Agent and Advisor Guide to
Advanced Markets Concepts

Reducing Transfer Taxes Through Discounting

Do you have clients with substantial wealth who could benefit by transferring assets at a fraction of their fair market value?

Minority interests in certain types of entities (i.e. Family Limited Partnerships, Family Limited Liability Companies, etc.) can be transferred for less than the value of the assets owned by the entity. This is because the ownership of a minority (i.e. non-controlling) interest in a family business does not: (1) provide the ability to control the entity or its underlying assets; or (2) provide a market where the ownership interest can be freely transferred to non-family members. This lack of control and lack of marketability reduce the value of the business interest and therefore allows a reduction in transfer (gift and/or estate) taxes.

Lack of Control Discount

This discount is often applied to transfers during life or at death and reflects the inability of the minority owner to control the entity and the assets owned by the entity. Minority owners cannot dictate management decisions regarding the entity's direction; cannot dictate investment decisions regarding the entity's assets; and are at the mercy of those who "control" the entity. Lack of control discounts are applicable not only to "minority interests" (less than 51% ownership) but can be applied to "non-voting" and "limited" interests in the entity. Typical discounts for lack of control generally range between 20 percent and 30 percent.

Lack of Marketability Discount

This discount is often applied to transfers of minority interests because of the inability to negotiate the sale of the interest in a readily available market. Most family-owned businesses contain specific provisions ensuring that ownership of the interests will remain within the family group. Each of these provisions, by design, reduces the owner's ability to sell his/her interest and thereby reduces its value.

Several factors can influence the level of discount for lack of marketability. These factors include, but are not limited to, the entity's asset mix (i.e. marketable securities, real property, etc.) and transfer restrictions contained in the entity's legal documents. Typical discounts for lack of marketability also range up to 30 percent.

Bottom Line

Valuable assets such as a successful family business, real estate, etc., can be transferred to the next generation in a very tax-efficient manner. Parents can gradually give away business units which represent the bulk of the economic ownership of the entity while maintaining control of the business. Discounting for transfers of minority interests, limited interests and/or non-voting interests can be an effective way to transfer significant amounts for a fraction of the overall value. These discounts must be determined by a qualified appraiser in conjunction with an experienced estate planning attorney.

The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. For Advisor Use Only.

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