CODE §§ 2701–2704 LET'S VALUE THE VALUATION CODES: CAN WE ASK FOR CHANGES OR USE DEFERENCE TO GET AROUND THEM?

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ABSTRACT

The Valuation Codes found in Chapter 14 of the Internal Revenue Code are confusing, overly complex, and act as a trap for family-owned businesses trying to make legitimate wealth transfers. These codes, designed to curb tax abuse, unintentionally penalize families through the creation of excessive tax consequences and make estate and business planning unnecessarily difficult. This Comment breaks down each section, highlighting the issues it creates and proposes changes to simplify the rules and reduce their negative impact on family businesses. Since legislative and court changes take time, this Comment also explores how Internal Revenue Service rulings and workarounds can be used to avoid these traps in the meantime. Finally, it examines how the Supreme Court's decision in Loper Bright Enter. v. Raimondo—overturning broad deference to agency interpretations—could affect Internal Revenue Code guidance and what this means for navigating Chapter 14. Family businesses can be better positioned to survive and thrive across generations through making these changes or strategically working around the current rules.

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I. INTRODUCTION

In 1990, Congress passed the Omnibus Budget Reconciliation Act, containing the puzzling Chapter 14 Valuation Codes (the Codes) of the Internal Revenue Code (IRC).[1] The Codes were established to prevent perceived tax abuse by estate planners using estate strategies to minimize taxation during family-held entity transfers.[2] While the Codes were initially created to prevent estate freezes, Congress took this opportunity to target other types of transfers between family members.[3] There are three major issues with the Codes: (1) not enough people are aware of it; (2) those who are aware of it, but find it confusing; and (3) those who know how to use it and realize it complicates matters for family businesses—the Codes demonize transfers within family businesses that would otherwise be bona

1. Bradley T. Borden et al., *Tax Flotsam of Partnership Mergers and Divisions*, 77 TAX LAW. 425, 493 (Feb. 9, 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4722044 [https://perma.cc/AC5V-PMQS].
2. *Id.*
3. *Id.*

fide, effectively squashing incentives to keep family businesses in the family.[4] The base objective for many of these families is not to evade taxes owed to the Internal Revenue Service (IRS), but to keep their family business around for generations.[5] For many people unaware of these rules or who do not understand how to use them, violating these rules can lead to extreme tax consequences and hefty fines, deterring business owners from structuring their business in a way that will incentivize the younger generations to stay in the business.[6]

American family business owners typically have a desire to keep the companies within their family.[7] Currently, 35% of Fortune 500 companies are family-owned enterprises.[8] These family-owned businesses significantly contribute to the economy, representing 64% of the gross domestic product and 62% of the overall employment in the nation.[9] Despite these optimistic statistics, family businesses face extreme challenges in staying around for more than three generations.[10] Only 30% of family-owned businesses survive from the first generation to the second.[11] Furthermore, only 10% of the 30% progress from the second generation to the third.[12] Many of these families had the desire to pass down the business to family members but were not capable of success.[13] Implementing new changes and educating those unaware of the Codes could allow family businesses to incentivize younger generations to stay in the business thus, increasing the success of family businesses in America.[14]

Family businesses are integral to the vitality of local communities and significantly contribute to the community's economic prosperity.[15] These enterprises frequently provide employment opportunities within the community, which in turn drives economic development.[16] Moreover, family businesses are generally more conservative in their approach to risk, enabling them to better withstand economic downturns compared to standard businesses that are more susceptible to conventional economic cycles.[17]

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4. *Id.*
5. *Id.*
6. *Id.*
7. Claudio Fernández-Aráoz et al., *Leadership Lessons from Great Family* Businesses, HARV. BUS. REV. (Apr. 2015), https://www.administratorindependent.ro/uploads/doc/resurse/Leadership-Lessons-from-Great-Family-Businesses.pdf [https://perma.cc/ST5P-P5LF].
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. Alfonso Chiner, *10 Reasons Why We Need Family Businesses*, IESE FAM. BUS. BLOG NETWORK (Jan. 12, 2022), https://blog.iese.edu/family-business/2022/10-reasons-why-we-need-family-businesses/ [https://perma.cc/5PG4-6FKL].
16. *Id.*
17. *Id.*

Family businesses also tend to uphold community values and possess a long-term vision that remains stable amid changing social trends.[18] Overall, there is a pronounced commitment to growth within these communities fostered by family-owned enterprises.[19]

First, this Comment seeks to analyze the Codes because understanding each section and its complexities is crucial for effective change.[20] Second, this Comment will provide suggested changes that should occur in each section of the Codes to lessen the previously discussed complexities and incentivize family businesses to last longer.[21] Consequently, the IRS has released numerous rulings and regulations involving the use of these Codes and the author of this Comment understands that change is not a quickly occurring event.[22] Third, this Comment discusses how to use the different tools the IRS has released to work around these complicated problems created by the Codes.[23]

This Comment will follow a hypothetical family business, Wolf Enterprises, that Gene, Sherri, and their two kids, Tyler and Clint, own.[24] Wolf Enterprises is a family-owned business renowned for its handcrafted wooden furniture.[25] Gene and Sherri, the founders, started their journey in their garage over two decades ago, blending their passion for woodworking with a strong commitment to quality and sustainability.[26] They often spend their time making tables and want the boys to continue in this lucrative business that they have spent nearly half of their life growing from the ground up.[27] Over time, they have used their funds to explore other income-generating activities and have transformed their business into a multimillion-dollar company.[28] This Comment will provide examples of the family business as the Codes currently stands and how the transactions will change with the new code section implementations this Comment proposes.[29]

18. *Id.*
19. *Id.*
20. *See* discussion *infra* Part II.
21. *See* discussion *infra* Part III.
22. *See* discussion *infra* Part III.
23. *See* discussion i*nfra* Part III.
24. Author's original thought (For simplicity in this already complex topic, this Comment will not explore the differences in how structuring different entities could impact the final results of the transfers, which is outside the scope of this Comment).
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*
29. *See* discussion *infra* Parts II–III.

II. BACKGROUND

A. The Negative Impact of Chapter 14 Valuation Codes on Estate Planning and Family Business Transfers: Challenges and Considerations for Estate Freezes

Congress created the Codes to prevent perceived tax abuse by estate planners who created estate freezes for their clients.[30] The legislative history shows that Congress believed these families solely used estate freezes to reduce the value of taxable estates.[31] Whether reducing the taxable estate was a nefarious act, the subsequent rules created proved detrimental to business planning and transfer valuation within family businesses.[32] In Chapter 14 Valuation Codes, there are two different types of provisions: the "Deemed Gift Provisions" and the "Disregard Provisions."[33] The main focus of this Comment is on the deemed gift provision in Section 2701, but this Comment will also touch on the deemed gift provision in Section 2702 because many of the proposed changes to implement in Section 2701 also apply to Section 2702.[34] Lastly, this Comment will also give explanations for Section 2703 and Section 2704 with possible changes to those sections as well.[35]

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30. Todd N. Angkatavanich, *Chapter 11 Floating Cars – Moving Staircases Understanding the Mystical Rules of Chapter 14 in the Muggle World*, 58 UNIV. MIA. L. CTR. ON EST. PLAN. 1100, 1101 (Oct. 2024).

31. *Id.*

32. *Id.*

33. *See generally id.* ("The 'Deemed Gift Provisions' are found in three sections of the Code: § 2701, relating to recapitalizations and other types of "transfers" of business interests where different economic classes of equity are involved; 5 § 2702, relating to transfers (and deemed transfers) to trusts with retained interests and joint purchases of property; 6 and § 2704(a), relating to lapses of liquidation or voting rights. Generally, the deemed gifts determined under these provisions are created by applying a 'zero valuation' concept (except for § 2704(a) which determines the value of a deemed gift, or increases the value of an asset for estate tax purposes by measuring the difference in the value of the interest immediately prior to the lapse of a right versus its value immediately after the lapse), which assigns a value of zero to an interest in a business or trust that is held or retained by senior family members. These provisions have the potential to result in a deemed gift of some or perhaps even all of the value of the business or other interests in connection with transfers of certain interests in which another interest is retained.

The 'Disregard Provisions' refer to the Chapter 14 provisions that have the effect of ignoring or disregarding, for transfer tax purposes, certain agreements or restrictions that would otherwise artificially assign a lower value to a business interest or would artificially reduce its value for estate or gift tax purposes. These provisions are included in Code §§ 2703 and 2704(b).").

34. *See* discussion *infra* Parts II–III.

35. *See* discussion *infra* Parts II–III.

1. Navigating Section 2701: Implications for Estate Freezes, Preferred Partnerships, and Gift Tax Planning

Deciphering Section 2701 is challenging, yet developing a strong understanding of this section reveals its pitfalls and enables one to see the necessary changes that need to occur.[36]

a. Understanding the Estate Freeze and the Issues Estate Freezes Cause

To effectively comprehend the complexity of Section 2701, it is crucial to understand the estate freeze—the tactic Congress sought to prevent with the introduction of this code.[37]

An estate freeze is a financial strategy that involves creating two distinct classes of stock within a legal entity, such as a corporation.[38] This method is often utilized to lock in the current value of an individual's estate for taxation purposes while allowing future appreciation to be transferred to lower generations.[39] In this setup, the original owner retains a class of stock that represents the current value of the entity, effectively freezing their estate's value at that point in time.[40] Meanwhile, a second class of stock is created, often with minimal or no current value, then it is gradually transferred to succeeding generations.[41] There is also preferred stock, which will grow at a certain percentage and once it reaches the threshold percentage, any other growth is given to the common stock.[42] Parents, who own the business, would own the preferred stock so their kids could receive any excess growth without it being included in the parents' estate.[43] This enables any future growth in the value of the entity to accrue to the second class of stock rather than increasing the senior generation's estate thus, reducing future estate tax and facilitating wealth transfer.[44]

Gene and Sherri are the owners of Wolf Enterprises, and they have two children, Tyler and Clint.[45] Gene and Sherri have recently decided they do

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36. *See* discussion *infra* Section II.A.1.a.

37. Julia Kagan, *Estate Freeze How It Works and Wealth Planning*, INVESTOPEDIA (Sept. 10,2025), https://www.investopedia.com/terms/e/estate_freeze.asp [https://perma.cc/9CUP-MNY3].

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. Author's original thought (The variations in structure can lead to minor changes in how we define certain terms. For the purposes of this discussion, we will specifically refer to these terms as "the organization" and "the enterprise." Understanding these distinctions is crucial, as organizations typically focus on specific operational goals and activities, whereas enterprises often encompass a broader scope, including strategy, innovation, and overall market presence. By clarifying these definitions, we can better explore their implications and relevance within different contexts).

45. *Id.*

not want to give up control of Wolf Enterprises, but are willing for Tyler and Clint to become part of the organization.[46] So, Gene and Sherri create two levels of stock in Wolf Enterprises: preferred stock and common stock.[47] The parents hold the preferred stock and give the common stock to the children.[48] The preferred stock holds all the voting rights in Wolf Enterprises but only up to 5% of growth in the organization.[49] Any growth in the organization that exceeds 5% is then passed to the common stock.[50] This planning tool allows Gene and Sherri to give Tyler and Clint a share of the company without giving up any controlling ownership, effectively reducing their gift and estate tax during their life and after death—or so they thought.[51]

Gene and Sherri had no nefarious intent in creating this tax structure, but Congress targets this type of creation.[52] The legislative history from Congress suggests that a structure like Gene and Sherri's is likely to face challenges, irrespective of the intentions behind it.[53] This is because the control exerted by the senior generations can lead to an inflated value of the junior stock—given that the senior generation still retains sufficient control that is not reflected in the value of the stock.[54] Even if the structure was not established for nefarious tax purposes, the fact that it incentivizes the junior generations to participate in the business is irrelevant, but other parts of the Codes shows Congress has a desire to keep family businesses around.[55]

b. The Subtraction Method Introduced to Curb the Effect of Estate Freezes

Section 2701 is used to determine the gift value when a family member transfers part of a business to an applicable family member, and the transferring family member holds on to an applicable retained interest or discretionary distribution right after the transfer.[56] There are no specific instructions in the Codes on determining the value of this transfer, so the next step in determining the gift value is to look at the Treasury Regulations.[57] In

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46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. Treas. Reg. § 25.2701-1.
54. *Id.*
55. *See generally* I.R.C. § 6166 (discussing how a decedent that owned part of a family business can have tax reductions in his estate because the IRS seeks to incentivize family businesses).
56. *See* Treas. Reg. § 25.2701-1(d)(2) (defining "member of the family" and "applicable family member" "(d) Family definitions—(1) Member of the family**.** A member of the family is, with respect to any transferor—(i) The transferor's spouse;(ii) Any lineal descendant of the transferor or the transferor's spouse; and (iii) The spouse of any such lineal descendant. (2) Applicable family member. An applicable family member is, with respect to any transferor—(i) The transferor's spouse; (ii) Any ancestor of the transferor or the transferor's spouse; and (iii) The spouse of any such ancestor.").
57. I.R.C. § 2701.

the Treasury Regulations, there are step-by-step instructions on how to determine the value of the transfer.[58]

The "Subtraction Method" is used to determine the amount of the gift value resulting from the transfer of a senior equity interest to a junior equity interest.[59] The first step in the Subtraction Method is to determine the fair market value of all family-held equity interests in the entity after the transfer occurs.[60] There are certain assumptions made in determining the fair market value, but those are outside the scope of this Comment.[61] The second step is to subtract the senior equity interests from the value determined in step one.[62] The amount of the senior equity interest is determined by the fair market value of the family-held senior equity interests, not including any retained interests.[63] Then, the value of those retained interests are subtracted out at fair market value, or if it is an applicable retained interest or discretionary distribution right they are subtracted out at a value of zero.[64] The third step is to allocate the remaining value to the common interests remaining in the entity.[65] The fourth, and final step, is to determine the amount of the gift by applying any adjustments to the amount determined in step three.[66] These four steps, under Section 2701, provide the value of the gift after it has been transferred from a senior family member to a junior family member.[67]

Section 2701 introduced a "zero-value" rule in the Subtraction Method for valuing certain attributes at zero for transfers to junior members to combat estate freezes.[68] So, whenever a senior member holds an applicable retained interest or discretionary distribution right, instead of valuing it at the amount the family business would (or what the fair market value of the interest would be), Section 2701 values it at zero.[69] The senior member can still get credit for other rights they have retained, but any applicable retained interest or discretionary distribution right they have retained will be valued at zero.[70]

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58. Treas. Reg. § 25.2701-3.
59. *Id.*
60. Treas. Reg. § 25.2701-3(b)(1).
61. *Id.*
62. Treas. Reg. § 25.2701-3(b)(2)(i).
63. *Id.*
64. Treas. Reg. § 25.2701-3(b)(2)(ii).
65. Treas. Reg. § 25.2701-3(b)(3).
66. *See generally* Treas. Reg. § 25.2701-3(b)(4) (Examining several important adjustments that play a crucial role in accurately assessing value is discussed in step four. First, there is the application of minority discounts–which are reductions in value applied to ownership interests that do not confer control over the entity. Additionally, consider adjustments related to transfers that have retained interests, meaning situations where the transferor maintains some level of interest or ownership in the asset even after the transfer. Lastly, look at reductions for consideration, which refers to any compensation received by the transferor in exchange for the gift, provided that this amount does not exceed the total value of the gift itself. These adjustments ensure that the valuation reflects a more precise market reality).
67. Treas. Reg. § 25.2701-3.
68. Treas. Reg. § 25.2701-2(a).
69. *Id.*
70. *Id.*

There are two types of rights after the transfer is valued at zero for the purpose of the Subtraction Method: "extraordinary payment rights" and "discretionary distribution rights."[71] "An extraordinary payment right is any put, call [(including any warrant, option, or other right to acquire one or more equity interests)], or conversion right, any right to compel liquidation, or any similar right, the exercise or nonexercise of which affects the value of the transferred interest."[72] A discretionary distribution right is the right to receive distributions at any time from the equity interest.[73] There are some exceptions to distribution rights that do not receive a value of zero.[74] For example, if the right to receive comes from an interest in the same class or subordinate class, then the class is transferred.[75] Other examples include, if the right to receive the payment is mandatory and not discretionary, if it is a right to participate in a liquidating distribution, if it is a guaranteed payment with a fixed amount under Section 707(c) determined by a fixed rate, or if it is a non-lapsing conversion right, then the distribution right will not be valued at zero.[76] Essentially, if the distribution right is a discretionary distribution right, then it will have a value of zero.[77]

c. The Safe Harbors and Pitfalls in the Code

Similar to the rights that do not receive a value of zero, there are family transfers that completely avoid the use of Section 2701.[78] When the transfer involves equity of the same class which carries the same rights, Section 2701 does not apply.[79] Additionally, if there are available marked quotes for the equity interest, Section 2701 is not applicable.[80] A common workaround for Section 2701 is known as the "vertical slice."[81] This is when the senior member transfers the same percentage of both common and preferred stock to the junior member equity interest, causing an equal reduction in both common and preferred stock.[82] For example, if Gene holds 3% preferred stock and 2% common stock in Wolf Enterprises and gives 1% of both preferred and common stock to Tyler, the transfer would leave Gene with 2% of the preferred stock and 1% of the common stock.[83] This transfer would not

71. *Id.*
72. Treas. Reg. § 25.2701-2(b)(2); *see* Angkatavanich, *supra* note 30, at 92.
73. Treas. Reg. § 25.2701-2(b)(3).
74. Treas. Reg. § 25.2701-2(b)(4).
75. *Id*.
76. *Id.*
77. *Id.*
78. *See* Angkatavanich, *supra* note 30, at 108.
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*

trigger the use of valuation under Section 2701.[84] This is also favored by tax planners because it avoids Section 2701, ultimately helping them avoid the unintended consequences of improperly handling a Section 2701 transfer.[85]

Section 2701 has unintentional pitfalls.[86] These pitfalls are easy to trigger, which disincentivizes tax transfers that could trigger the gift value under Section 2701.[87] This problem discourages family businesses from making transfers that could keep the family business alive for generations.[88] Often, if the gift value is done improperly, a senior member could unintentionally use their lifetime gift tax exemption amount without realizing it.[89] Moreover, a family business might not be aware there is a Section 2701 issue until they are attempting to sell the business and a new attorney finds the issue, which could squash the sale and impose harsh tax consequences on the company.[90] Because of these issues, Section 2701 needs effective changes that do not disincentivize keeping family businesses around for generations.[91]

2. Navigating Section 2702: The Role of GRATs, QPRTs, and Deemed Gift Provisions in Estate Freeze Planning

Section 2702 and its validity are currently on petition in the Tax Court; however, the outcome of this case could potentially change the way regulations are interpreted.[92] Section 2702 is the statutory basis for grantor retained annuity trusts and qualified personal residence trusts, but it also includes note recharacterization, grantor-retained income trusts, remainder interests, and joint purchases.[93] Similar to Section 2701, Section 2702 is a deemed gift provision that uses very similar zero-value rules.[94] This means that any retained interest that is kept is valued at zero, so taxes are paid as if the whole interest has been given away.[95] Different from Section 2701, Section 2702 applies to transfers within the trust to a family member in which the donor retains an interest.[96] While Section 2701 is multi-step, Section 2702 is blunt.[97] If Section 2702 is violated, the entire retained interest is zero, and

84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id*; *see generally Estate Tax*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax[http://perma.cc/MD4Z-73GZ] (last visited Jan. 24, 2025) (discussing the current estate tax exemption of $13.99 million).
90. *See* Angkatavanich, *supra* note 30.
91. *Id.*
92. Elcan v. Commissioner, T.C. No. 3405-25 (*pet. filed* March 14, 2025); Author's original thought.
93. I.R.C. § 2702.
94. I.R.C. § 2702(a)(2).
95. I.R.C. § 2702(a)(1).
96. *Id.*
97. *See* I.R.C. § 2701; *see* I.R.C. § 2702.

the entire transfer is deemed to be a gift for estate purposes.[98] This is different than 2701 because some retained rights are valued at zero while others are given full value for the Subtraction Method.[99] There are a few exceptions to this rule and the main exception is a grantor retained annuity trust.[100]

Before Section 2702 was implemented, a grantor could put money in a trust and the grantor would retain the right to the income.[101] A grantor would file a gift tax return using the assumed income over the next fifteen years and the retained income would be subtracted.[102] For example, if the grantor puts $100 in a trust, the retained income interest would be $40 and the taxable gift would be $60.[103] Now, with a grantor-retained income trust, the retained income interest is not subtracted, so the taxable gift would be $100 when the transfer occurs.[104]

Section 2702 uses a four-part Subtraction Method in order to value the common/subordinate interests.[105] To determine the value of the interest, a person must (1) conduct a valuation of all family-held equity interest, (2) subtract the value of the parent's retained senior equity interest (i.e., the preferred interest), (3) allocate the remaining value to the common/subordinate interests, and (4) determine the taxable gift value of the transferred common interest (apply discounts, consideration offset).[106]

A grantor-retained annuity trust (GRAT) is a trust a grantor creates.[107] This type of grantor trust is essentially an estate freeze, but instead of an outright estate freeze, it is one where the assets are in a trust.[108] Because of this particularity, the rules of Section 2701 do not apply, and instead, 2702 kicks in.[109] This is a major inconsistency in the rules because it is a workaround for the estate freezes that are not allowed.[110] Section 2701 could be abolished if we are going to allow estate freezes inside trusts.[111] In a GRAT, the retained interest is not valued at zero but rather is given the appropriate amount of credit for the retained interest thus, reducing the amount of gift tax that is paid.[112]

98. Treas. Reg. § 25.2702-2(b).
99. *Id.*
100. *Id.*
101. *See generally* Treas. Reg. § 25.2702-2 (discussing the different valuation rules under I.R.C. § 2702).
102. *See id.*
103. *See id.*
104. *See id.*
105. *See id.*
106. *See id.*
107. *See id.*
108. *See id.*
109. *See id.*
110. *See id.*
111. *See id.*
112. *See id.*

There are certain structures that are required for GRATs to use to get around this rule.[113] GRATs must have a fixed amount that cannot change once it is established.[114] GRATs do self-adjust for any incorrect valuation, so it does have to be structured in accordance with some code rules and are not a free-for-all.[115] There can be no payment of debt obligations in GRATs.[116] Once the GRAT is created, there can be no additional contributions to it, so plan accordingly.[117] There can be no prepayment from a GRAT.[118] This is not like a typical trust in which the trustee has the ability to make discretionary payments to the beneficiary.[119] All payments are on a tight schedule and cannot be altered to benefit anyone once the GRAT has been created.[120] In the end, if a family is looking to create an estate freeze, a GRAT is an excellent alternative.[121]

3. Navigating 2703: Challenges and Exceptions in Buy-Sell Agreements, FLPs, and Family Business Planning

Section 2703 was specifically crafted to prevent unfair "sweetheart" buy-sell agreements, which can undermine the integrity of business valuations.[122] In the case of *Holman*, the existence of the right of first refusal is disregarded because it is employed in a manner that artificially lowers the value of the business.[123]

Section 2703 deals with the issues that arise in buy-sell agreements, options, family limited partnerships, multigene split dollars, and derivatives.[124] A transfer for tax purposes is when an individual disregards any option, agreement or right to acquire or use property (at less than fair market value), or restriction on the right to sell or use property.[125] It is extremely difficult to overcome the presumption that one should not disregard the transfers for tax purposes.[126] There is the possibility that this can create a loss of the marital deduction.[127] Certain exceptions exist within

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113. *See id.*
114. *See id.*
115. *See id.*
116. *See id.*
117. *See id.*
118. *See id.*
119. *See id.*
120. *See id.*
121. *See id.*
122. *See* Angkatavanich, *supra* note 30, at 51.
123. *See generally* Holman v. Comm'r of Internal Revenue, 130 T.C. 170, 172 (U.S.T.C. 2008) (explaining new law around artificially lowering the value of family businesses by using buy-sell agreements between family members).
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*

this section and are notably challenging to navigate.[128] A request for a new ruling from the court to adjust these exceptions, aiming to reduce the stringent criteria currently in place, could potentially make meeting the standards of Section 2703 easier.[129] This would ultimately facilitate a more manageable burden for those seeking to overcome these exceptions.[130]

First, it must be a bona fide business agreement.[131] Second, it cannot be a device to transfer property for less than full and adequate consideration.[132] Third, it must be a comparable agreement to similar arm's length agreements.[133] The agreement cannot be a testamentary disposition agreement.[134]

4. Navigating 2704: Lapses and Family-Controlled Entities in Estate and Gift Tax Planning

Section 2704 addresses lapses and family-controlled vehicles and is often regarded as the most esoteric section of the tax code.[135] While Section 2701 may be deemed the most complex, Section 2704 has secured the title of "most outdated."[136] This estate tax provision considers the disappearance of voting or liquidation rights in family entities as transfers subject to estate or gift tax.[137] There are indicators to determine whether this provision will apply, such as: Did the family maintain control before or after the lapse?[138] More often than not, the answer is in the affirmative—suggesting that these rules are always relevant.[139] This creates a significant pitfall that could lead to unexpected gift tax liabilities.[140] Fortunately, there are existing strategies to navigate around this section.[141]

It is important to restructure entities to when some are voting and some are not voting, so if there is a transfer of ownership in a particular entity, there are no changes in the voting rights.[142] It is also important to be wary of eliminating voting rights in transfers or at death.[143]

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128. *Id.*
129. *Id.*
130. *Id.*
131. I.R.C. § 2703(b)(1).
132. I.R.C. § 2703(b)(2).
133. I.R.C. § 2703(b)(3).
134. *See* Angkatavanich, *supra* note 30, at 51.
135. *See* I.R.C. § 2704.
136. *Id.*; *see* I.R.C. § 2701.
137. *See* Angkatavanich, *supra* note 30, at 75.
138. *Id.*
139. *See* I.R.C. § 2704.
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.*

B. Deference and How It Has Changed with Recent Court Rulings

This Comment will suggest changes to sections of the Codes, but it is a lengthy process.[144] Gene and Sherri do not want to wait until the next legislative session for these proposed regulations to pass, nor wait for a court to rule otherwise.[145] The next step for them is to look at what the IRS has released to see how much they can reduce their taxes by hopefully disregarding some of the IRS rulings and regulations.[146] With recent changes to agency deference, a look into agency regulations could be beneficial to Gene and Sherri.[147] Changes are always necessary, but changing the Codes and adding new questions to forms is a lengthy process that takes time and effort from multiple parties.[148] In the meantime, it is important to understand how to use the Codes to the advantage of the taxpayer.[149]

In 2024, the Supreme Court overturned a long-standing doctrine coined "Chevron Deference."[150] The theory behind *Chevron* was a two-step framework used to interpret statutes that executive branch agencies administered.[151] The first step in this framework is to look at if Congress has spoken directly on the issue.[152] If they have, and only if the intent is clear, then there is no need for further analysis and the agency interpretation is dismissed.[153] If Congress has spoken on an issue and it is ambiguous or silent to an issue, then the court must refer to the agency's interpretation.[154]

In *Loper Bright*, the Supreme Court turned to the Framers' intent in creating the foundation of democracy for the United States.[155] The Framers intended that the courts would be the final interpreter of any law.[156] The only reason the courts had given deference to agencies was because they were "able" men, so courts treated these interpretations as fact.[157] The courts have always had the ability to seek aid from these able men, but it was not the intent of the Framers for these men to have the final say on the interpretation of the law.[158]

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144. *See* discussion *infra* Part III.
145. Author's original thought.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.*
150. *See generally* Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 839–841 (1984) (discussing now outdated deference to agency interpretations).
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *See generally* Loper Bright Enters. v. Raimondo, 603 U.S. 369, 370–72 (2024) (explaining the new changes to agency law and how interpretations are going to be scrutinized by the courts and not given full weight to the interpretations of the agencies).
156. *Id.*
157. *Id.* at 386.
158. *Id.* at 410–12.

The Supreme Court engaged in an in-depth discussion regarding the various tiers of delegation it planned to implement.[159] The Supreme Court examined the implications of each level, considering how authority might be distributed among different branches of government, and analyzed the potential impact on governance and the rule of law.[160] Each proposed level of delegation was evaluated in terms of its effectiveness, transparency, and accountability to ensure that the constitutional framework was upheld while addressing contemporary challenges.[161]

III. Fixing the Code with Changes, Court Rulings, and Statutory Interpretations

A. Asking for Changes

Under the current Codes, a transfer in Wolf Enterprises is valued as follows: Gene and Sherri own 100% of the preferred stock valued at $15 million and 100% of the common stock valued at $10 million in Wolf Enterprises.[162] They then transfer 100% of the common stock to Tyler and Clint, holding onto all the discretionary distribution rights valued at $5 million.[163] Next, they use the Subtraction Method to calculate the value of the gift.[164] Step one is to determine the fair market value of all family-held equity interests in the entity after the transfer occurs, which is $25 million.[165] Step two is to subtract the senior equity interests from the value determined in step one, and give the discretionary distribution right the value of zero.[166] Immediately after the transfer of all the common stock, Gene and Sherri hold $15 million in preferred stock, but the discretionary is zero, so $25 million minus $10 million is $15 million.[167] The third and final step is to allocate the remaining value to the common stock, thus the $15 million gets distributed to Tyler and Clint, making the gift worth $15 million dollars—assuming there are no adjustments to make in step four.[168]

159. *Id.*
160. *Id.*
161. *Id.*
162. Author's original thought.
163. *Id.*
164. Treas. Reg. § 25.2701-3.
165. Treas. Reg. § 25.2701-3(b)(1).
166. Treas. Reg. § 25.2701-3(b)(2).
167. Treas. Reg. § 25.2701-3(b)(2).
168. Treas. Reg. § 25.2701-3(b)(3)-(4).

1. Section 2701: Implementing New Questions on Existing 706 and 709 Forms to Avoid Hidden Pitfalls

The incorporation of a set of questions on Forms 706 and 709 would simplify the valuation process of Section 2701, ultimately reducing confusion so that fewer individuals fall into the Codes' traps and do not need knowledge of the Codes to value a transfer properly.[169] The Codes already has safe harbor transfers, but not every transfer falls into one of those categories.[170] Incorporating the proposed questions would allow transfers that do not fall into those categories to have more opportunities to avoid holding zero value and instead be valued under the Subtraction Method.[171] Currently, on Form 706 in part four, question 11 reads as follows:

> 11a. Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), an unincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation?
> b. If "Yes" to line 11a, was the value of any interest owned discounted on this estate tax return? If "Yes," see the instructions on reporting the total accumulated or effective discounts taken on Schedule F (Form 706) or G (Form 706).[172]

This Comment proposes the removal of "b," the addition of questions to Form 706, and an inclusion of the same question on Form 709.[173] The new questions would read as follows for Form 706:

> b. If "Yes," did any entity have multiple classes of stock or different economic interests?
> c. If "Yes," did you have a discretionary distribution right or an extraordinary payment right under I.R.C. § 2701?
> d. If "Yes," there is an assumption that those rights are not exercised. If those rights have been exercised, value them at zero using the Subtraction Method; if the assumption holds, value them at fair market value in determining the gift.[174]

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169. *See Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-706[https://perma.cc/Y6Y2-G6HJ] (last visited Jan. 24, 2025); *see Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-709 [https://perma.cc/KH39-GSYR] (last visited Jan. 24, 2025).

170. *See* Angkatavanich, *supra* note 30, at 108.

171. Author's original thought.

172. *See Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-706[https://perma.cc/Y6Y2-G6HJ] (last visited Jan. 24, 2025).

173. Author's original thought.

174. Author's original thought.

The questions for Form 709 would read as follows:

> 11a. Was there a transfer of "any interest in a partnership (for example, a family limited partnership), an unincorporated business, a limited liability company, or owning any stock in an inactive or closely held corporation?"
> b. If "Yes," did any entity have multiple classes of stock or different economic interests?
> c. If "Yes," did you have a discretionary distribution right or an extraordinary payment right under I.R.C. § 2701?
> d. If "Yes," there is an assumption that those rights are not exercised. If those rights have been exercised, value them at zero using the Subtraction Method; if the assumption holds, value them at fair market value in determining the gift.[175]

If all of these are answered "Yes," then use the Subtraction Method without valuing applicable retained rights and discretionary distribution rights at zero.[176] If this is implemented and Congress feels there are additional protections needed, there could be a presumption or requirement that if a senior generation retains discretionary rights, it will not be exercised, but if there is a discretionary right held by the succeeding generation, it will be fully exercised.[177] Under the current Codes, anything that is not a qualified payment is given a zero value, but the new changes would allow transfers to occur and only obtain zero value if certain standards are met.[178] Thus, following the initial desire of Congress in the creation of the Codes, but allowing family members to make transfers to incentivize succeeding generations to stay in the family business.[179] This would ensure that any false inflation of one generation's ownership is not inflated.[180] If the discretionary right is either exercised by the senior generation or not exercised by the succeeding generation, the transfer is valued at zero to ensure there are no estate freezes.[181] Still employing what Congress intended, but not diminishing family businesses.[182]

Under the proposed implementations, a transfer in Wolf Enterprises would look as follows: Gene and Sherri own 100% of the preferred stock, valued at $15 million, and 100% of the common stock, valued at $10 million, in Wolf Enterprises.[183] Gene and Sherri transfer 100% of the common stock

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175. *Id.*; *see Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-706[https://perma.cc/Y6Y2-G6HJ] (last visited Jan. 24, 2025).
176. Author's original thought.
177. Author's original thought.
178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.*
183. *Id.*

to Tyler and Clint, holding onto all the discretionary distribution rights, valued at $5 million.[184] At the end of the year, Gene and Sherri file Form 709 to report the gifts they made during the year.[185] When they get to question 11a, which asks: "Was there a transfer of" any interest in a partnership (for example, a family limited partnership), an unincorporated business, a limited liability company, or owning any stock in an inactive or closely held corporation?"[186] They answer yes and move to 11b, which asks: "If "yes," did any entity have multiple classes of stock, or different economic interests?"[187] They answer yes, and move to 11c: "If "Yes," did you have a discretionary distribution right or an extraordinary payment right under § 2701?"[188] Because they answered "Yes" to c, Gene and Sherri move to 11d.[189] Question 11d reads: "If "Yes," there is an assumption that those rights are not exercised. If those rights have been exercised, value them at zero using the Subtraction Method; if the assumption holds, value them at fair market value in determining the gift."[190]

Since Gene and Sherri have not exercised their discretionary distribution right, they will use the Subtraction Method to calculate the value of the gift, giving the discretionary distribution right fair market value.[191] The first step is to determine the fair market value of all family-held equity interests in the entity after the transfer, which is $25 million.[192] The second step is to subtract the senior equity interests from the step one value and give the discretionary distribution right the fair market value of $5 million, immediately after the transfer of all the common stock they hold $15 million in preferred stock, but the discretionary distribution right is valued at zero.[193] The third step is to allocate the remaining value to the common stock, and since Tyler and Clint own all the common stock, the $15 million gets allocated to them, making the gift worth $15 million dollars, assuming no adjustments in step four.[194]

184. *Id.*
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.*
192. Treas. Reg. § 25.2701-3(b)(1).
193. Treas. Reg. § 25.2701-3(b)(2).
194. Treas. Reg. § 25.2701-3(b)(3)–(4).

The Steps To Value a Gift:	**Zero Value**	**New Change**
Step One: Find the fair market value of all family-held equity interests in the entity.	$25,000,000	$25,000,000
Step 2(a): Subtract an amount equal to the sum of the fair market value of all family-held senior equity interests (excluding retained interest).	$10,000,000	$10,000,000
Step 2(b): Subtract the value of all applicable retained interests held by the transferor or applicable family members.	$0	$5,000,000
Step 3: Equal to the Amount Left and Allocate if necessary.	$15,000,000	$10,000,00[195]

This process fixes the main issues within Section 2701.[196] Through modification and adding the question to Forms 709 and 706, there are no longer hidden pitfalls for business owners to fall into, and there is still an incentive to keep family members in the businesses because transfers can occur without losing tax incentives.[197] There could be an argument that this is confusing, but when looking at other valuations in the Codes (for example, fair market value) there are assumptions made in appraisals, and this is no different.[198] There might also be an argument that this allows an artificial inflation of capital, but this is negated by implementing the zero-value rule if the discretionary right is used.[199] There would need to be subsequent additions to the Codes for the forms to function properly, but that is outside the scope of this Comment.[200]

Often, the Codes promote tax incentives for family members.[201] There are other parts of the Codes that encourage incorporation within families.[202] To keep consistent with the desires of Congress the Codes require a change.[203] Section 2701 is important because a generation holds the artificial inflation of the value of businesses, but at the same time, the complicated and archaic valuation process disincentivizes people to keep businesses in the family because the valuation method from family members is more egregious than for transfers outside of the family.[204]

195. *See* Treas. Reg. § 25.2701-3(b); Author's original thought.
196. Author's original thought.
197. *Id.*
198. *Id.*
199. *Id.*
200. *Id.*
201. *See* I.R.C. § 6166.
202. *Id.*
203. Author's original thought.
204. *Id.*

2. Section 2702: GRATs, QPRTs, and the Valuation Changes

The changes made in Section 2701 should be implemented in Section 2702.[205] An additional questions on Forms 709 and 706 relating to transfers in trusts could stop the gift from being valued at zero, which would render the gift moot.[206] If this change is not made, there are other ways to safely make gifts under Section 2702.[207]

GRATs and qualified personal residence trusts (QPRTs) serve as effective strategies to navigate the implications of the Codes Section 2702.[208] These mechanisms allow individuals to transfer assets while minimizing gift tax exposure.[209] By utilizing GRATs, a grantor can retain an income stream from the trust for a specified period, after which the remaining assets pass to the beneficiaries, often with reduced tax implications.[210] Similarly, QPRTs enable grantors to transfer their personal residence to beneficiaries while retaining the right to live there for a designated term.[211] This offers significant estate planning advantages, allowing for the potential appreciation of the property outside the grantor's taxable estate.[212] Both options provide a strategic approach to wealth transfer while ensuring compliance with tax regulations under Section 2702.[213] This is because, as discussed, a GRAT is quantifiable and cannot be manipulated.[214] However, there is a large pitfall for GRATs under Section 2702.[215]

> Mortality risk is perhaps the most significant downside to the GRAT; the grantor must outlive the trust term to remove all of the transferred assets from his estate under § 2036(a)(1). If the grantor dies during the trust term, then a portion (or possibly all) of the assets necessary to produce the remaining annuity payments will be included in the grantor's gross estate.[216]

205. *Id.*
206. *Id.*
207. *Id.*
208. *See* I.R.C. § 2703.
209. *Id.*
210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. Christine Quigley et al., *Unpacking the Myths and Mysteries of Chapter 14* (May 6, 2016), https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://www.proskauer.com/events/download-pdf/155&ved=2ahUKEwj86ejlse-QAxW9EmIAHaGGJLIQFnoECBYQAQ&usg=AOvVaw27QEloD2e-X7u4vuKCFWQX [https://perma.cc/8N9P-PVSN].

These retained interests have no value unless they are qualified.[217] The IRS tried to recharacterize promissory notes.[218]

According to the definitions and valuation rules:

> If section 2702 applies to a transfer in trust of tangible property described in paragraph (c)(2) of this section ("tangible property"), the value of a retained term interest (other than a qualified interest) is not determined under section 7520 but is the amount the transferor establishes as the amount a willing buyer would pay a willing seller for the interest, each having reasonable knowledge of the relevant facts and neither being under any compulsion to buy or sell . . . .[219]

If the transferor cannot reasonably establish the value of the term interest pursuant to paragraph (c)(1), the interest is valued at zero; this provision is significantly at odds with other sections outlined in Chapter 14.[220] While most provisions within this chapter adhere to a structured and formulaic approach to valuation, this particular section introduces the possibility of valuation based on the subjective assessment of what a willing buyer would pay for an asset.[221] In contrast, the other sections employ rigid methodologies that do not take into account the perspective of a hypothetical reasonable buyer, thus creating a more standardized, but less flexible, framework for valuation.[222]

This discrepancy introduces a layer of ambiguity through Chapter 14 and could lead to varying interpretations by different stakeholders, including taxpayers, tax practitioners, and representatives from the IRS.[223] The lack of a unified approach could result in confusion and disputes over valuations, complicated compliance, and enforcement of the tax code.[224] This incongruity warrants careful consideration and potential rectification to ensure that the provisions within Chapter 14 function cohesively and effectively.[225] The lack of a unified approach could result in disputes and litigation, adding complexity to estate and gift tax planning.[226] However, it could be intriguing to explore how applying this more flexible standard to

217. *Id.*
218. *Id.*
219. Treas. Reg. § 25.2702-2(c).
220. *Contrast id.* (retaining trust interests are valued at zero unless qualified), *with* I.R.C. § 2703 (ignoring certain restrictions or agreements when valuing property transfers to prevent artificial undervaluation).
221. *See* I.R.C. §§ 2701–2704.
222. *Id.*
223. *Id.*
224. *Id.*
225. *Id.*
226. *Id.*

other parts of the Codes might impact valuations throughout Chapter 14.[227] Such an approach might offer greater flexibility in certain scenarios and potentially align the valuation process more closely with real-world market dynamics, however, this approach would require a careful balance to maintain fairness and predictability in the application of tax laws.[228]

3. Section 2703: Ambiguities in Buy-Sell Agreements and the Challenges of Court-Imposed Rules

This is the shortest section of Chapter 14 with three difficult assumptions to meet:

> **§ 2703. Certain rights and restrictions disregarded**
>
> (a) General rule. For purposes of this subtitle, the value of any property shall be determined without regard to
>
> (1) Any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
>
> (2) any restriction on the right to sell or use such property.
>
> (b) Exceptions. Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:
>
> (1) It is a bona fide business agreement.
>
> (2) It is not a device to transfer such property to members of the decedent's family for less and adequate consideration in money or money's worth.
>
> (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.[229]

This short section of the Codes looks the least complex out of all of the sections but it is confusing because code regulations are difficult to adhere to, and the courts have implemented extra requirements.[230]

Section 2703 has three requirements that are code-created.[231] The three requirements are as follows: (1) the transaction must have a bona fide business purpose, (2) the transaction must not permit a wealth transfer to the natural objects of the decedent's bounty, and (3) the transaction must be comparable to similar arrangements if they were to be negotiated at arm's

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227. *Id.*
228. *Id.*
229. I.R.C. § 2703.
230. *See id.* § 2703(b).
231. *Id.*

length, between non-family parties.[232] In addition to the rules created under the Codes, courts have tacked on three additional rules that these buy-sell agreements must comply with.[233] Under the agreement, (1) the offering price must be fixed and determinable, (2) the parties must be bound during life and death, and (3) the transaction must have been entered into for a bona fide business reason and must not be a substitute for a testament disposition.[234] This creates two sets of rules that need to be considered when drafting a buy-sell agreement.[235] Some of the rules overlap, but ultimately, the court-imposed rules have turned the three-part test, into a five-or-six-part test.[236] The court has the power to interpret Codes, but this new set of rules creates ambiguity instead of clarity.[237] Not only is the ambiguity apparent, but the court-created code has some troublesome requirements.[238]

In a business context, the factors to consider upon an individual's death can differ significantly from those that apply during their lifetime.[239] This disparity highlights the need for agreements specifically tailored to address these unique business concerns.[240] Such agreements can satisfy the established legal tests and the stipulations outlined in Section 2703 without transforming into instruments that function as substitutes for a testamentary distribution or facilitate the transfer of wealth to the decedent's natural heirs.[241]

The requirement regarding testamentary substitutes should be reconsidered and potentially eliminated; as long as the other criteria are adequately met, there is no discernible risk of estate tax avoidance in this scenario.[242] Notably, the third court-imposed requirement and the first two requirements of Section 2703 essentially convey the same underlying

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232. *Id.*

233. *See generally* Est. of True v. C.I.R., 390 F.3d 1210, 1218 (10th Cir. 2004) (discussing additional requirements imposed by the courts); Est. of Lauder v. C.I.R., 64 T.C. 1, 18 (T.C. 1992) (offer must be fixed and determinable); Fiorito v. C.I.R., 33 T.C. 440, 444 (T.C. 1959) (property value for estate tax purposes may be fixed by enforceable life-and-death agreement setting sale price).

234. *Est. of True*, 390 F.3d at 1218; *Est. of Lauder*, 64 T.C. at 18; *Fiorito*, 33 T.C. at 444.

235. *Compare* I.R.C. § 2703 (ignores options or restrictions on property valuation unless bona fide business arrangement, not testamentary device, and comparable to arm's-length terms), *with Est. of True*, 390 F.3d at 1218 (discussing additional requirements imposed by courts).

236. *See* I.R.C. § 2703; *Est. of True*, 390 F.3d at 1218.

237. I.R.C. § 7442.

238. *See generally Est. of True*, 390 F.3d at 1218 (discussing additional requirements imposed by courts).

239. *See id.* at 1230–1231.

240. *See id.*; I.R.C. § 2703.

241. *Id.*

242. *Id.*

principle.[243] However, the third requirement of Section 2703—an element rooted in the tax code—presents a particular challenge.[244]

Moreover, the circumstances surrounding transfer agreements within a business environment often depend on the unique characteristics of the business in question.[245] This makes it challenging to find comparable arrangements that effectively address the pertinent business issues in unrelated entities.[246] Therefore, the states should adopt a more straightforward rule that as long as an agreement is genuine, conducted at arm's length, and not a strategy to redistribute wealth to the decedent's heirs, the valuation determined by the agreement should be upheld and respected.[247]

In relation to Section 2703, it is essential for the Codes to provide a precise definition of what constitutes a bona fide arms-length transaction.[248] The Codes should establish clear guidelines to eliminate any ambiguity surrounding this requirement.[249] Additionally, courts should conduct a thorough re-evaluation of the criteria it has previously established that contribute to the confusion in interpreting the Codes.[250] By doing so, it will enhance clarity and ensure that all parties involved have a proper understanding of their obligations and the actions that constitute compliance with the necessary provisions.[251]

4. Section 2704: Deemed Gifts, Disregarded Restrictions, and the Need for Consistency in Tax Transfer Rules

Section 2704(a) outlines a provision that treats certain transfers of property as deemed gifts for tax purposes.[252] This means that under specific circumstances, the value of the transferred property may be considered a gift, even if no actual gift transaction occurs.[253] This provision is significant for understanding how the law addresses the valuation of gifts and the implications for estate and gift tax calculations.[254] This applies to the lapse of

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243. *Compare Est. of True*, 390 F.3d at 1219 (requiring that the transaction be motivated by a bona fide business purpose rather than serve as a testamentary substitute), *with* I.R.C. § 2703(b)(2), (3) (disregarding restrictions on property valuation unless part of a bona fide business arrangement and not a testamentary device).

244. *See* I.R.C. § 2703(b)(3).

245. *See* Treas. Reg. § 20.2031–2(h) ("The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case.").

246. *See* I.R.C. § 2703.

247. *See id.*

248. *See id.* at (b)(3).

249. *Id.*

250. *Id.*

251. *Id.*

252. *See* I.R.C. § 2704.

253. *Id.*

254. *Id.*

voting rights and liquidation rights.[255] This provision treats those rights as disappearing rights.[256] If there is a transaction that causes a right to lapse during a lifetime, then it is treated as a deemed gift, or if it happens at death, it is then treated as an increase in the estate.[257] Section 2704(b) is a disregarding provision.[258] As discussed above, a disregarding process will ignore some provisions that could otherwise depress the tax of the transfer.[259] This means that for transfer tax purposes, the Codes will ignore provisions in an agreement that are regarded as fake provisions when evaluating a family-controlled entity.[260] The Codes will not give the discount that is created in the "fake" provision.[261]

Section 2704(a), commonly referred to as the anti-Harrison rule, addresses specific circumstances surrounding the transfer of interests in a partnership, particularly in relation to valuation upon the death of a partner.[262] If a general partner (GP) possesses the right to liquidate the partnership, but that right is not passed on or transferred upon their death, this situation leads to a scenario in which there is no reduction in value, even if the partnership's overall value may decline over time.[263] Consequently, because the liquidation right remains with the GP and is not subject to transfer, the partnership interest is considered a full-price transfer despite any potential decreases in its worth.[264] This principle is crucial for understanding how partnership interests are valued in the context of estate planning and tax implications.[265]

Proposed changes to the regulations under Section 2704 have been under discussion for some time now.[266] However, despite these proposals, there have been no actual amendments or updates to the existing regulations, and it appears unlikely that any modifications will be enacted in the near future.[267] In fact, a similar set of proposed changes were rejected back in 2016, highlighting the challenges in reforming these regulations.[268] Given this stagnation, it may be prudent for courts to reconsider some of its earlier rulings pertaining to Section 2704.[269]

255. *Id.*
256. *Id.*
257. *Id.*
258. *Id.*
259. *Id.*
260. *Id.*
261. *Id.*
262. *See* Angkatavanich, *supra* note 30, at 75.
263. *Id.* at 77.
264. *Id.* at 79–80.
265. *Id.*
266. *Id.* at 82.
267. *Id.* at 83.
268. *Id*. at 82.
269. Author's original thought.

A pertinent case that exemplifies the issues at hand is the *Estate of Rankin M. Smith*.[270] In this case, Rankin M. Smith held class A stock at the time of his death, which subsequently converted to class B stock.[271] The specifics of this stock conversion and its implications under the current interpretation of Section 2704 warrant a re-evaluation of past legal determinations to ensure they align with the ongoing regulatory landscape and the intent behind the regulations.[272] The court ruled that the $30 million would be included in the estate tax, even though when the class stock converted to B it became worth $2 million.[273] This ruling resulted in an $8 million loss in the transfer that the estate still had to pay taxes on.[274]

Courts should determine that, in cases such as this, the value of a stock should be assessed based on its market price at the time of an individual's death, rather than relying on its prior valuation.[275] This approach is particularly pertinent when there has been a change in the class of stock at the time of death, as it reflects the true financial standing and current worth of the asset.[276] This lapse rule can create large taxable estates in which the value is not its fair market value.[277] There should be some form of liquidation value in the Codes.[278]

There has been case law that underscores the arguments that the IRS uses.[279] For example, situations in which a stock is parent-gifted but the parent retains stock control, the IRS says that because the parent can control who benefits it is cause for gross estate inclusions.[280] So, it is important to think about clearing parents' roles as they get older.[281] One must have to do it carefully to not cause an immediate deemed gift.[282]

Section 2704(b) ignores restrictions on dissolving family-controlled entities.[283] This is because the family could remove that restriction after a transfer or take it away to increase their value later.[284] So, if there is a transfer of interest in a family-controlled interest that is more restrictive than state law, it will be ignored if it passes on its own, or if it can be removed by the family.[285]

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270. *See generally* Estate of Smith v. United States, 103 Fed. Cl. 533, 536–41 (2012).
271. *Id*. at 536.
272. *Id.* at 546.
273. *Id.*
274. *Id.*
275. Author's original thought.
276. *Id.*
277. *Id.*
278. *Id.*
279. *Id.*
280. *Id.*
281. *Id.*
282. *Id.*
283. I.R.C. § 2704(b).
284. *Id*.
285. *Id.*

B. The Advantages of Deference If the Code Is Left Unchanged: The Different Types of Guidance from the IRS and the Deference It Deserves

The process of developing and enacting newly codified law is often lengthy and complex, involving numerous stages legislation must undergo before it can be altered or officially implemented.[286] Within this context, it is important to acknowledge that significant reforms to the existing legal framework are unlikely to occur in the immediate future.[287] Therefore, it is essential to establish alternative strategies to address the issues outlined in Chapter 14 of the current Codes during this interim period.[288] Estate planners have traditionally utilized a variety of methods to navigate these complexities; however, recent developments in the interpretation of agency administrative powers have altered the landscape significantly.[289] Specifically, the recent legislation associated with *Loper Bright* introduces several ambiguities because it proposes changes still at the genesis of interpretation and application.[290] This lack of clarity raises important legal questions and presents relevant issues that have yet to be thoroughly examined in a court setting, leaving many aspects unresolved and uncertain.[291] As a result, the legal community and stakeholders are left to speculate about the potential ramifications and outcomes that could emerge from this evolving framework in the near future.[292] The unfolding situation calls for careful observation and adaptive thinking among those affected as they navigate the complexities introduced by these new legislative changes.[293]

Recently, the Court overturned *Chevron* when it issued its ruling on *Loper Bright*.[294] After *Chevron*, deference was given to agencies when interpreting their authority and regulations, so long as it was reasonable.[295] There was a two-part test to determine what was reasonable.[296] First: Is the statute ambiguous?[297] If so, then: Is the interpretation reasonable?[298] The courts let the agencies come up with reasonable interpretations to the Codes if it was ambiguous.[299] However, after *Loper Bright* was decided, it was up to the courts to figure out if something was ambiguous and no longer up to

286. Loper Bright Enters. v. Raimondo, 603 U.S. 369, 405 (2024).
287. Author's original thought.
288. *Id.*
289. *Id.*
290. *Id.*
291. *Id.*
292. *Id.*
293. *Id.*
294. *Id.* at 412.
295. *Id*. at 382–83.
296. *Id.*
297. *Id.*
298. *Id.*
299. *Id.*

the agencies.[300] The opinion of the Court in *Loper Bright* was that it has always been the job of the judiciary to say what the law is.[301] Now, courts decide all relevant questions of law and sets aside any agency action that is not found in accordance with the law.[302] *Loper Bright* only overturned implied delegations given to agencies and did not overturn express delegations given to agencies.[303]

Many experts do not think that the Treasury and IRS will need to change the way they issue rulings and regulations in a dramatic or different way, but they will need to be more deliberate in addressing issues.[304] In O*hio vs. EPA*, the Court made it clear that you cannot only acknowledge comments, you have to engage with commenters.[305]

In terms of how courts will analyze agency rulemakings, Batchelder said "I don't think the *Loper Bright* case implies that we're moving to a literalist approach."[306] Even textualists like Scalia "have emphasized that the search for best meaning involves understanding the context and purpose of the Code."[307] However, Batchelder was fearful that a few lower courts might adopt "literalist interpretations" that are problematic because they don't account for the tax code's interconnectedness."[308]

Congress has the power to tax under the Constitution, which they implement through the creation of the IRC.[309] The IRC is found in Title 26 of the United States Code.[310] The Treasury then provides its official interpretations of the IRC.[311] The IRS issues various guidance to clarify the laws created in the IRC and gives its own interpretations as to what it thinks the law means.[312] The Treasury releases Treasury Regulations, which are found in the Code of Federal Regulations.[313] The final regulations are legally binding interpretations of the IRC that provide detailed rules about the

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300. *Id.* at 382–87.
301. *Id*. at 369.
302. *Id.* at 371.
303. *Id.* at 394.
304. Ohio v. Environmental Protection Agency, 603 U.S. 279, 282 (2024); Terence Floyd Cuff, *Loper Bright Enterprises, Major Questions Doctrine, the Non-Delegation Doctrine, the Administrative Procedure Act, and Partnership Rules and Regulations*, 83 NYU ANNUAL INSTITUTE ON FEDERAL TAXATION § 14.14 (2025).
305. *See* Cuff, *supra* note 304.
306. *How Loper Bright Might Impact IRS Rulemaking*, THOMSON REUTERS (Nov. 6, 2024), https://tax.thomsonreuters.com/news/how-loper-bright-might-impact-irs-rulemaking/ [https://perma.cc/HMV5-W2P5].
307. *Id.*
308. *Id.*
309. *Tax Code, Regulations and Official Guidance*, I.R.S. https://www.irs.gov/privacy-disclosure/tax-code-regulations-and-official-guidance [https://perma.cc/VU3C-AS3H] (last updated Sept. 4, 2024).
310. *Id.*
311. *Id.*
312. *Id.*
313. *Id.*

Codes.[314] The taxpayers, the IRS, and the courts are to follow it.[315] They are an example of legislative intent.[316]

Under *Loper Bright*, perception of agency deference is likely to change.[317] There is discussion about whether this change is desirable.[318] If deference is not given to the IRS and Treasury in shaping Treasury Regulations, challenges are likely to occur in how tax law is interpreted and enforced.[319] The proposed regulations are framed as public comments but are not legally binding; nevertheless, they provide valuable insight into the interpretation of the Codes.[320] The temporary regulations offer immediate guidance, although there is an ongoing debate regarding their effectiveness and finality.[321]

The IRS uses Revenue Rulings to interpret tax laws through examples of how the law applies to specific situations.[322] These rulings serve as a way for the IRS to address common issues that arise in tax practice, offering insight into how the IRS might treat similar situations.[323] While they are binding on IRS employees, they are not binding on taxpayers or the courts, meaning that a court could rule differently in a particular case.[324] Nevertheless, Revenue Rulings are an important tool for understanding the IRS's perspective and can influence how taxpayers and practitioners approach certain tax issues.[325]

Similar to the Revenue Rulings are Revenue Procedures.[326] These explain the procedural aspects of the Codes.[327] They provide instructions on how to comply with various provisions of the Codes, including how to make certain elections, request specific determinations, or follow administrative processes.[328] Revenue Procedures are also published in the Internal Revenue Bulletin and offer practical guidance, although they do not carry the same weight as regulations.[329]

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314. *Id*.
315. *Id.*
316. Author's original thought; *see generally* Cuff, *supra* note 304 (explaining the difficulty of adhering to current laws regarding agency deference).
317. Author's original thought; *see generally* Cuff, *supra* note 304 (explaining the complexities and entanglements of current laws regarding agency deference).
318. Author's original thought; *see generally* Cuff, *supra* note 304 (stating taxpayers believe public comments are not adequately responded to).
319. *See generally Tax Code, Regulations and Official Guidance*, *supra* note 309 (explaining proposed regulation as still open to public commentary).
320. *Id.*
321. *See* Cuff, *supra* note 304, at 508.
322. *Id.*
323. *See Tax Code, Regulations and Official Guidance*, *supra* note 309.
324. *See generally id.* (stating that the Revenue Rulings are official tax guidance, not laws).
325. *Id.*
326. *Id.*
327. *Id.*
328. *Id.*
329. *Id.*

One change we may see in IRS rulemaking going forward is the language, Ravichandran predicted. "The IRS needs to focus on what it is an expert in, and on demonstrating why its rule is consistent with that expertise." And the IRS, as a tax administration expert, may be "quite different" from other agencies, he said. It has seen a lot of tax returns and many types of taxpayers and transactions—so it is "able to demonstrate that expertise."[330]

The agency issues regulations that are either legislative or interpretative.[331] Legislative regulations are those that Congress has given the IRS authority, in the Codes, to create regulations.[332] Any regulation issued, that Congress did not expressly grant, is an interpretive regulation.[333] This is granted under Section 7805(a), which gives the IRS general authority to publish interpretive rulings and regulations.[334] The ruling in *Loper Bright* brings a question to the validity of interpretive regulations that do not represent the best reading but expand on the Codes.[335] Under *Loper Bright*, the interpretative regulations are no longer stronger than what the courts could rule, because under *Loper Bright*, the Court established it is the job of the judiciary to interpret the law.[336] *Loper Bright* established that courts should rely on its own interpretations.[337]

1. Using the Changes in Deference to the Advantage of the Taxpayer

Regulations in Section 2701 show three distinct ways in which the Secretary may act, and in two of those, the Secretary is allowed to create regulations for specific circumstances.[338] Because Congress allows these regulations, they are legislative regulations, but any other regulations under the Codes are interpretive.[339] The three ways a Secretary may act read as follows:

> Except as provided by the Secretary, any difference described in subparagraph (C) which lapses by reason of any Federal or State law shall be treated as a nonlapsing difference for purposes of such subparagraph.[340]
>
> Under regulations prescribed by the Secretary, if there is any subsequent transfer, or inclusion in the gross estate, of any applicable

330. *How Loper Bright Might Impact IRS Rulemaking*, THOMPSON REUTERS (Nov. 6, 2024), https://tax.thomsonreuters.com/news/how-loper-bright-might-impact-irs-rulemaking/ [https://perma.cc/766G-8VKV].
331. *See* Cuff, *supra* note 304.
332. *See* Cuff, *supra* note 304, at 295–99.
333. *See* Cuff, *supra* note 304, at 295–99.
334. *See* Cuff, *supra* note 304, at 295–99.
335. *See* Cuff, *supra* note 304, at 295–99.
336. *See* Cuff, *supra* note 304, at 342–49.
337. *See* Cuff, *supra* note 304, at 342–49.
338. I.R.C. § 2701.
339. *See* Cuff, *supra* note 304.
340. I.R.C. § 2701(a)(2)(C).

> retained interest which was valued under the rules of subsection (a), appropriate adjustments shall be made for purposes of chapter 11, 12, or 13 to reflect the increase in the amount of any prior taxable gift made by the transferor or decedent by reason of such valuation or to reflect the application of subsection (d).[341]
>
> The Secretary may by regulation provide that any applicable retained interest shall be treated as 2 or more separate interests for purposes of this section.[342]

One of the Treasury Regulations speaks on how the indebtedness owed to the transferor can change the value of a gift.[343] This is not an area in Section 2701 that the IRS has been given implied power to interpret, so if Gene and Sherri do not like the value they compute for indebtedness under this regulation, it is possible they could include more in the calculation than what the regulation explicitly states.[344]

If Gene and Sherri come to the decision to sell their company, Wolf Enterprises, they will encounter several potential outcomes and processes to navigate.[345] Some of these options are well-established and are well-understood in the business community.[346] They may consider traditional routes such as negotiating a sale to another private entity or potentially bringing in investors interested in acquiring a stake in the business.[347] Additionally, they will have to evaluate the financial and legal implications of the sale, including tax obligations and valuation assessments.[348] More likely than not, Gene and Sherri will want to sell the company to their children, Tyler and Clint, but to ensure everything goes smoothly, they want to bring in a lawyer who knows about the sale of family businesses.[349] If the lawyer discovers that Gene and Sherri did not comply with the Chapter 14 Code, then the first step the lawyer will take is to request a private letter ruling from the IRS—as this is the quickest way to rectify any mistakes.[350] For example, if Gene and Sherri placed their personal residence into a trust, past rulings indicate that "a qualified personal residence trust is a trust [that meets all the requirements of §25.2702-5(c)]; these requirements must be [satisfied] by provisions in the governing instrument, [which must] remain in effect [for the duration] of any term interest in the trust."[351] This means that if Clint and Tyler are to receive the corpus of the trust containing the business and the

341. I.R.C. § 2701(e)(6).
342. I.R.C. § 2701(e)(7).
343. Treas. Reg. §25.2701–3(c).
344. Author's original thought.
345. *Id.*
346. *Id.*
347. *Id.*
348. Treas. Reg. § 25.2702-5.
349. *Id.*
350. *Id.*
351. *Id.*

personal residence, the personal residence must be treated as a qualified payment.[352] This mistake can cause the whole trust to be penalized, so the private letter ruling would then be used to request the mistake be excused.[353] Meanwhile, the lawyer would fix the mistake without any extra penalties that would have been incurred by the mistake.[354]

Recently, however, a new option has emerged due to the overturn of *Chevron*, which could influence their decision-making process.[355] This legal shift may open up new avenues for them in terms of regulatory compliance or reconsideration of their business structure, providing creative solutions for the sale that were previously not viable.[356] In navigating these options, Gene and Sherri will need to carefully assess their goals and the current market environment to make the best decision for the future of Wolf Enterprises.[357] It is possible that the *Loper Bright* ruling will cause changes to the deference given to the IRS, but only time will tell, as it is now within the courts' discretion.[358] Even though courts may take time to rule on the level of deference given to each type of ruling from the IRS, tax planners need to make bold steps to ensure that courts sees the rulings by bringing them to light through cases.[359] Bold planners must find the sections of the Codes that are ambiguous with the rules and use them to create change. [360] It is important to be cautious while doing this to avoid malpractice and everything must be in the best interest of the client, but it is important that these changes are made.[361]

Gene and Sherri may wish to adopt a strategic approach to tackle the pressing issues currently plaguing Wolf Enterprises.[362] One possible avenue they could explore is having their attorney initiate a lawsuit aimed at clarifying the intricate legal matters surrounding the trust that governs both the business and the residential property.[363] This legal move would likely involve the presentation of compelling evidence drawn from *Loper Bright*, particularly emphasizing the critical point that it is the courts—not administrative agencies—that hold the responsibility for resolving any ambiguities.[364] In the opinion articulated in *Loper Bright*, the judicial system has been firmly reaffirmed as the ultimate arbiter of legal interpretation.[365]

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352. *Id.*
353. *Id.*
354. *Id.*
355. *See* Cuff, *supra* note 304.
356. *See* Cuff, *supra* note 304.
357. Author's original thought.
358. *Id.*
359. *Id.*
360. *Id.*
361. *See* discussion *supra* Section III.A.
362. Author's original thought.
363. *See* Loper Bright Enters. v. Raimondo, 603 U.S. 369, 371 (2024).
364. *Id.*
365. *Id.*

The Court made it clear that it is their essential duty to define the boundaries of the law.[366] Consequently, it has consistently dealt with all relevant legal questions and retained the authority to nullify any actions that administrative bodies have taken that do not conform to established legal principles.[367] This foundational concept highlights the role of the judiciary in upholding the law, ensuring that all actions administrative entities consider align with the rule of law.[368]

IV. CONCLUSION

Family businesses face extreme challenges in staying around for more than three generations.[369] Studies have shown that only 30% of family-owned businesses make it past the first generation to the second generation.[370] After that, only 10% of that 30% make it past the second generation into the third.[371] Many of these families had the desire to pass down the business to family members but were not capable of success.[372] While not all of the failures were due to tax purposes, around 15% of family businesses failed because of planning.[373] Proper planning could lead to making a positive impact on the other 85% of reasons that businesses fail.[374]

The Valuation Codes outlined in Chapter 14 create significant obstacles for businesses attempting to execute transfers that would ensure the sustainability of family-owned enterprises.[375] These complexities hinder the ability of families to pass their businesses down through generations, ultimately leading to struggles that jeopardize the survival and growth of these foundational family institutions.[376] This situation places a strain on their legacy, making it increasingly challenging for them to thrive and flourish in the future.[377] It is not always the case that the senior generations are ready to give up control, but even if they are, they still want to incentivize the succeeding generations through the gift of stock.[378] Sadly, this transfer can do more harm than good and could result in the senior generations not making the transfer, so the succeeding generations often bail.[379] The proposed changes in this Comment address that issue through the reduction of

366. *Id.*
367. *Id.*
368. *Id.*
369. *See* discussion *supra* Section II.A.
370. *See* discussion *supra* Part I.
371. *See* discussion *supra* Part I.
372. *See* discussion *supra* Part I.
373. *See* discussion *supra* Parts II–III.
374. *See* discussion *supra* Part I.
375. *See* discussion *supra* Section II.A.
376. *See* discussion *supra* Section II.A.
377. *See* discussion *supra* Section II.A.
378. *See* discussion *supra* Section II.A.
379. *See* discussion *supra* Section III.A.

restrictions that these business owners face.[380] The creation of a less confusing and less complex code will ensure that the functions of taxation are still in play while families decide how they want to plan for the success of future generations without government overreach.[381]

This Comment articulates a request for the implementation of specific modifications, while simultaneously conveying a sense of optimism about the outcomes despite potential obstacles.[382] It emphasizes that even if these requested modifications do not materialize, there remains considerable potential to effectively navigate the intricate challenges posed by the error codes referenced in Chapter 14.[383] Addressing these challenges head-on, one can still establish and maintain a thriving family business, which is crucial for ensuring a seamless transfer of wealth to future generations.[384]

These future generations are not only enthusiastic about preserving the entrepreneurial spirit their predecessors instilled in them, but are also deeply committed to cultivating a robust free market environment.[385] They recognize the importance of resisting monopolistic practices that can stifle competition and innovation.[386] This commitment underscores a profound belief in the necessity of maintaining a balanced economic landscape that serves the interests of all participants in the marketplace.[387]

While the principle of deference plays a critical role in this context, it is essential to note that the type of deference being referenced is distinct from the typical government agency deference that has been illustrated in cases like *Loper Bright*, which effectively overturned *Chevron*.[388] The IRS, along with its various regulatory tools and frameworks, presents a unique set of challenges that requires careful handling and thoughtful consideration.[389] Unlike the unwavering laws that govern many aspects of society, the IRS's regulations are not insurmountable; there is room for interpretation and maneuvering.[390] It is indeed feasible to devise strategies that circumvent what may initially appear to be rigid or inflexible requirements, allowing for more adaptive approaches to compliance and business operation.[391] The existing framework of regulations necessitates a thorough reassessment and modification to better reflect the original purposes behind their establishment.[392] If both Congress and the judicial system opt to ignore these

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380. *See* discussion *supra* Section III.A.
381. *See* discussion *supra* Section III.A.
382. *See* discussion *supra* Section III.B.
383. *See* discussion *supra* Section III.B.
384. *See* discussion *supra* Section III.B.
385. *See* discussion *supra* Section III.B.
386. *See* discussion *supra* Section III.B.
387. *See* discussion *supra* Section III.B.
388. *See* discussion *supra* Section III.B.
389. *See* discussion *supra* Section III.B.
390. *See* discussion *supra* Section III.B.
391. *See* discussion *supra* Section III.B.
392. *See* discussion *supra* Section III.B.

shortcomings, attorneys may find opportunities to capitalize on the inherent ambiguities that exist within the current rules.[393] This tactic could enable attorneys to maneuver around the foundational intentions that Congress sought to implement, particularly in scenarios in which the application of these rules have been inconsistent or poorly defined.[394] By strategically utilizing these ambiguous elements, attorneys could engage in practices that significantly diverge from the legislative spirit envisioned by lawmakers, allowing for interpretations and actions that may not align with the intended ethical or legal standards.[395] Such a strategy raises critical questions about accountability and the adherence to the principles of justice and fairness.[396]

393. *See* discussion *supra* Section III.B.
394. *See* discussion *supra* Section III.B.
395. *See* discussion *supra* Section III.B.
396. *See* discussion *supra* Section III.B.