Private Client Valuation Update 2017:

Commentary on Tax Law, Court Cases, Market Multiples, Discounts, Interest Rates and More[1]

What a difference a few months and an unusual election season can bring. Let's recall what was, or was not, going through our collective brains on those hot summer days in late July 2016. Many of you were likely on the beach, and giving little thought to the potential for proposed 2704 regulations to disrupt the second half of 2016 or for the Presidential election to go the way of Donald J. Trump. In early August, the Treasury issued potentially far-reaching proposed regulations under Section 2704 of the Internal Revenue Code, and as Summer turned to Fall, Mr. Trump cut into Hillary Clinton's projected lead and went on to a resounding electoral college victory.

With respect to gift and estate taxes, industry dialogue took multiple turns. When it appeared that the Democrats had good odds of retaining the Presidency, it was assumed that we were headed for another round of proposals in Congress to lower gift and estate tax exemptions and raise tax rates. When the proposed Section 2704 regulations were issued, the perceived burden on families and small businesses was ratcheted up to an even more expensive and onerous level, as the specter of reduced valuation discounts appeared.

Donald J. Trump was declared the winner of the Presidential Election in the early morning hours of November 9, 2016. Shortly thereafter, the dialogue shifted dramatically. No longer was the concept of lower exemptions and higher gift and estate tax rates on our minds. Suddenly, the tax proposals of the President-Elect and the House Republicans became must-reads. Is estate tax repeal now on the table? Might we be moving to a Canadian-style capital gains tax system? What impact might the election results have on the proposed Section 2704 regulations? Will a change in leadership in the White House and at Treasury lead to the removal or overhaul of the proposed 2704 regulations? Will the future of the gift, estate and GST taxes be impacted by the President-Elect's desire to pursue major infrastructure spending? What about the potential that President-Elect Trump's own family stands to benefit greatly if the estate tax is repealed or reduced? How will President-Elect Trump's appetite for spending, tax relief, regulatory relief and debt financing jive with Congressional Republicans, many of whom are deficit hawks? Must the gift tax remain in place to protect the income tax? Will states enact or increase estate taxes to take

[1] This piece has been prepared for informational purposes only, and is not meant to be and should not be construed as legal or financial advice or used as a substitute for advice from a credentialed legal or financial professional.

advantage of a "new" source of revenue? In February 2017, California State Senator Scott Wiener proposed a bill that calls for enactment of a 40% state estate tax if the federal estate tax is repealed. And if estate tax repeal does happen, would it be retroactive to January 1, 2017, effective January 1, 2018, or phased in over a period of years like the Economic Growth and Tax Relief Reconciliation Act of 2001?

As of this writing, the inauguration has passed and a new Treasury Secretary has been confirmed, but the future of the transfer tax system remains unclear. What is clear is that there is a long list of other issues that are being prioritized, including healthcare, illegal immigration, border security, defense spending, infrastructure and foreign relations.

We can only hope that the Congressional sessions leading up to the Summer recess will shed some light on the matters at hand. In the meantime, about the only planning strategy that is widely accepted is to avoid transactions that generate a current gift tax. Meanwhile, equity markets and valuation multiples continue to climb, interest rates and preferred yields remain low, and discounts are alive and well. We will examine each of these topics herein.

Heckerling Tax Institute

The 2017 edition of the Heckerling Tax Institute was held in early January in Orlando, Florida. Attendance was similar to last year at approximately 3,100 registrants, and the overwhelming theme of the week was "uncertainty." With a new administration in Washington, D.C. led by President Donald J. Trump, and Republican control of both houses of Congress, the extent to which tax law changes will be pushed through is anyone's guess. If only I had a nickel for every time I heard one of the following phrases during Heckerling week:

- "There is no way of knowing how this will play out"
- "If anyone claims they know what will happen with the estate tax, they are lying"
- "Nobody has a crystal ball"
- "I don't see the estate tax being repealed, but who knows"

Speakers led discussions in the areas of charitable donations and deductions, CLATs, GRATs, preferred partnership freezes, fiduciary risks for trustees, elder law, the role of private placement life insurance, the growing importance of non-tax factors in the planning process, partnership income tax fundamentals, and the impact of technology on the estate planner, among others. Certain panels addressed the uncertainty surrounding the future of the estate, gift and GST taxes, and reviewed what has transpired with respect to proposed Section 2704 regulations.

Court Cases

There were a number of notable Tax Court decisions in 2016 where fundamental estate planning and/or business valuation issues were prominent, two of which we summarize here.

Estate of Virginia E. Dieringer v. Commissioner (146 T.C. No. 8)

In this case, Judge Kathleen Kerrigan issued a Tax Court Opinion addressing key questions about charitable contribution deductions and the effect of post-death events. Judge Kerrigan determined that the estate owed over $4.1 million of additional tax and assessed an accuracy-related penalty under section 6662(a) of the IRC of $825,000.

Includable in the estate was a controlling interest position in a real estate management company. Ms. Dieringer was the Chairperson of the company's board of directors, and her three sons Eugene, Patrick and Tim were the only other owners of the company. Eugene was the President of the company and the other sons served on the board. Eugene was also the executor of the estate. As of the date of death, the estate reported that the value of the decedent's stock was worth $14.2mm, as determined by appraisal. Since the stock was to be contributed to a foundation pursuant to the will, its value was used for a charitable contribution deduction.

Seven months after Ms. Dieringer's death, the company executed a redemption of the stock, but at a deeply discounted price reflecting minority and lack of marketability discounts (i.e., as if the block was a minority interest position). The same appraiser was used for the two valuations, but in the case of the redemption, the appraiser testified that he was asked to value the stock on a minority interest basis. The value of the block for purposes of the redemption was determined to be $7.1mm, inclusive of discounts for lack of control and lack of marketability of 15% and 35%, respectively, even though it was clear that the block had control.

This case raised and answered a number of interesting questions pertaining to the charitable contribution deduction and the roles of the appraiser and the executor. First, is it true that the charitable contribution deduction is determined as of the date of death? Yes. However, the Estate Tax Regulations are pretty clear that an estate must show that such deduction reflects the amount that passes to charity. The Estate's argument that the deduction should not depend upon or be measured by the value received by the foundation is, thus, invalid. Looking back over the totality of events in this case, it is hard to argue (although the estate tried) that the testamentary wishes of the decedent were being honored. Rather, it is clear that the sons of the decedent were trying to have their cake and eat it too. They sought a full or high price of the shares to maximize the estate's charitable contribution deduction and minimize estate taxes, and then flipped the switch and sought a low price to minimize the cost to redeem the shares. Post-death events matter insofar as they can undermine testamentary wishes and the proper administration of an estate.

Was the date of death value determined properly? Yes, although it is unclear why the appraiser would have valued the non-voting shares at a 5% discount. The shares should have been aggregated for valuation purposes and viewed as one controlling interest block with a value equal to the pro-rata share of the Company's control/sale value.

Was the appraiser at fault in providing a minority interest value as of the redemption date? Maybe, but it appears that he simply provided an appraisal assuming a certain set of conditions (i.e., that a transaction was going to happen involving the transfer of a minority interest). It is best practice, and a technical requirement, for an appraiser to fully understand and disclose the purpose for which the appraisal is being used. While an appraiser cannot always prevent misuse, the appraiser should (a) make maximum effort to understand the purpose and use; (b) fully disclose the presumed purpose and use in the appraisal he prepares; and (c) push back firmly on clients if he believes that his appraisal is being sought in a way that is inconsistent with a contemplated or executed transaction.

Estate of Clara M. Morrissette v. Commissioner (146 T.C. No. 11)

This case clarified the tax treatment of split-dollar life insurance arrangements. The decedent's revocable trust contributed $29.9 million to three trusts in 2006 to purchase life insurance policies covering her three sons. The IRS issued a notice of deficiency in 2013, concluding that the entire contribution was a taxable gift. The IRS declared that the split-dollar arrangements were loans. The estate disagreed, and moved for a summary judgment seeking to have the arrangements classified under the so-called "economic benefit" regime.

IRS regulations outline two mutually exclusive regimes governing split-dollar life insurance arrangements: economic benefit and loan. The determination of the applicable regime depends on which party is deemed to own the subject life insurance policy. Treasury Regulation Section 1.61-22(c)(1) indicates that the person named as the owner in an insurance contract is considered the owner. However, the regulations include an exception stating that the economic benefit regime applies if the only benefit provided by the split-dollar arrangement is current life insurance protection, which equals the death benefit stated in the contract less the amount payable to the owner plus the portion of the cash value taxable to (or paid by) the owner.

The subject arrangements stated that the children's trusts were not to receive any benefit other than current life insurance protection, and that neither the revocable trust nor the children's trusts could borrow against a policy. The children's trusts had no access to the current cash values of the policies, and upon the death of the insured, these trusts would only receive the portion of the death benefit exceeding the amount due to the decedent's revocable trust. The Tax Court agreed with the estate's arguments, and entered a partial summary judgment under Rule 121(a) of the Tax Court Rules of Practice and Procedure that the decedent's revocable trust is considered the owner of the subject life insurance policies, and that the economic benefit regime applies to the split-dollar arrangements.

This case was decided on the legal matter of the appropriate regime to apply to split-dollar life insurance arrangements, and not on the valuation techniques applied to any receivables generated by these arrangements. It is important to understand the tax consequences of the two regimes that apply to split-dollar life insurance arrangements. Under the economic benefit regime, split-dollar receivables come with a high degree of uncertainty over the timing and amount of future payment, which could impair their value substantially.

Market Multiples

Commentators in financial markets have often cited and warned investors about the increases in valuation multiples in recent years. One measure often cited when this topic is raised is the "Cyclically Adjusted PE Ratio" (CAPE Ratio)," also known as "PE 10."[2] The CAPE Ratio in January 2017 exceeded 28.0x trailing ten-year average earnings. The current multiple is approaching the high end of its historical range, and compares to 15.1x near the market bottom in early 2009, and 21.9x in early 2013.

Some market pundits believe that the rise in the CAPE ratio is a sign that the stock market is at or near a cyclical peak, while others point to the impact of low interest rates on the pricing of financial assets (think discount rate mechanism) and the heightened expectations for future earnings growth. Dr. Jeremy Siegel of the Wharton School, University of Pennsylvania, cites the dramatic decline in real yields on bonds, as well as other factors as influencing the CAPE ratio. Dr. Siegel cites declines in the required equity risk premium over time and changes in the computation of the denominator (earnings) due to the evolution of accounting rules and practices.[3]

It is likely that equity markets are, in part, pricing in accelerated earnings growth on account of expected changes in fiscal policy by the new administration. According to Keynesian economic theory, increases in government spending and decreases in tax rates are both expansionary fiscal tools. President Trump has indicated his strong desire to embark on a major infrastructure program and reduce corporate tax rates. In addition, the market is likely seeing the new administration as being "pro-business" with respect to regulations. In the four months following election day 2016, the S&P 500 increased 11%.

MPI's clients fall primarily in the "middle market," defined herein as having revenues between $5.0 million and $1.0 billion.[4] We reviewed publicly traded middle market company multiples across industries as of year-end 2016 compared to the prior year-end. Excerpts from that review are contained on the table following this page. Some observations include the following:

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[2] Data Source: www.multpl.com. The CAPE Ratio is computed using the S&P 500 index and its constituents, and compares equity market capitalization to average inflation-adjusted earnings from the previous 10 years.

[3] Siegel, Jeremy J. 2016. "The Shiller CAPE Ratio: A New Look." Financial Analysts Journal, vol. 72, no. 1 (May/June): 41-50.

[4] Some researches distinguish further between the lower middle market ($5.0 million to $50.0 million in annual revenue), middle market ($50 million to $500 million), and upper middle market ($500 million to $1.0 billion), although all of these are subjective cutoffs and there are many variations thereof.

Review of Industry Performance and Valuation Multiples
December 31, 2016

Sorted by Industry

Industry	One-Year Change	12/31/2016 Trailing EV/EBITDA Multiple	12/31/2016 Forward EV/EBITDA Multiple	12/31/2016 Trailing P/E Multiple	12/31/2016 Forward P/E Multiple
Aerospace and Defense	28.4%	12.4	10.4	33.0	30.8
Apparel Retail	1.9%	6.1	6.8	17.2	16.8
Apparel, Accessories and Luxury Goods	0.1%	12.2	8.5	14.4	13.4
Application Software	7.7%	20.5	17.1	28.8	29.8
Auto Parts and Equipment	19.5%	10.9	8.1	16.5	16.8
Biotechnology	-8.4%	12.4	9.0	26.4	30.8
Broadcasting	25.5%	9.1	8.9	15.5	15.9
Building Products	28.4%	11.3	9.0	20.2	18.7
Casinos and Gaming	25.2%	9.2	8.3	13.2	18.2
Coal and Consumable Fuels	96.9%	8.5	7.1	6.2	12.1
Commodity Chemicals	23.5%	10.8	8.6	11.8	18.7
Communications Equipment	25.3%	16.1	10.5	17.6	18.7
Construction and Engineering	73.0%	9.6	7.8	19.4	20.7
Construction Machinery and Heavy Trucks	33.8%	8.6	9.4	11.5	20.9
Data Processing and Outsourced Services	9.1%	11.8	9.9	14.5	19.3
Education Services	34.1%	10.1	8.0	15.1	23.2
Electrical Components and Equipment	12.8%	11.2	11.4	15.6	19.4
Electronic Components	38.8%	17.8	16.3	18.6	28.9
Electronic Equipment and Instruments	22.8%	14.9	9.6	21.6	25.3
Electronic Manufacturing Services	25.4%	9.8	7.9	14.8	19.0
Environmental and Facilities Services	48.1%	11.1	8.8	12.6	19.7
Health Care Technology	-0.9%	18.8	13.8	28.6	27.5
Healthcare Equipment	25.3%	15.1	17.0	32.1	33.0
Healthcare Services	4.5%	10.3	10.4	22.9	21.5
Healthcare Supplies	24.7%	16.1	12.1	23.1	29.5
Homebuilding	23.3%	15.3	11.0	15.4	16.8
Human Resource and Employment Services	9.1%	12.4	8.9	20.8	23.0
Industrial Machinery	26.6%	11.9	12.2	17.1	23.5
Internet and Direct Marketing Retail	40.6%	18.4	12.3	19.6	36.1
Internet Software and Services	18.1%	17.0	13.3	30.5	31.9
IT Consulting and Other Services	2.2%	12.7	9.5	19.2	20.0
Leisure Facilities	15.7%	8.5	8.2	21.9	21.0
Leisure Products	6.4%	9.3	7.2	14.5	15.0
Life Sciences Tools and Services	1.7%	20.9	13.3	21.2	23.1
Office Services and Supplies	41.2%	9.1	7.8	11.6	20.3
Oil and Gas Equipment and Services	11.9%	12.7	12.6	29.5	70.2
Oil and Gas Exploration and Production	46.2%	19.9	8.9	41.3	34.1
Oil and Gas Storage and Transportation	15.9%	12.3	10.2	16.4	17.1
Packaged Foods and Meats	18.1%	15.5	13.8	25.1	22.2
Personal Products	7.7%	11.0	10.8	16.1	23.8
Pharmaceuticals	0.3%	13.5	12.9	20.1	20.2
Property and Casualty Insurance	14.5%	7.9	NM	11.4	14.2
Real Estate Operating Companies	4.9%	19.7	19.2	26.8	32.8
Renewable Electricity	-9.2%	13.1	10.9	44.6	37.2
Research and Consulting Services	20.5%	11.1	9.6	16.2	20.2
Restaurants	-1.6%	10.3	9.1	23.2	22.6
Semiconductor Equipment	52.1%	18.0	11.4	18.3	21.6
Semiconductors	27.9%	20.6	12.9	23.1	25.2
Specialized Consumer Services	8.0%	13.1	6.5	14.0	15.6
Specialty Chemicals	57.9%	11.5	10.3	15.7	19.8
Specialty Stores	12.3%	11.3	6.9	23.3	17.0
Systems Software	14.7%	18.7	12.2	25.7	27.5
Technology Hardware, Storage and Peripherals	-14.7%	9.5	8.1	15.5	16.5
Trading Companies and Distributors	27.3%	12.3	9.3	15.2	12.0
Trucking	-2.5%	5.9	6.1	16.0	28.2
Water Utilities	46.3%	16.2	15.2	22.4	25.4
Low	-14.7%	5.9	6.1	6.2	12.0
Median	18.8%	12.3	9.6	18.5	20.9
High	96.9%	20.9	19.2	44.6	70.2
S&P 500 Index	9.5%				
Russell 2000 Index	21.3%				
S&P SmallCap 600 Index	24.8%				
Dow Jones U.S. Micro-Cap Stock Mkt Index	15.9%				

Note:
(a) Source: S&P Capital IQ.
(b) Dataset includes companies squarely in the middle market (annual revenues between $5 million and $1 billion).

- Middle market companies' stock prices increased by a median of 18.5%. Smaller firms generally outperformed larger firms in 2016.
- Market multiples mostly increased in 2016. Approximately 80% of the industry groups reviewed experienced multiple expansion in 2016 (based on EBITDA[5] multiples). The median increase in industry multiples was approximately 22%.
- Industry groups trading at the highest EBITDA multiples today include semiconductors, life sciences tools and services, application software, and internet and direct marketing retail.
- Industry groups trading at the lowest multiples today include trucking, apparel retail, and property and casualty insurance.
- The best performing industries, by stock price, in 2016 were coal and consumable fuels, construction and engineering, specialty chemicals, semiconductor equipment, and environmental and facilities services.
- The worst performing industries, by stock price, in 2016 were technology hardware, biotechnology, renewable electricity, trucking and restaurants.

Valuation Discounts

In the appraisal of closely held companies and securities, the most critical and scrutinized valuation adjustments are typically the discounts applied for lack of control and lack of marketability, as applicable. It is the business appraiser's primary job to customize these discounts to the situation at hand, and to support these discounts with relevant capital market evidence.

The following tables summarize data used for lack of control (minority interest) discounts as of the end of the third and fourth quarters of 2016:[6]

Summary of Median Discounts for the Week Ended Friday, December 30, 2016
(Negative values indicate discounts; positive values indicate premiums)

Equity Closed-End Invst. Companies		Debt Closed-End Invst. Companies		Real Estate Limited Partnerships (a)	
Domestic Equity	-9.0%	National Muni	-4.5%	Overall Median	-22.7%
International Equity	-13.0%	Single State Muni	-7.0%	10th Percentile	-7.2%
Global Equity	-12.0%	Domestic Corp. (Invst. Grade)	-5.7%	90th Percentile	-37.6%
Real Estate Equity	-11.6%	Domestic Corp. (Non-IG)	-6.7%	Non-Distributing	-37.8%
Natural Resource Equity	-10.1%	Global Bonds	-7.7%	Low-Distributing	-24.4%
Preferred Equity	-2.1%	Mortgage/Govt. Agency	-4.1%	High-Distributing	-14.2%

5 Earnings before interest, taxes, depreciation and amortization.

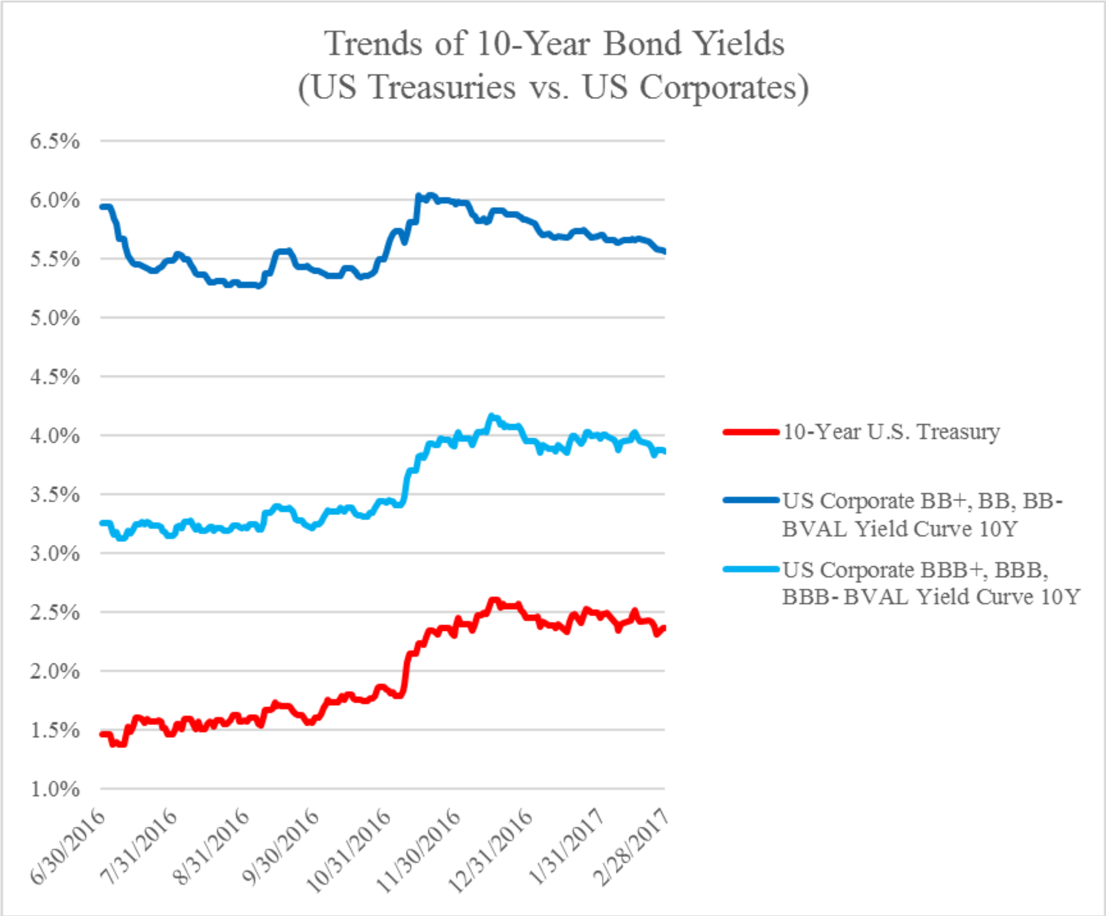
6 Sources: Bloomberg Finance, L.P.; Partnership Profiles, Inc.

Summary of Median Discounts for the Week Ended Friday, September 30, 2016 (Three Months Prior)					
Equity Closed-End Invst. Companies		Debt Closed-End Invst. Companies		Real Estate Limited Partnerships (a)	
Domestic Equity	-7.7%	National Muni	-1.4%	Overall Median	-22.7%
International Equity	-12.8%	Single State Muni	-1.3%	10th Percentile	-7.2%
Global Equity	-10.9%	Domestic Corp. (Invst. Grade)	-5.1%	90th Percentile	-37.6%
Real Estate Equity	-9.8%	Domestic Corp. (Non-IG)	-7.2%	Non-Distributing	-37.8%
Natural Resource Equity	-6.5%	Global Bonds	-8.5%	Low-Distributing	-24.4%
Preferred Equity	-0.6%	Mortgage/Govt. Agency	-4.4%	High-Distributing	-14.2%

Since the late 1980s, MPI has maintained a proprietary lack of marketability discount study. The latest version of the MPI Restricted Stock Study includes over 2,000 private placement transactions spanning three decades. The latest version of the MPI Restricted Stock Study includes a nine-factor multiple regression model that allows us to customize the lack of marketability discount to any business interest. Lack of marketability discounts for restricted securities are typically indicated in a range of 15% to 40%. Three factors weighing heavily on discounts are the implicit holding period, the size of the subject company, and the volatility of the company's stock, the latter generally driven by the nature and riskiness of the industry.

Interest Rates

Since the financial crisis of 2008/2009, the general level of interest rates declined to historically low levels. In fact, the decline persisted longer than most investors and market pundits predicted. However, since Election Day 2016, interest rates are noticeably higher. In fact, if we were to look at a long-term chart of yields, it is possible that long-term rates, as measured by 10-year Treasury notes, may have bottomed in July 2016. Only time will tell whether this was the inflection point, but eight months have passed and 10-year Treasury Note yields are approximately 100 basis points higher, the Federal Reserve is in the early stages of a monetary tightening campaign, and the Trump administration's policies could be inflationary.



Preferred Yields

MPI recently completed an update of its preferred stock database and model as of February 28, 2017. Despite the general consensus that the Federal Reserve will increase the federal funds rate several times in 2017, the continuing low interest rate environment has manifested itself in historically low preferred stock yields. As of February 28, 2017, the median yield of 263 publicly traded preferred stock issues that met MPI's criteria was 5.40%.[7] The yields ranged from 3.2% to 7.4% for the middle 80% of the observations. The database includes preferred stocks from issuers in a variety of industry categories, including asset management, automotive, capital markets, hospitality, insurance, media, oil and gas, real estate and telecommunications.

Prices of preferred stock for the most highly leveraged issuers generally traded at yields of between 5.5% and 8.0%. For our private clients considering various estate planning alternatives, these capital market conditions might warrant consideration of a preferred freeze structure. At other points in history, highly leveraged preferred stock may have traded at significantly higher yields.

[7] Based on the yield-to-worst convention. The median current yield was 6.22%.

Ten Thoughts for 2017

1. Fool's Errand - With respect to the future of the estate tax system, the best we can do is review history, contemplate Republican tax proposals, and understand the differences between the traditional legislative process and the budget reconciliation process. No one has a crystal ball and playing the prediction game is a fool's errand at this point.

2. Permanence Does Not Exist - It is always important to keep in mind that no change to the tax code is permanent. Regardless of what transpires in 2017 with respect to the estate, gift and GST taxes, there is no way to predict what tax policy will look like for the next generation, no less under the next (post-Trump) administration.

3. Remember 2001 - It was only 15 years ago that the Republicans controlled Congress and the White House. At that time, there were many Republicans that were proponents of eliminating the estate tax and overhauling the entire transfer tax system. What the country ended up with was a phase out of the estate tax over a ten-year period, only to have it reset to historical levels if Congress did not act in Year 10. We had one year of no estate tax in 2010, and then a subsequent return of the estate tax with annual increases indexed for inflation. In fact, at that time, there was far less concern over deficits and the national debt than there is today.

4. Budget Reconciliation - So much talk has been about Budget Reconciliation as a means to skirt the need for a three-fifths vote in the Senate, allowing the Republican-controlled Congress to push through a myriad of tax reforms. Yet a basic understanding of Budget Reconciliation uncovers the realization that it is all about revenue neutrality. How could Trump push through billions, if not over 1 trillion, of infrastructure spending while also making tax cuts? Seems far-fetched at first glance, although potentially large revenue offsets include the border-adjustment tax, taxes on repatriated assets, recharacterizing carried interest income into ordinary income, and eliminating "stretch" IRAs.

5. "A Better Way" - In 2016, House Republicans put a tax proposal on the table that included the following:

    a. Marginal rate of 33% on ordinary income over $230,000 (married) / $190,000 (single);
    b. Eliminates all deductions except mortgage interest and charitable contributions;
    c. Top effective rate on capital gains and dividends of 16.5%;
    d. No alternative minimum tax;
    e. No surtax on net investment income;
    f. Top marginal rate on pass-through income of 25%;
    g. Corporate tax rates reduced to 20%;
    h. No proposal on carried interest;

   i. Estate tax eliminated; may be replaced with tax on unrealized capital gains held at death for estates over $5.0 million (single) and $10.0 million (married). Unclear whether or not capital gains tax is due at death or when assets are subsequently sold.
   j. Gift tax – unclear;
   k. GST tax – eliminated; and
   l. Step-up in basis on death – unclear.

6. President Trump's Campaign Plan –
   a. Marginal rate of 33% on ordinary income over $225,000 (married) / $112,500 (single);
   b. Caps itemized deductions at $200,000 (married) / $100,000 (single);
   c. No change to capital gains and dividend tax rates;
   d. No alternative minimum tax;
   e. No surtax on net investment income;
   f. Tax rate on pass-through income of 15%;
   g. Corporate tax rates reduced to 15%;
   h. Carried interest to be taxed as ordinary income, but the implementation and reach of this feature is unclear;
   i. Estate tax eliminated; replaced with tax on unrealized capital gains held at death for estates over $5.0 million (single) and $10.0 million (married). Unclear whether or not capital gains tax is due at death or when assets are subsequently sold.
   j. Gift tax – unclear;
   k. GST tax – eliminated; and
   l. Step-up in basis on death – unclear, but a likely tie to the capital gains tax payment would be made.

7. Gift Tax - It is difficult to find anyone who believes that the elimination of the gift tax is feasible. A primary reason for this view is the concept that the free transfer of assets could undermine the income tax system.

8. IRC Section 2704 - The finalization of proposed Section 2704 Regulations now appears to be a long shot. Treasury received a barrage of educated and insightful comments during the 90-day comment period and at a day-long public hearing on December 1. In addition, with a Republican administration taking over in Washington D.C., it appears that the Section 2704 project will be quashed or the proposed regulations will be significantly revised. In his first full week in office, President Trump issued an executive order that froze the regulatory apparatus of the federal government at least until agency appointees are fully in place. A subsequent order requires two regulations to be eliminated for every one new regulation implemented.

9. IRC 457A - 2017 is a big year for hedge fund managers. This is the last year in the ten-year window to recognize previously deferred management and incentive fees into income. Advisors have been scurrying to find ways of minimizing the impact of this recognition event on their clients. There is clearly no magic bullet available, but two strategies getting consideration are charitable donations and the establishment of charitable lead annuity trusts ("CLATs").
10. Exemptions - The federal exemption amount for 2017 is $5.49 million, or $10.98 million per married couple. The annual gift exclusion for 2017 is $14,000 for gifts to any person, and $149,000 for gifts to a spouse who is not a U.S. citizen. Notably, the most common estate planning advice on the street today calls for the avoidance of any strategy or transaction that gives rise to current gift tax.

As of this writing, we face great uncertainty as to many aspects of the tax code. It is at these times that clients are wise to increase the frequency of dialogue with their trusted advisors. For some clients, taking a "wait-and-see" approach may be prudent. For others, such an approach may be risky and lead to lost opportunity. We appreciate your business and look forward to working with you to navigate what appears to be an intriguing 2017.

For questions pertaining to this article or further information on MPI's business valuation and advisory services, please contact the primary author, Todd G. Povlich, CFA, ASA, or your local MPI representative.[8]

<u>*About MPI:*</u>

MPI is a business valuation and advisory firm that was founded in 1939. MPI's business includes providing business valuation and advisory services to closely held companies and partnerships for a variety of purposes including estate and gift tax, income tax, charitable contributions, buy-sell agreements, ESOPs, and exit planning. We provide fairness opinions, sell-side and buy-side advisory services, intangible asset valuation, purchase price allocations, goodwill impairment testing, valuations for equity-based incentive plans, and blockage and restricted stock studies. We conduct every project as if it is going to face the highest level of scrutiny, and our staff has extensive experience presenting and defending our work in front of financial statement auditors, boards of directors and other corporate fiduciaries, the IRS and in various courts.

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