share our concerns. I will echo what Ernie said earlier. It really truly is an honor to be able to participate and to have you participate and hear what's on our minds in terms of our real-world concerns and fears and anxieties.

Visiting from Columbus, Ohio, and folks shared here that this is a town that really relies a lot on precedent. So, I thought I might take us all back to a precedent we could probably relate to. I'd like to go way back to speaker number 2, when she said and showed that food can be used as a visual device as long as it's shared. So, I have one of these for everybody. Let's make sure we do it right. (Laughter)

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I work at White Castle. I'm a fourth generation family member, so I get to sell hamburgers for a living. For us, we've been a family-owned business for 95 years now. So, we're just in the midst of transitioning from the third generation to the fourth generation, which has been really a thoughtful process and one that we've worked on pretty hard. But we almost didn't get to that point.

When our founder passed away almost 50 years ago, we hadn't planned well for the estate tax and it almost put us under. And if you look back on our history there is about a 10-year period where there is very little growth because every dollar we were able to generate was trying to figure out how to deal with the effect of our founder's death. So, we've been very aware of it ever since.

But, our language is very different. The language we use is around sacks of 10 or a crave case of 30 hamburgers. So, when we heard 2704, that would be a good price point for a crave case and four drinks and some sides, but we didn't understand fully what the implications were. (Laughter)

As we learned more, we became anxious and concerned because we know how much hard work has gone into this as a family business looking forward to the future. There are now 35th generation children, none of whom work in the business, but the hope is someday they'll pick up the spatula and get behind the counter and do their best so we can continue to pay it forward.

For us, as a family-owned business, it's really not just the family, it's the stakeholders. I say stakeholders for a reason because there are two key stakeholders we try to impact and be part of their lives every day: Our 10,000 team members and the communities that we serve with our restaurants. In those communities, when we see that estate tax liability we feel that robs us of our ability to invest in those communities and invest in our team members.

We are incredibly fortunate as a family-owned business. We have over 10,000 team members. And of those 10,000 team members who work in fast food, more than 1 in 4 have been with us 10 years or more. Oftentimes, they started maybe during the summer to raise some money to pay for car insurance, the next thing you know it's 6 months, then a year. And it becomes more than just a part-time job, it becomes a calling. They become part of our family, extended family.

Of our 450 top leaders in restaurant operations, 444 started behind the counter in a White Castle in an hourly role. Now, we love the other 6, they're great, too, but it's just amazing that we've been able to build this kind of a family flavor and feel.

We do that because we invest the money the business makes back in our people. We've offered health insurance since 1924. We've offered retirement benefits since 1928. We have a holiday bonus that comes out tomorrow that's not based on your title, it's based on how long you've worked at the company. We take up to 1 percent of our total sales, not our profit, to go into that program. So, that's going to be a happy day around White Castle tomorrow because the holiday shopping is going to really start. We haven't tracked that for economic

impact in different geographies. I guess in a round-about way of saying, we really generally care and are committed to our people and what they do for us.

Similarly, through our giving back to community, which we tend to do quietly, our focus is on feeding hunger, hopes, and dreams because we know that if we're able to be part of the fabric of where we live, where we work, and where we raise our families, we want to give back and be part of that. So, a lot of our charitable giving is above and beyond, candidly, much larger -- maybe more Wall Street-style corporations. Because we've been there for 20, 30, 40, sometimes 50 years at the same very corner. So, for us that commitment is very important as well.

Our vision is to feed the souls of craver generations everywhere, and our mission is to make memorable moments every day before our customers and our team members. So, when we pause and see a change in something so fundamental to a family business as the estate tax, it gives us serious concern because our fear is that it makes it harder for us to do those things for our people, harder for us to give back to community because we need to be able to account for it. So, if that estate tax liability increases by 30 percent in a margin business that's pretty small already, that makes it even more difficult for us to imagine, how are we going to work that out, and how are we going to be able to continue to do hopefully the good we've started to do?

I think a lot of times for us, as a family-owned business, it's listening to our customers. Just coincidentally, one of our favorite all-time customers is a gentleman, God rest his soul, he passed away a few years back. His name is Newt Brokaugh. Newt would call, he would complain all the time, and finally we just had him into the home office and we didn't spend as much time as this, but we spent some time together. And he got really frustrated. He was upset about our mustard packets because he couldn't open them. We tried to give him the instructions. Finally, we gave him a mustard packet opener kit. It was a pair of sewing scissors. He was happy as could be. (Laughter)

But his phrase that I'll never forget was, "issue obfuscation," which is a mouthful and a little bit ironic, but I do think that that's what we're hungry for and hoping for when it comes to, how do we get to be in our neighborhoods and communities and be able to serve the people we want to serve? So often it feels if we could just simplify, if we could just have a cleaner, clear path, that would be great for everybody.

So, for us, because of the hardworking Americans who are part of family businesses everywhere, and their reliance on family business to remain family business, we would really urge you to withdraw the rule. We think it's important for the future of family business, and it is a big threat.

So, thank you for your consideration. Thanks for the chance to share.

MS. CHYR: Thank you, Mr. Richardson. (Applause) Next is Mike Hamra with Family Enterprise USA.

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MR. HAMRA: Thank you for your time today and thank you for your listening. This is a privilege to be able to stand up here and share our position.

My name is Mike Hamra, and I'm here today as the Chair of Family Enterprise USA, which is a 501(c)(3) organization that is dedicated to educating the public, policymakers, and lawmakers about the positive role private family businesses play in our communities and in our country.

I am also a second generation CEO of a chain of quick casual restaurants, employing almost 7,000 people today. So, my views are not just theoretical, but based in the daily struggles of the average American, and I care very much, like Jamie does and Roger and Ernest have shared, about protecting the careers of our employees, their families, and the communities we do business in.

One thing that I will share is that many of the people that started in our organization are still with us today after 35 years, and in the same position that they were when we had one store. So, it speaks tremendously to the value of family business, and especially ours.

It's important to be clear about the value of family businesses and what they provide to our economy and to our country. And to understand their impact, we must understand how we define a family business. There are essentially three types of definitions. The broadest of definitions includes businesses where the strategic direction is controlled by the family and the family runs the business. When using this broadest definition, 64 percent of the GDP in this country is generated by family businesses and those businesses support 62 percent of the workforce.

A second, more narrow definition, includes family-owned business where the founder or founders' descendants run the business and take actions to keep the family in control of the business. Using this definition, family businesses in this country generate 59 percent of the GDP and support 58 percent of the workforce.

The third, and most narrow definition of family businesses includes businesses in which multiple generations participate in the business and where more than one member of the ownership group has management responsibility and members in multiple generations of the family hold controlling ownership. In this highly conservative definition, family-owned businesses generate 29 percent of the GDP and support 27 percent of the workforce.

Regardless of the definition used, family-owned businesses account for a significant part of our economy, and because they are driven to create sustainable businesses that can be passed to one generation to the next, they are ideally set up to employ strategies that focus on the future. Decisions that are made daily are made to be consistent with the long-term vision of the business, and the long-term welfare of the communities in which they live.

Statistically, family-owned businesses are the first to hire and last to fire. Specifically, they are the first to hire in an upturn of our economy, and last to let people go in a downturn of our economy. They are attributable to 70 percent of all net new jobs in this country. In addition, they maintain cultures that cultivate

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people in their careers, and because they are focused on being multigenerational businesses with long-term strategic objectives, they are able to support people in ways that other non-family-owned businesses are incapable of doing.

Statistically, people who work in family-owned businesses are happier and their families and communities are more stable because of the stability and their employment and support they receive from these family-owned firms.

Family businesses are also great contributors to the communities they do business in, and are more trusted by the average citizen as a result. They know that being a multigenerational business, they must also become integral threads to the communities they live in.

Family-owned businesses play an important role in providing economic stability. They are strong sources of employment and critical to our economy. The average American trusts them more than any other business form. We should be doing everything we can from a policy perspective to support family businesses in being foundational stewards of the communities they do business in.

FEUSA surveys family businesses each year to understand the issues that are facing them. Input to the survey comes from both members of FEUSA and non-members, so that we may have a broad understanding of the issues and can truly represent the views and the concerns of hardworking family-owned businesses in the United States.

The majority of family business owners who responded to the survey this past year are business owners who own companies that generate $50 million or less in revenue, and 85 percent of those respondents employ less than 1,000 people. The respondents are diverse and consist of industries ranging from manufacturing and construction to transportation and healthcare.

It's important to know that 38 percent of these family-owned businesses do not have wealth outside of the business. For these owners, the business is their nest egg and their legacy.

Statistically, only 30 percent of all businesses are passed from first generation to the second generation, and only 30 percent of second generation businesses are passed on to third generation owners. Over 50 percent of the respondents to the survey are in their third generation.

The majority of these respondents have strong structures in place, such as formal boards, and rely on family members as well as independent and external advisors to lead their businesses. Given the generational structures and long-term focus, 92 percent of these respondents give back to their communities. And 61 percent of them encourage their employees to participate and contribute to their communities. 78 percent of these businesses experienced revenue growth in 2015, and they were confident about the "business" ability to increase revenue each year going forward. Increases in revenue lead to net new jobs, and 66 percent of these companies had plans in place to hire additional employees through 2016.

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Our survey this past year disclosed that 77 percent of participants see external influences such as government regulation, tax policy, and the economic environment as a greater threat to the sustainability of a family business versus the internal issues such as family conflict.

In spite of revenue and job growth, participants are concerned about government regulation of their business. Valuation discounts are critical to the stability and continuity of family businesses and their ability to grow their employment base and be contributions to their communities, thus, eliminating valuation discounts will harm the ability of these businesses to grow and add net new jobs and sustain themselves as strong stewards of the communities they do business in.

If valuation discounts are eliminated, many of the businesses that had survived from first generation and beyond will be impeded in their ability to continue to grow and could easily be forced to sell to pay taxes. Families that are adding net new jobs and being strong stewards of their communities should not be forced to sell to pay taxes.

Furthermore, valuation discounts reflect reality inasmuch as anyone trying to sell a minority stake of a business will have a very hard time finding a buyer and will have to offer deep discounts. And when taking that into consideration, eliminating the valuation discounts only eliminates a level playing field versus creating and supporting a level playing field for privately held family-owned businesses.

Family businesses are uniquely structured to possess the social, human, and financial capital and, as a result, they are uniquely in a position to foster economic and social health in the United States. As I stated earlier, only 30 percent of all family-owned businesses survive from first generation to the second. Thus, polices should be established to support that sustainability versus hindering it in a way that stifles the most significant part of our economy from adding net new jobs and continuing to be contributions to their employees, the families of those employees, and the communities they do business in.

I ask, on behalf of Family Enterprise USA, that you withdraw the proposed regulations. And I want to thank you for the opportunity to be here today and share about the positive impact of family-owned businesses and how they make a difference in our economy and our country. Thank you.

MS. CHYR: Thank you. (Applause) Next is Lance Hall with FMV Opinions, Incorporated.

MR HALL: Thank you. I'm a valuation expert and my firm performs over 1,000 valuations a year in the estate and gift tax arena. On a personal level, I grew up in Minnesota. A regular part of my diet was White Castle burgers. I beg you: save White Castle. (Laughter)

One of the problems I have with the proposed changes is the underlying premise seems to be a mistake in premise. And, that is, somehow when we do estate planning and divide up the assets amongst the family members, they can

magically put it together again to maximize value. And the reality is we've created Humpty Dumpty who has fallen off the wall and putting those pieces together are very difficult to do. One of the reasons for that is when I'm dealing with unrelated investors -- they are motivated by economics. When I am dealing with family members, an additional motivation is there and that deals with emotions.

Let me give you an example that actually happened a little over a decade ago. We had a client who had an estate of about $100 million, and his son was an estate planning attorney, very brilliant. And there were two daughters. And through the planning, Dad was able to die owning a minority interest and receiving the discounts appropriate for that. And the kids were left with one-third each in the family partnership. The family partnership had an asset in it that was a family ranch that was over 100 years old, that initially had been on the outskirts and now the city had surrounded this. It was very, very valuable. It lost $3-5 million a year.

But that was okay, because the other assets that they had in the partnership generated a little bit more than that, able to cover the losses of the ranch. When Dad died, the son was ecstatic: "Let's sell the ranch." The daughters exclaimed, "But we like horses," and they kept the ranch for the next seven years losing $3-5 million a year. The only thing that the sisters would do would allow Dad's mistress to be fired who was making $350,000 a year. Humpty Dumpty isn't so easy to put together again.

When I determine fair market value, the thing that I need to do is look at comparable arm's-length transactions with similar situations and similar rights, preferences, and privileges. The problem with 2704 changes is when they ask me to ignore any restrictions on liquidation or redemption treat them as though they do not exist. In other words: silence.

There are no comprables. What you've done is akin to going to the Sistine Chapel as Michelangelo is painting the ceiling and ask him, "I want you to do everything you're doing, just don't use blue. Do everything you're doing, make it beautiful, just don't use blue." Or the chef who makes rice pudding. We love your rice pudding. We want you to make it but don't use any rice. Or as Pharaoh asking the Israelites to make bricks without straw.

2704-3 Example 4(i)(I) is very clear, explicit. It says non-family members are to be valued under fair market value standards. Charities are to be valued under fair market value standards. Families are not. If charities receive fair market value, and non-family members receive fair market value, what do family members receive? The only conclusion is it reaches unfair market value. So much for equal protection under the law.

Let me give you a ludicrous outcome of having these rules here. You have mom, she started a company, it has over 100 employees. She owns control of that company, it's very successful. She establishes an employee-stock ownership plan. We're required under the Department of Labor standards to value those shares under fair market value. Her daughter works in the company, has accumulated a large amount of ESOP shares. She passes away. The daughter

passes away. Now, we are required to value her estate. Under the proposed guidance you give us now, it is highly probable the value of her shares in the ESOP are worth more for estate tax purposes than we are required to value those shares under Department of Labor standards, and they will repurchase her shares at the lower value that reflects discounts for lack of control, lack of marketability.

You know, fair market value is a very simple concept. The Treasury regs basically have one sentence. It sits on the three-legged stool. Willing buyer/willing seller. Reasonable knowledge of all facts and circumstances. No compulsion to buy or sell.

Do you realize we've had over 60 years of litigation to understand what that means? Just last August, the IRS lost in The Estate of Deputy because the definition of fair market value that they were using was wrong. The prior year, in September of 2014, the 5th Circuit overturned a tax court because they didn't understand what the definition of fair market value is.

When you read the proposed regs as they currently are situated, how many decades of litigation do we need to go through that will tax the resources, the IRS and the taxpayer, to understand what it means to be silent? A situation that's never existed before.

Perhaps we can turn to *The Estate of mAdams*. *The Estate of Adams* is a 2001 case. It dealt with a Texas partnership that had been dissolved for approximately eight years and the descendent held a 25 percent interest in that dissolved Texas partnership. What is the value of that?

The Tax Court said, "well, you can liquidate that interest and force the sale of the properties and, therefore, there are no discounts applicable." It then went to the 5th Circuit, and the 5th Circuit said, "wait a minute. Texas state law is silent in regards to how you would treat this." And this is what the 5th Circuit said: "The legal uncertainty which raises the specter of costly litigation in addition to an adverse result, is itself a factor to be taken into account when appraising the fair market value."

They then remanded it back to the Tax Court to determine what the value of that interest is. The discount the Tax Court allowed was a 54 percent discount. Is that really what Treasury and IRS is asking us to do? To have discounts even larger than we would normally take because of the silence we have to treat liquidation and redemption rights?

Families do not act in unison at all times under all situations. It is unfair to expect Michelangelo to paint the Sistine Chapel ceiling without using blue. It is unfair to demand that fair market value be used for charities and unrelated parties, but only unfair market value is to be used for families.

I can't imagine the divisiveness within the courts and the expense and burden of trying to figure out what this all means if we have been fighting for 60 years on one little sentence as to what fair market value is. The only conclusion I can reach is we need to withdraw these regulations. Thank you very much.

MS. CHYR: Thank you, Mr. Hall. Next is Marvin Hills with the National Automobile Dealers Association.

MR. HILLS: Thank you for -- I don't know often you guys have pulled the short straw and have had to sit through these things all day long, but you're showing amazing stamina and I appreciate your continuing to at least try to pay attention to us. (Laughter)

My name is Marv Hills. I am a geeky CPA wearing a bowtie, and I've managed to get promoted to partner within Crowe Horwath, LLP, which is the eighth largest CPA firm, accounting and consulting firm, in the United States. Thank you for being here and listening to us.

I'm speaking on behalf of the National Automobile Dealers Association. They represent over 16,000 franchise dealers, which is slightly smaller than the, what, Subway shops we heard earlier. But 16,000 franchise dealers in all 50 states who sell finance service new and used vehicles. The members of NADA collectively employ almost 1.1 million people nationwide. And most of the NADA members are small businesses, as defined by the Small Business Administration. And approximately 85 percent are family-owned businesses, which seem to be, according to the speakers today, in the cross-hairs under these proposed regulations.

Since I didn't find out in advance what the other 29 speakers before me were going to say, I'm probably going to repeat a few things. They have already said over and over again that they felt like the validity of the proposed regulations is questionable, and I generally agree with that because, number one, I think that they are not supported by the congressional intent as shown when 2704 was initially enacted. I also think that they assess, as the valuation folks today have said, fair market value is at one level and these regulations assess transfer tax on an amount larger than that. But I will leave all of that to what's already been said by the other 29 speakers.

I want to focus instead on specific issues involving family-owned car and truck dealerships. Crowe Horwath, on behalf of the NADA, already submitted a mere eight pages of detailed comments, unlike Keith Miller who gave us 41, so we're easy, we're only eight pages. I want to pick out three of those comments as they specifically address car and truck dealerships.

My first comment is that these new proposed regs require appraisers to value business entities, which I will just refer to as dealerships, using unrealistic assumptions based on non-existent scenarios, which are oftentimes mutually exclusive with each other. Specifically, the proposed regs require an appraiser to ignore any restriction on the owner's ability to redeem or liquidate the ownership interest. And John Porter tried to differentiate that from a put right versus the ability to liquidate, but if we have to ignore the restriction on the ability to liquidate, this, in essence, requires an appraiser to assume that a fictitious hypothetical public market exists where every ownership interest in a dealership can be immediately sold with full payment received in six months. The words on

the page would seem to me to only be able to be interpreted as eliminating marketability discounts.

Furthermore, the appraiser is required to assume that this sales price in this hypothetical public market will always be no less than an amount referred to as minimum value. Minimum value is computed as the fair market value, the assets of the dealership, which there may be some valuation discounts in determining the assets, but it can only be reduced by non-contingent liabilities. Then this net equity is multiplied by only the owner's share of the entity, regardless of whether that's majority control or whether that's a small sliver of ownership. This effectively eliminates any minority discounts.

So, obviously, these assumptions are fictitious and hypothetical and simply don't exist for the actual ownership interest in dealerships. Therefore, we believe the regulations asses transfer tax on amounts greater than true fair market value and should be withdrawn.

However, if they are finalized, we instead feel that they need to at least allow the appraiser to acknowledge and reflect the existence of what I call the automatic consequences of those very assumptions. Such as, first, if the shareholders really did have the ability to require the company to redeem their stock at any point in time for any reason, that's going to cause the company to retain cash to cover that possibility, which would mean that the dealership would not be able to make long-term investments in new equipment, buildings, business operations, or to hire new employees the way it otherwise would have done. All of these would clearly affect the company's future growth. Please allow the appraisers to take those consequences into consideration.

Likewise, the minimum value requirement states that only non-contingent liabilities can reduce the values of the company's assets. This automatically creates mutually exclusive assumptions. For example, most dealerships use the last-in/first-out, or LIFO, method of accounting. Every appraiser, though, in computing the minimum value of the assets is going to convert LIFO into FIFO. However, an actual conversion is going to trigger an income tax liability. But the regulations say that the liabilities have to be ignored if they are merely contingent rather than actually existing.

Therefore, we ask you to clarify that appraisers are allowed to take these, as well as other natural consequences, into account in doing their valuation.

My second comment is the proposed reg requires that in order for the ownership by a non-family member to be recognized and given weight in the valuation process, the non-family member has to meet what the regulations call some bright line tests. One of which is that the non-family owner must have a put right. Those are the words on the page for the non-family owner, which we believe is unrealistic. But it also requires that both a 10 percent and a 20 percent test has to be met.

For car and truck dealerships, the general manager of a particular store will often hold an ownership interest in that particular store. We believe that these

non-family ownership positions meet the intent of the requirements, but would often not meet the current bright line test.

Therefore, we recommend two changes. One is, get rid of the put right provision because it's simply unrealistic and not practical. But second, we believe that the goals of the regulations would be fulfilled by allowing either the 10 percent or the 20 percent test to be met. In other words, change the "and" test to an "or" test. That is detailed in our written statements.

My final comment is that the proposed regs already contain a helpful exception which does, in fact, allow the appraiser to take into account what's called a commercially reasonable restriction. We believe that this exception should be expanded in two ways. One is that it exempt any operating business as defined in Code Section 6166. You've heard that already today.

But the other thing is that it currently only applies to restrictions imposed by "an unrelated person providing capital to the entity for the entity's trade or business operations." Okay. We've heard today from other franchisors that a new car dealership is by definition operating under a franchise agreement granted by automotive manufacturers such as Ford, Toyota, Honda, whoever. Those manufacturers impose significant restrictions on both day-to-day operations of the dealership, what they can build, how their building has to look, as well as the owner's ability to transfer ownership of the entity.

As Keith Miller of Subway mentioned, there are significant restrictions there. The regulation should be allowed to reflect the impact of the restrictions imposed by franchisors just the same way it does for restrictions imposed by lenders.

To summarize: we request that the regulations be withdrawn rather than finalized. You've heard that a few times today. But if they are finalized, we ask that they at least allow three things. One is to the extent that certain fictitious assumptions really are going to be mandated, the appraiser should at least be able to take into account the natural consequences of those assumptions. Second, the bright line tests for family ownership should be changed from an "and" test to an "or" test. Third, that the restrictions imposed by franchisors can be acknowledged.

Thank you for listening.

MS. CHYR: Thank you, Mr. Hills. The next speaker is Frank Clemente with Americans For Tax Fairness.

MR. CLEMENTE: Good afternoon, actually my last name is Clemente. Unless I missed someone else's testimony, I may have the distinct honor and high privilege to be the only person testifying in favor of these IRS regulations today so let me thank you very much for promulgating these.

I am here -- I think I am getting combat pay for this and probably you folks are too. I am here representing a coalition. Americans for Tax Fairness represents 425 national and state organizations that are united around the principles of tax fairness. Those organizations have tens of millions of members in them and so I feel like today we are speaking on behalf of their voice as well.

I also -- we submitted into the record a letter signed by 45 national organizations in favor of these -- this rule. It was signed by the AFL CIO, American University Women, American Association University Women, Children's Defense Fund, Coalition on Human Needs, National Education Association and even the Patriotic Millionaires and even the Patriotic Millionaires which has scores of millionaires as their members.

We also, as part of the rulemaking -- as part of our participation in the rulemaking process secured support from 18,930 of our members and supporters who signed a petition which we also submitted to the IRS Treasury Department. All of these folks are concerned that the wealthy and many large corporations avoid paying their fair share of federal taxes by taking advantages -- sophisticated interpretations of the law and regulatory guidance, that is why we strongly support your efforts here to move these -- to address these instances of tax avoidance wherever possible and appropriate.

The present Treasury action on the valuation discount rule is just such a situation and represents a highly appropriate action on your part to protect the tax base and enforce the intent of the law in this area.

The estate tax was implemented 100 years ago to impose a check on the growing intergenerational concentrations of wealth and to generate much-needed revenue. Loopholes in the estate tax enable the wealthy to dodge paying their fair share of taxes. While the nominal tax rates on the states is 40 percent, the effective tax rate is 17 percent for all estates and 19 percent for estates that are valued at more than 20 million dollars.

Over its century-long existence, the estate tax has been significantly more robust and with higher rates and lower wealth exemptions than in the last two decades. The efficacy of the tax as a break on concentrated wealth has been undermined both by legislation and by tax loopholes. The estate and gift taxes have become riddled with loopholes that the wealthy exploit, eroding the intended scope and revenue raising potential of these progressive taxes.

Instituting this rule to close one of these loopholes is an important step towards restoring the state and gift taxes to their intended scope.

Much information has been spread about the estate tax, some of it in earlier testimony today. Excuse me, much misinformation. First, opponents claim it impacts middle income families. In fact, the federal estate tax is levied on an individual's estate worth more than 5. 45 million dollars or in the case of a couple's estate, 10. 9 million dollars. Estates worth less than that amount pay absolutely nothing. The estate taxes paid by just the wealthiest 0.2 percent of estates in the country, that's fewer than two out of 1000 estates, that's roughly 4,700 estates in any given year according to the joint committee on taxation so we are talking about an infinitesimally small number of people here in America.

Opponents claim that it hurts small family businesses and breaks up family farms. We hear a lot about that today. In fact, only about 20 small family businesses and small farm estates, total, 20 both small businesses and small

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farm estates in the entire country-owned any federal estate tax in 2013 according to the tax policy center, and that is analyzing IRS data.

Opponents allege it is a form of double taxation. In fact, the bulk of assets and the biggest estates that are subject to the estate tax are unrealized capital gains that have never been taxed.

No one who relies on a paycheck to make a living is impacted by the estate tax. The valuation discount rule seeks to close a loophole that the wealthy exploit to dodge paying their taxes. It enables the wealthy to place assets and specially created partnerships for the sole purpose of reducing the value of partnership assets for tax purposes.

This technique can discount the value of their assets by as much as 40 percent. Like many aspects of our tax code, the technical details are complicated but the concept is fairly simple.

If I own an asset worth 100 million dollars and I am looking to dodge paying some estate tax using the valuation discount, here is how I would do it. I could create a limited partnership and place that 100 million dollars in it. My wife and children would also contribute some assets because control of the partnership is dispersed among a number of us. Our estate lawyers would argue that the partnership interest would be harder to sell and therefore each person's individual share should be assessed at a lower value.

After I am gone and my estate is taxed, my partnership interest could be discounted up to 40 percent using the valuation loophole -- discount loophole. So 100 million dollar asset becomes a partnership interest worth 60 million dollars when the estate tax is at 40 percent, that's an estate tax cut of up to 16 million dollars.

For very wealthy households that take advantage of this loophole, this is a great deal, but for the overwhelming majority of families, this loophole means less revenue for vital public services that so many of us depend on.

What is the impact of this tax cut to the wealthy? Consider that closing this loophole could generate up to 18 billion dollars over 10 years.

In essence, by giving an 18 billion dollar tax break to the wealthiest households in the country, we are collectively choosing not to address serious and significant social problems. For example, for less than 15 billion dollars, we can help end family homelessness by helping 550,000 homeless families with children pay for housing over the next 10 years at the cost of 11 billion dollars. In addition, we can also help 100,000 young people get their first job through partnerships with businesses and communities. That would cost 3.5 billion dollars.

It is unconscionable that tax loopholes exist exclusively benefitting the very wealthy. They should not be allowed to continue. We are hopeful that closing the valuation discount loophole is just the first of other efforts to preserve fairness and balance in the tax system, including by protecting the integrity of the estate and gift taxes. Thank you very much.

MS. CHYR: Thank you, Mr. Clemente. Next is Matthew Beard with Meadows, Collier, Reed, Cousins, Crouch and Ungerman.

MR. BEARD: Thank you all very much. My name is Matt Beard. I am with Meadows, Collier, Reed, Cousins, Crouch and Ungerman in Dallas, Texas. Our firm was involved with the Keller and Kimball cases over the last 20 years.

I've had the privilege of working with chief council and Treasury over the years with different PLRs. Actually my first legal job was as an extern in the Dallas field office. I worked with Aubrey Garber and John Rapsis and thank you for your time and I really appreciate you giving a young attorney like me the opportunity to be a part of this process; it's a real honor. I'd like to spend the time today talking about family attribution, really just focus on that one piece.

It seems to me that the proposed regulations, as currently drafted, will have the effect of broadly applying family attribution or unity of ownership principles to proper evaluations for transfer tax purposes. This appears to be in direct conflict with the intent of Congress, of course, on the legislative branch and also judicial precedent on the judicial branch of the government.

Using the language of the Ninth Circuit, in Propstra, in absence of explicit directives from Congress, the proposed regulation should not include provisions that apply these principles when computing the value of a transferred interest.

The statute that Congress enacted is in Section 2704. As we know, we have the general rule in 2704(a) which is where we see the family attribution rules.

However, importantly, they included several exceptions in the most important by effect, and practically day-to-day operations is the state law exception that is in section 2704(b)3 Cap B and that provides that the term applicable restriction shall not include any restriction imposed or require to be imposed by federal or state law.

This is fleshed out by Treasury in the regulations 25.2704-2(b) includes a no more restrictive standard that says applicable restriction is limitation on ability to liquidate the entity in whole or in part that is more restrictive that the limitations that would apply under state law, generally applicable to the entity in the absence of the restriction.

The Tax Court has called this a broad standard and I think we would all agree the preamble to the regulations point out that this is broad and Treasury feels that it is hard to have an example where practically that standard would actually apply.

As a result, the state law exception broadly applies. The proposed regulations are in sharp contrast. In fact, they contain a new and substantially narrowed standard for the exception under 2704(b)3.

The standards in -2(b)(4)(i) for applicable restrictions as well as -3(b)(5)(iii) with respect to disregarded restrictions and they provide that the provisional law that applies only in the absence of a contrary provision in the governing

documents or that may be superseded with regard to a particular entity is not a restriction that is imposed or required to be imposed by federal or state law.

In other words, for the state law exception to apply, the state law has to be mandatory -- is what it looks like the new standard is.

This unwarranted revision to the regulations is not the result of a directive from Congress. Something very interesting to note is that Section 2704 has not been amended since it was added to the code in 1990 except for one small revision to a section reference in 1996.

As pointed out in the preamble, it is true that many state statutes governing limited partnerships provide that a partnership may be liquidated on the vote or written consent of all partners. I am from Texas and I am very well aware of section 11.051 of the TBOC which provides that the winding up of a domestic entity is on the voluntary decision to wind up.

That is then defined as requiring the consent of all partners, the written consent of all partners. The preamble states that this is one of the reasons why we have the new rules contained in the proposed regulations because when a state sets the standard at maximum, there is no way to be no more restrictive than that.

However, it is very important to note, and this is left out of the preamble, that other state statutes do not have unanimous standards.

For example, some may actually have less than unanimous. Delaware is a leading state in the country for business, corporate and entity law. Their standard is 2/3s. It could be more restricted in Delaware.

Specifically, section 17-801-2 of the current rule of the Delaware Revised Uniform Partnership Act provides that when a limited partnership is dissolved, its affairs shall be wound up upon the first occurring: upon the written vote or written consent of all general partners and 2/3 of the limited partners. And these are not unique. Most states will also include provisions that allow the partners to amend those default provisions. Both of the sections that I just cited in Delaware and Texas provide the partners' ability to change that standard, either to reduce it or increase it depending on the state.

And the approaches used in Texas and Delaware are not unique to those states.

Most states fall into one of the two. In fact, these are consistent with the Uniform Partnership Acts dating back to 1914, over 100 years ago.

If you look at the Uniform Partnership Act of 2001, section 808, it uses a majority standard which looks like Delaware.

It states that a partnership may be wound up on a majority -- the limited partners -- only a majority agreeing so the Uniform Partnership Act is actually a little bit less than the Delaware standard of 2/3s.

If you look at 1997 Act and the 1976 Act and the Uniform Partnership Act of '97, the Uniform Partnership Act of 1976, and you go all the way back to the Uniform Partnership Act of 1914, they all use something similar to Texas which is a unanimous standard.

They all say that you may be wound up on the express wheel of all the partners.

Interesting language, and I appreciate the history, the law where we came from.

The 1914 Act express language is: "By the express will of all the partners who have not assigned their interest or suffered them to be charged for their separate debts, either before or after the termination."

So as a result, most, if not all state statutes will fall within the description of these new proposed regulations as being a law that does not apply only in the absence of -- or, excuse me -- that does apply only in the absence of a contrary provision.

In other words, the provisions of a partnership agreement restricting liquidation will rarely qualify for the exception under the proposed regulations.

It's very difficult to think of an example or to find a state that will satisfy the new proposed regulation standard. Accordingly, the result will be that the proposed regulations will have the effect of broadly extending family attribution or unity of ownership principles to valuation for transfer tax purposes.

And the way it's done mechanically is through Section 2704(b)(1). By completely eviscerating the state law exception through the standard in the regs, the family attribution rules of 2704(b)(1) will broadly apply to most, if not all, partnerships.

I believe that this was not the result intended by Congress. The legislative history for Section 2704 recognizes that courts have refused to consider the familiar relationships among co-owners and states that Chapter 14 was not intended to affect discounts available under then present law.

An often-cited report is the House conference report 101-964.

There, they stated that these rules are not intended to prevent results -- excuse me -- these rules are intended to prevent the results similar to Harrison. These rules do not affect minority discounts or other discounts available under present law.

The intent that no inference be drawn regarding the transfer tax effect of restrictions of lapsing rights under the present law.

Further, the language of section 2704(b)(3) reflects this congressional intent.

We see specific language in the state law exception that refers to any restriction imposed, or required to be imposed by federal or state law.

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Clearly, the addition of the phrase "are required to be imposed" shows that congress intended the exception apply with respect to both default and mandatory provisions.

As stated before, the proposed regulations also ignore the long-established case law, fifth circuit and Bright states that first we reject any family attribution to the state stock because of established case law requires this result. The ninth circuit and *Prostra* says we are unwilling to impute to congress and intend to have any unity of ownership principals apply to property evaluations for state tax purposes.

Even the tax court in *Andrew* says the leading case dealing with this question is *Bright*, in which the court recognized that a minority interest in a corporation should not be seen as having any control value, even though the family unit had control of the corporation.

These cases and their history date back to 1940. So in light of all the foregoing, what can we do?

My respectful request would be that treasure revise the proposed regulations -2(b)(4)(ii) and -3(B)(5)(iii) and provide clarity on the issues raised in the preamble but at the same time, not narrow the exception under 2704(B)(3), the state law exception to the extent that it is meaningless and has rare or no effect.

And two, without causing family attribution or unity of ownership principles to broadly apply in the absence of an explicit directive from Congress.

I think this can be accomplished by retaining the no more restrictive standard that is currently set forth in the current regulations rather than bringing forth the mandatory as alternatively request an example if we do use the new standard showing when the state law exception would apply.

MS. CHYR: Thank you, Mr. Beard.

MR. BEARD: Thank you very much.

MS. CHYR: We'll take a break and resume at 3:15.

(Recess)

MS. CHYR: Our next speaker is Dawn Jinsky with Plante Moran.

MS. JINSKY: Thank you everybody. The home stretch, right? There are still a few people remaining, so I appreciate you sticking in there with this.

Thank you (laughter) -- that's why you're here, right? Thank you so much for the opportunity to speak today. My name is Dawn Jinsky and I am a partner and leader of the wealth transfer practice Plante Moran specializing in estate planning, business succession planning, and charitable giving. For those of you who don't know, Plante Moran is the fourth largest accounting firm in the United States, and as you can imagine, we consult with and advise a lot of closely held businesses.

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I am located in our Detroit office and have the opportunity to work with many different clients in several different areas. Service, manufacturing, construction, real estate, and of course automotive. In the Detroit area auto dealers and auto suppliers are a significant makeup for our economy. Today I would like to talk specifically about one of these auto supplier clients and the potential impact of these regulations to his, and others in similar situations, succession plans. My client came to me about five years ago and said, "Dawn, I'm ready." And what he was ready for, for those of you who have ever worked with the wealth creator, that entrepreneur generation one, what he meant he was ready for was he was ready now to build a succession plan, to hand over the keys and think about retirement, which for many of my entrepreneur clients almost never happens. And so the minute he said that he was ready I sprung into action and began working with him and his wife. And in working with them they said they had identified two capable young men, bright and able to take -- they felt comfortable that they were ready to turn the keys over to.

So now many of you may know, with most succession plans they take place over a number of years. They're thoughtful, we have to make sure that the owners are ready to take on the keys, and we also need to make sure that we don't do undue burden to the company itself from a financing perspective. We use the term in succession planning -- "sweat equity" -- a lot, making sure that the new owners really are ready for the investment and commitment into the new company. So now here we are 5 years later and the company is 60 percent with mom and dad and 20 percent with each of these two new young men.

Now what I'd like to comment on specifically today is the concern I have with the proposed regulations because these two individuals, these two young men who have taken over the business are doing a phenomenal job. They're running the management team, they're taking the strategic vision, they're really running this closely held business. The concern I have, though, is these two men, one is the son and one is not related. And so the concern I have is under these proposed regulations when I go to sit and talk to them and I talk to them about doing the next structured sale I'm going to have two different price points. John, who is the son, and Mark who is the -- although they treat him as a son, is the non family member -- I have two different price points that I'm working with and I now have to talk to John about why he needs to pay more for his next 10 percent tranche in the company than what Mark is going to have to pay. If John then chooses to go out and look for third-party financing, this third-party financing may not be possible based on the valuation that is put on his interest in the business. For any of you who have attempted to go get a mortgage on a house that doesn't appraise, you understand how this situation can be difficult. Business transition and succession takes place in many different ways, to third-parties, to management teams, to families, and often times a combination of these. On behalf of Plante Moran and our closely held business clients I respectfully ask you to consider these businesses when you contemplate the future of these regulations.

Thank you.

MS. CHYR: Thank you, Ms. Jinsky. The next speaker is Alex Ayers with Heating, Air-conditioning & Refrigeration Distributors International.

MR. AYERS: Good afternoon, and thank you for giving me the opportunity to speak today. I'm here today representing the Heating, Air-conditioning & Refrigeration Distributors International. HARDI represents nearly 500 U.S. Companies in the heating, air-conditioning and refrigeration distribution industry. Nearly 80 percent of our member companies are classified as small businesses and collectively employ more than 40,000 individuals. Many of our members are their second and third generation of ownership, making the estate tax a top priority.

I'd like to cover three topics today, and I will limit them mostly to the HARDI industry due to the fact that so many have already been talked about. Specifically, why valuation discounts are important to HARDI members, the cost to our membership in assessing this proposal, and the impact of the proposal on our members.

As distributors of heating and air-conditioning equipment, HARDI members carry large inventories of parts and supplies to install or repair HVAC and refrigeration equipment. This inventory makes them susceptible to the estate tax by increasing their net worth well above the estate tax exemption. Unfortunately for our members what part of the year an owner dies will affect their estate tax bill. If an owner dies in summer when inventories are highest, the tax bill will be significantly larger than during the winter when inventories are lower. The estate tax is a barrier to keeping the business in the family for many of our members and valuation discounts are an important part to helping to transfer the business from one generation to the next.

When the realities of the industry are apparent the willing seller test becomes very important in establishing the value of an HVAC distribution business. Many HVAC distributors are members of purchasing cooperatives or buying groups, which allow small businesses to band together and purchase products at a better price. The relationships with purchasing cooperatives can be very valuable to a business. However, membership within these groups is subject to the approval of the cooperative. And therefore a business owner cannot simply put a business or even part of a business up for sale with 100 percent certainty that membership in the cooperative will remain. This reality should be considered in valuing a company, but the proposed regulations would eliminate this from happening through the use of family attribution.

Among the many, many comments submitted by business owners and associations representing small business one thing becomes clear, valuation discounts are an important tool in succession planning and any attempt to change how those discounts work will not be taken lightly by the business community. The current use of valuation discounts by family businesses has worked for over two decades with extremely low incidents of abuse. Keeping the current system is the best option for our family business members.

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In looking at the cost to our membership in assessing this proposal we talked to our members and we discovered how little clarity there was in the rule. Our member business owners came back to us with estimates ranging from the tens of thousands to over a million dollars in extra costs to comply with the rule. Our members estimate that with this proposal it would increase their tax burden between 30 and 35 percent. But the opinion most shared with us was their utter disbelief that this rule was even being considered.

In order to comply with the proposal, HARDI members would be forced to change their succession plans in a variety of ways, from increasing life insurance purchases to changing gifting strategies. In fact, the mere proposal of this regulation has forced a significant number of HARDI members to engage legal representation at a cost at or near $500 per hour to assess what the potential impact is to their business. Furthermore, our members may need to reissue their corporate formation documents or redraft partnership agreements to account for the new regulations. This extra cost and time to move a business from one generation to the next that is caused by this proposal would make it harder for the business to survive if hit by a large estate tax bill.

And then, finally, on the impact of the proposal, this additional tax burden would hinder small businesses in a few distinct ways. Companies could seek to restrict the growth of their business to prevent escalation in taxes, companies may strip capital from the growth to add it to a tax payment reservoir to be available when their tax bill comes due, and others may purchase insurance policies to cover the tax burden, while others still may just outright sell the company, likely to a larger entity than themselves. HARDI believes that many businesses would be harmed by this proposal, but not all, because it is apparent to our membership that Treasury's proposal is an absolute boon to estate planning attorneys, accountants, and insurance companies who specialize in selling expensive policies to help families cover the cost of the estate tax in the event of a death of an owner of a company. These and those mentioned previously are direct costs to small businesses.

It is for this reason we were surprised to see that the IRS did not complete a Regulatory Flexibility Analysis. In certifying that this regulation did not need a Regulatory Flexibility Analysis the IRS did not meet the requirement set out by the Regulatory Flexibility Act for three reasons. First, agencies are required to provide a factual basis to support their certification that regulations will not have an impact on the business. The IRS made two statements to support the certification, neither of which met the factual basis test. Second, the Proposed Rule would have a significant economic impact on a substantial number of small entities. It is widely understood that for a pass-through entity, such as partnerships, the taxes of the business are paid by the individual because there is no separation between the two. It is odd to us that while in one case for income taxes it is seen this way but for estate taxes it would not be seen in the same way. And, third, the IRS did not conduct a Regulatory Flexibility Analysis to consider whether it is possible to exempt small, family controlled, owner-operated business from the Proposed Rulemaking.

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For these reasons we request that the Treasury Department withdraw the current Proposed Rule and if the Rule is resubmitted that the Department conduct a Regulatory Flexibility Analysis with appropriate time for comment.

Thank you for your time and consideration, and I am available to answer any questions about how this regulation will impact the HVAC and refrigeration distribution industry.

MS. CHYR: Thank you, Mr. Ayers. Next is Chris Treharne with Gibraltar Business Valuations.

MR. TREHARNE: Good afternoon. Thank you for the opportunity to speak here today. I'm a business appraiser with 27 years of experience. I have three business valuations designations, the Accredited Senior Appraiser designation from the American Society of Appraisers, Master Certified Business Appraiser with the Institute of Business Appraisers, and I'm also a Certified Valuation Analyst with the National Association of Certified Valuators and Analysts.

While not the exclusive focus of my practice, the primary focus of my practice is federal gift and estate tax appraisals, and I'm proud to say that Ms. Law is one of my clients and has been for a number of years. We have worked on her estate a number of times. I've invested more than 80 hours in reading and re-reading the proposed regs, listening to or attending multiple presentations, including the American Bar Association and the Colorado Bar Association webinars. I've done multiple presentations myself on the topic, which requires a lot of preparation work. I've communicated with numerous attorneys and business valuation colleagues, read too many articles and too many emails. Based on this, it's my perception Treasury is primarily focused on remedying perceived abuses of gift and estate tax regulations associated with *Estate of Harrison* and *Kerr v. Commissioner*. While I believe the proceeding is a prospective Treasury wants to communicate, I did not come to that conclusion until the end of almost 80 hours of effort.

With regard to the preceding as background I offer my comments and suggestions as a business appraiser and not as a legal expert. Under section 2701, expansion of the regs to include entities other than corporations and partnerships is appropriate. It's unclear to me, however, that if tenant in common ownership interest, and perhaps other forms of ownership interest, should be included in expanded scope. Even if they are, I'm concerned that the proposed 50 percent control threshold would not represent the financial realities of a tenant in common real estate ownership interest absent an operating agreement to the contrary. And we do do tenant in common interest real estate appraisals as business appraisers.

Whether it's a fraction of real estate or other asset interest, I encourage Treasury to more closely consider and address my concerns in the Proposed 2701 Regs.

Regarding 2704-2 and the perceived abuses associated with deathbed transfers, I'm sympathetic towards Treasury's concerns about fact intensive

inquiries needed to resolve claims associated with such transfers. However, I'm also troubled that inflexible bright line rules may be potentially abusive too. Here are a couple of examples. A healthy 55 year old business owner makes intra-family gifts. Two yearsand eleven months after making the gifts, she's the unfortunate victim of a fatal accident when a semi trailer crosses the center line of a two-lane road. I literally had this happen to a client of mine. Her clearly accidental death will negate mindful and legitimate estate planning strategies implemented without motivations similar to the perceived abuses of the above cited cases. I don't know how to get around the issue, but that does concern me. In the same scenario it's unclear to me whether the proposed regs will claw back into her estate her intra-family gifts at the original transfer value or their possibly appreciated value. If it is the latter, her clearly accidental death will again negate mindful and legitimate estate planning strategies implemented without motivations similar to the perceived abuses of the cited cases.

It's my understanding that applicable restrictions associated with the proposed 25.2704-2 apply to liquidation rights associated with the entity as opposed to the individual owner. I've made a point of trying to emphasize this with individuals that I'm speaking to because I felt like for the first tens of hours I was working on this project that I didn't understand it. Somebody mentioned that to me as like a light went off for me. So it helped. So I offer that to you in hopes that it will also make others more enlightened.

If my interpretation is correct, including explicit language similar to what I have offered will make the regs more understandable to my profession.

While I understand Treasury's perception of abuses associated with third-party owners -- I'm sorry, I want to back up. It's also my understanding that disregarded restrictions as opposed to the applicable restrictions we just discussed associated with the proposed 25.2704-3 apply to liquidation rights associated with individual owners as opposed to the entity. Again, if my interpretation is correct, including explicit language similar to what I have offered will make the regs more understandable to my profession.

While I understand Treasury's perception of abuses associated with third-party owners inasmuch as they may affect the inability to liquidate an ownership or the entity, I'm again concerned that inflexible bright line rules may be potentially abusive too. As an example, any business less than three years old will not comply with this bright line rule, regardless of the legitimacy of the unrelated party capital structure.

I encourage Treasury to identify and adopt alternate, more flexible language that accomplishes its goals of preventing taxpayer abuse without imparting inflexible constraints on legitimate ownership structures and strategies.

The term liquidation is used throughout the proposed regulations and relies on a definition cited in the current gift tax regulations. Just for the rest of the audience these are not proposed regs, this is from the current regs. "The ability or right, including by reason of aggregate voting power to compel the entity to acquire all or a portion of the holder's equity interest in the entity, whether or not

it's exercise would result in the complete liquidation of the entity." In contrast, the term liquidation in the business valuation profession refers to process of dissolving the entity where the prior definition refers to the process of liquidating the ownership interest. And liquidation, again dissolving the entity and distributing pro rata to all owners' proceeds associated with the sale of the entity's assets. Treasury's definition is more consistent with what valuation professionals call a put right. To increase clarity and understanding among business valuation professionals I encourage Treasury to use the financial term "put" in lieu of liquidation to describe an owner's ability to "compel the entity to acquire all or a portion of the holder's equity interest in the entity," with the preceding quote coming directly from the gift tax regs that I just read.

Further, the term "liquidation" only should be used to describe dissolution of the entity, not a fractional ownership interest and distribution of the pro rata proceeds associated with sale of the entity's assets. As I read the proposed regs, operating documents or state law which impose a contractual or statutory value on the purchase or sale of an ownership interest at a price other than minimum value, as defined in the proposed regs, have to be valued at minimum value using "generally accepted valuation principles". Regarding the preceding, I encourage Treasury to number one -- adopt explicit language stating my interpretation if it is in fact correct. So again, if there are operating documents or state laws which impose a contractual or statutory value on the purchase or sale of an ownership interest at a price other than minimum value, it has to be valued at minimum value using general accepted valuation principles.

And I want to move to the second point here with respect to the last four words, generally accepted valuation principles. Please define generally accepted valuation principles. (Laughter) I guarantee -- the second speaker this morning, Michelle Gallagher from the AICPA, Michelle and I disagree on whether the AICPA standards of which I do not have -- that's the only designation I don't have -- whether or not they represented generally accepted valuation principles.

I think we should also then encourage Treasury to explicitly state the definition of minimum value includes liabilities other than those allowed under Section 2053, as currently offered in the proposed regulations. Legitimate examples might include but be limited to the following, some of which appear on gap statements but not on income tax basis statements, and income tax basis statements are the typical source of information for many of my clients, small businesses. They don't have gap statements. C corporation built in gains tax. I know that that's a controversial topic, but nonetheless at least in the 11th Circuit they said, as a matter of law we will recognize it dollar for dollar, but that will not show up as a liability on a company's balance sheet. Environmental liabilities, again may show up on gap statements, but will not on a tax basis. Informal sinking fund liabilities -- and since I'm rapidly running out of time -- associated with capital reserve funds, potential litigation judgments.

In summary, I applaud Treasury for its effort to clarify the existing regs. I hope my comments contribute to that effort. And if I can be of additional assistance please give me a call or shoot me an email.

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Thank you.

MS. CHYR: Thank you for your comments. Next is Chris Quigley with the Real Property, Trust and Estate Law Section of the ABA.

MS. QUIGLEY: Thank you. Christine Quigley; I'm a partner with the law firm of Schiff Hardin and I'm here this afternoon on behalf of the American Bar Association Section of Real Property, Trust and Estate Law in support of the Section's comments. I intend to focus in four areas, starting first with the concept of applicable restrictions and the so- called state law exception. My comments with respect to this would also apply to the analogous provisions of the -3 regulations.

With respect to applicable restrictions, the proposed regulations would revise the regulatory interpretation of the statutory exception for a restriction imposed or required to be imposed by federal or state law in manner so narrow as to virtually nullify the exception. Furthermore, they disregard taxpayers' legitimate business decisions with respect to choice of entity. They may, however, be mitigated, for example, by the introduction of an exception for restrictions of a type that would be negotiated at arm's-length. The state law exception in the proposed regulations would only apply to provisions of federal or state law that are mandatory and cannot be overridden in the governing documents or by another statute available for creation of the same class of entity. While another statute may be available, it may be less desirable or even prohibited. Business owners would generally select a type of entity for a number of both tax and non tax reasons. For instance, they may choose limited partnerships over general partnerships for asset protection, centralized management, concentration of control, and other valid business reasons. However, the proposed regulations would look to the less restrictive general partnership statutes in determining whether a restriction were mandatory. This does not reflect the reality of choice of entity decisions and it may attribute phantom value to the interest, putting family businesses at a disadvantage as compared to non family businesses.

Importantly, state law -- particularly with respect to corporations -- does not restrict liquidation so much as it may authorize liquidation. The proposed regulations effectively assume the inverse, that a liquidation right exists unless it's denied by state law. In reality, a shareholder has no right to liquidate a corporation unless that right is granted by state law and the governing documents. To omit a process for liquidation from governing documents only creates the potential for conflict and uncertainty. As a result, to the extent state law authorizes liquidation, which it necessarily must in some fashion, the exception becomes meaningless, rendering the proposed regulations unduly burdensome on family business.

By way of example, Illinois law allows a corporation to select closed corporation status and any corporation that so elects can grant to any shareholder the right to dissolve the corporation. Absent selecting closed corporation status there is a two-third vote required for liquidation. So if we assume that a corporation puts in its governing documents a simple majority

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vote, which could hardly be viewed as abusive, it would nonetheless be an applicable restriction. Why? Well, because by requiring that majority vote they've placed a non-mandatory restriction in the governing documents with respect to who may liquidate even if they don't select closed corporation status merely because that alternative status is available.

So long as state law doesn't require a certain percentage to liquidate, any requirement of a minimum vote in the governing documents would be an applicable restriction under these proposed regulations. In that regard, the proposed regulation effectively asks family businesses to choose between protections of state law and governing documents that preserve the orderly transition and management of business on the one hand, and advantageous tax treatment on the other hand. Both that and the franchise issue that's been discussed earlier today, the concept that family members in a franchise business might have complete control to remove restrictions on liquidation voting, et cetera, but that could jeopardize the continued existence of the entity. Both of those issues could, again, be mitigated by the introduction of an exception such as something for bona fide limitations as found in an arm's length dealing.

Next issue, the concept of minimum value and the impact of disregarding a provision that limits the holder's redemption amount to less than minimum value. The definition of minimum value is the interest share of the net value of the entity determined on the date of liquidation or redemption is problematic for entities that hold illiquid assets or operating businesses. We've already heard today about the problem with owning real estate as tenants in common. If two sisters owned real estate as tenants in common they're entitled to fractional interest discounts. If they put it into an LLC then those fractional interest discounts go away based on the definition of minimum value.

The final regulations should not penalize co-owners of tangible or real property who form an entity to hold it as opposed to holding it in co-tenancy. The entity not only provides the limitation on personal liability, but it provides a reasonable and efficient mechanism for managing the property. In the case of an operating business, juxtaposed references in the proposed regulations to the net value of the entity on liquidation and the regulations under Code Sections 2031 and 2512 are not easily reconciled, with the latter considering fair market value, prospective earning power, and good will. Final regulations should explicitly state that minimum value in the case of an operating business means going concern value and not liquidation value. Family-owned operating businesses cannot be easily valued based on liquidation or breakup value, and any attempt to do so may significantly misrepresent the value of the entity.

In contrast to the minimum value rules, the proposed regulations under -3F provide for valuation of an interest with a disregarded restriction under generally applicable valuation principles as if the restriction did not exist. Now, by default most organizations today have perpetual existence and state law presumes that the entity will continue, not liquidate or allow an owner to liquidate. Thus, again, if state law permits the owner to withdraw it, authorizes withdrawal as opposed to liquidating. As a result, relying on silence simply does not provide sufficient

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guidance for valuation. Again, an exception, such as that found in an arm's-length dealing, might mitigate the situation.

Next issue, interests held by non-family members in these so-called put right exception. By requiring that a taxpayer meet four separate tests the proposed regulation section -3B is overbroad and captures too many bona fide structures within its net. Furthermore, if those tests are not met, it's unclear how this provision is reconciled with the commercially reasonable exception for third-parties that provide equity financing in the form of capital contributions to an entity. Is that financing disregarded because it doesn't meet the threshold? Moreover, the proposed regulation appears to seek to ignore restrictions that reduce the value of the transferred interest for transfer tax purposes and reduce the value of the transferred interest in the hands of the transferee. This application would exceed the regulatory authority granted by the statute.

Requiring that a family enters into a business arrangement with unrelated third-parties and provides the third-parties with put rights is an unworkable way to structure a business. It would be impossible to attract investors to an entity if other investors could withdraw their shares of the business at any time. There are numerous investment control, creditor protection, business planning, operational planning, and balanced portfolio reasons why a closely held entity would never maintain the cash level necessary to satisfy the potential of the described put right being exercised. The constant threat that capital would abruptly be withdrawn makes a long-term business plan simply inconceivable.

Finally, with respect to attribution, we did hear some comments earlier in the day on the inapplicability of Reg 252701-6 in the context of Section 2704. I would just like to reiterate, I hope in a clear manner, that what that reg does is attribute interest to more than one person. You then go through a series of tiebreaker rules to decide who should really have the interest. One of the main reasons that can't work in a 2704 context is because those rules presuppose the existence of both junior and senior equity interests, which you would always have if 2701 were at issue, but you often don't have when 2704 is at issue.

Thank you.

MS. CHYR: Thank you, Ms. Quigley. Next is Mr. Dennis Belcher, businessperson.

MR. BELCHER: Thank you. And I am the speaker you have been looking for. I am the anchor. (Laughter) And I do commend the four of you. I never thought I'd say I feel sorry for the IRS, but I really do. (Laughter) And I want to thank you for calling me a businessperson because I'm a lawyer. And I'm a partner of McGuireWoods. I had the pleasure of practicing law with Kathy many years ago. I'm also the Past President of the American College of Trusts and Estate Council, Past Chair of the American Bar Association Real Property, Trust and Estate Law Section, and I was the reviewer for RPTE's comments and I support what Chris' comment said.

But what I want to talk about is my role as a lawyer in advising clients. I have had the pleasure of doing this for 40 years and I've watched the perceived abuses, and I don't call them abuses, we could just take advantage of certain provisions. And it all started back in the '70s and the '80s when we would take a corporation that would be worth $1 million, we'd create $900,000 of preferred stock non cumulative. An appraiser would say that stock is only worth $700,000 because it's not going to be paying a dividend, and then we would gift away the common at $100,000 and then we would sell the preferred back at a lower number. That was solved by Chapter 14. Now I want to talk about what is perceived to be the abuses with Chapter 14, in particular 2704. And in my experience it is not with operating businesses. When the issues that you've addressed, such as requiring a minimum ownership, what I have seen that clients that do that are doing it with making gifts to charity of interest in family limited partnerships or LLCs that have marketable securities. And they do it to take advantage of state law. Operating businesses don't do that in my experience.

And the two things that I see happening deal with marketable securities and family limited partnerships and limited liability companies. And what has happened is that we as lawyers have rushed to the state legislature and encouraged the state legislature to have laws that are favorable to discount planning, but clients with operating businesses don't take advantage of that. It's clients that are wealthy clients that come in and say I've got a portfolio of $10 million, $20 million and I want to reduce the estate tax, how can we do it. We dump it into a limited liability company, we make a gift to charity, and then when the individual dies you can't liquidate it. We have an appraiser that says it's worth $.70 on the dollar. Clients don't do that with operating businesses. You look at the Tax Court cases that struggle with valuation, and what are they about? They're generally not about operating businesses, they're about marketable securities, whether it's an interest in a large closely held company that's marketable or what. And so what I'm afraid has happened is that you've used a shotgun when you should have used a rifle, because I think these rules would be applicable to non-operating businesses, or entities that don't own business interest. Then I think a lot of the rules make sense and would shut some of the stuff that's going on down.

Also, when you look at the state law issues, and I can share your concern about how there's been a rush to the bottom of states to make discount planning very attractive. And I can recall -- I've -- through presentations and -- would have been talking about the 2704 proposed regs for 10 years, and we would always be asked for a prediction of what they would do. And what most of us would say is that it would be a surgical strike aimed at marketable securities, partnerships, and state law. And that what we'd end up doing is Treasury would issue regs that would require a business purpose, similar to what you see the Tax Court doing and just go for that. And then on state law they would look at applicable state law in 1990, or the uniform acts, because that would end up shutting that down. And I understand your concern about deathbed transfers, and I think that was a surgical strike. And other than the issue of retroactivity, which will get resolved,

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that works. But I'm afraid that what you've done is use a shotgun when a rifle would have been a better strike.

So what I commend is -- and there has to be some lack of clarity, which I'm sure everybody has talked to you about -- but what I commend and suggest you think about is to carve out operating businesses, look at applicable restrictions of being a uniform act of the 1990 law, and then just make the three-year rule not retroactive. I think you have not heard anybody today come in and lobby for marketable securities partnership discounts. And there's a reason. There's a reason. There's not a lobby for that. And, you know, I would hate to see you eliminate it because we have been successful with that. But from a sense of fairness I can understand why you would.

Well, I could stand here for another four minutes, but I want to thank you for your patience today in hearing all of us out. Let's give them a hand. (Applause)

MS. CHYR: Thank you, Mr. Belcher. We did skip over a scheduled speaker, is she in the room? Samantha Jachion with the New York Law School?

Okay. Well, that concludes our scheduled speakers. We would like -- we're interested in hearing other speakers who are not scheduled to speak today. If there are any please raise your hand.

Okay. Well, that concludes our hearing and we appreciate all of your comments. We will take them all under advisement.

SPEAKER: Thank you.

SPEAKER: Thank you.

SPEAKER: Thank you.

(Whereupon, at 3:54 p.m., the HEARING was adjourned.)