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# The Gift Tax Cliff is on the Horizon

*by Ralph Consola, Principal, Marshall & Stevens* *- Wealth Transfer Insight*

**On December 31, 2025, the federal lifetime gift tax exemption will plummet from over $13 Million in 2024 and 2025 to $7+ Million for 2026. If you haven't taken advantage of this challenging economy to gift interests in your business, real estate, private equity, BDC or other funds, why are you waiting?**

**Lower values provide an opportunity to gift a higher percentage of one's investments tax free, but that opportunity is lost when valuations are higher, and the gift tax threshold is much lower.**

## BENEFITTING FROM ECONOMIC CHALLENGES

There was a significant decrease in transaction activity in 2023 when compared to the prior three years: M&A, IPOs, and private equity platform investments are all down. Even investors in industries experiencing significant increased activity, such as renewable energy, are seeing a lower return on investment (ROI) in 2023.

The cost of capital, ROI and uncertainty are factors taken into consideration by investors and valuation professionals when projecting future performance of an investment. Many investors chose to park their money on the sidelines in 2023, waiting to see where market multiples and cap rates will settle in 2024.

***These challenges can be advantageous for wealth transfer transactions.***

### Valuations in 2024

When valuing a business or real estate investment for wealth transfer (gifting) purposes, valuation professionals work under the Fair Market Value ("FMV") standard, as defined by IRS Revenue Ruling 59-60. This standard assumes a hypothetical "willing buyer" and "willing seller" arriving at a well-informed agreement on the value of the subject.

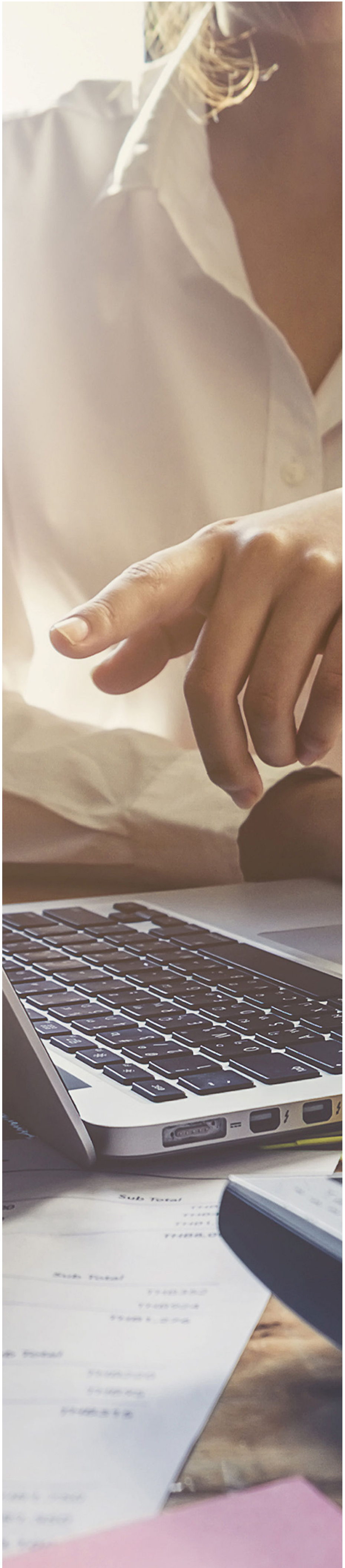
FMV analyses require valuation specialists take into consideration the current economic environment and a comparison of the subject's past and projected performance with similar industry enterprises and recent comparable transactions.

Not accounting for the performance of a specific subject entity, valuations in 2023 and early 2024 are reflecting the application of:

1. Higher costs of debt and equity to account for a theoretical market participant buyer financing the acquisition of the subject entity.
2. Higher costs to run a business due to increased labor and supply costs.
3. Fewer M&A and financing transactions to use as a benchmark for the subject theoretical transaction.

### Real Estate Gifting Opportunities

Higher interest rates result in higher cap rates which depresses real estate values, making 2023 and 2024 good years to (1) gift interests in real estate and (2) buy out shareholders in order to consolidate equity between family members.



We have worked with business owners who sell to their trusts the real estate owned by their business prior to the sale of the business in order to retain the real estate as a family asset. If a business sale is in your future, now may be an advantageous time for an owner/user real estate sale.

**Valuation of Minority Interests**

Wealth transfer transactions typically constitute gifts of minority interests in funds, businesses and/or real estate. These interests most often carry limitations on the rights of the equity holders including restrictions on the marketability of the subject equity (*how a future sale of the equity may be conducted and who may own the equity*), as well as a lack of control (*ability to make business decisions such as hiring and firing employees, employee compensation, debt financing, and sale of the business*). Discounts for lack of marketability ("DLOM") and lack of control "(DLOC"), if applicable, result in a lower value for the interest than the pro-rata percentage of the whole.

**Fund Investments**

Interests in funds held by private equity investors as well as private equity management ("*Carried Interests*") are as suitable for gifting to tax beneficial entities as are minority investments in an operating business or real estate.

***Carried Interests*** in funds that have not yet been invested have no visibility into the success of the fund at the time the fund is liquidated, typically five (5) to 10 years in the future.  Since the fund has ROI goals, but also has uninvested cash that is not accessible for years into the future, a proper valuation of the carried interests is greatly discounted for lack of performance (*what year-over-year growth rate should be assigned to uninvested cash)*.

Whether the fund has made investments or not, there are restrictions on who can purchase the interest ("DLOM") and there are typically liquidity restrictions (*one can't monetize the investment until the fund is liquidated*) that should be considered.

All these factors provide potential bases for discounts to the pro rata value of the investment in the underlying fund. These discounts reduce the FMV of the interest and therefore the value of the gift.

## THE SOLUTION

Founded in 1932, Marshall & Stevens' application of quantitative and qualitative valuation analyses of interests in businesses, real estate, funds, etc. provides a clearer, more supportable indication of value, especially in challenging times.

We are regularly engaged to assist investors and their trusted advisors with valuations of interest in businesses, funds, and real estate in order to facilitate gifting of equity and debt into tax efficient vehicles (Trusts, Family Limited Partnerships, etc.).

For more information, please reach out to one of the professionals lists below.

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