



IREON Insights: A convergence of calamities — same old story — Now is the time for planning with real estate - by Neil Axler and Craig Stephanson, part 3 of 3

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(This article is the third and final in a three-set series. Prior articles discussed sunseting gift and estate tax legislation, real estate values in a state of flux, and opportunities in a changing interest rate environment. This third article discusses the use of valuation discounting planning, the uncertain political environment, and opportunities when dealing with the IRS. Each of the three-part series articles should be read in conjunction with each other.)

Real estate that is owned through partnerships and limited liability companies can be fractionalized and gifted at lower values by utilizing valuation discounts. Instead of gifting fee simple title in the real estate, fractional ownership interests in entities owning the real estate are gifted. These fractional, minority interests lack control over the underlying real estate and lack marketability as they are private, hard-to-value equity securities for which no sales market or exchange exists. These lack of control and lack of marketability valuation discounts can legally reduce the fractional interest below its simple proportionate value of the real estate by meaningful amounts. Up front planning, however, is needed in these situations in order to supercharge the benefits, but with qualified real estate appraisers for the real estate and qualified business valuation professionals for the valuation discount analyses, these tools are immensely powerful.

Even after the opportunities presented by sunseting tax provisions, currently low real estate values, and the changing interest rate environment, there are still more happenings creating opportunities for real estate owners in the area of estate and gift tax planning. First, 2024 is a huge election year.

With every election cycle and change in administration comes potential legislative changes that can impact tax strategies. For years, there has even been discussions of eliminating valuation discount strategies in family entities. Investors in real estate (especially those minority partners or members in entities where they cannot control the underlying property) do not like uncertainty. Investors prefer reliability, assurance, predictability, and consistency in their investments. Such uncertainty in real estate values, changing interest rates, and uncertain tax and fiscal policies are risks that can impact the fair market value of these types of investments and thus tend to increase valuation discounts.

Second, another unique opportunity exists for the above gifting strategy as a result of the evolving IRS budget. It has long been known that the resources of the IRS are, at best, strained. However, in August of 2022, the Inflation Reduction Act (IRA) passed. Part of this legislation included a line item in the Federal budget of \$80 billion to help improve and better fund the IRS. The focus of these new initiatives will likely focus on the detection of noncompliance and enforcement of tax laws, especially for high-income individuals. Additional funds will be provided for new computer technology and attracting and retaining a much improved, skilled workforce. It is widely anticipated that gifting strategies for high-net-worth real estate owners such as those discussed here will likely be more scrutinized in the future. It will take considerable time before this funding fully takes place. Herein lies the opportunity. The old adage, “make hay while the sun is shining” comes to mind here. Initiate now and start making these gifts of real estate interests in 2024 and 2025 before the IRS is fully staffed.

In conclusion, now is the time to act and make transfers of real estate interests to take advantage of the benefits of tax free gifting while (i) the lifetime exemption remains high for a limited period, (ii) valuation discounts can still be used, (iii) real estate values are low but likely to increase as interest rates drop, (iv) there is still uncertainty as to our future political and legislative landscape, and (v) the IRS is still only in its ramp up/planning stage of its enforcement growth period.

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