
The Top 6 Issues That Trigger IRS Pushback in Estate & Gift Cases

And How to Spot Them Before They Become Problems

A Quick-Reference Guide for Trust & Estate Attorneys | Scott Abels, CPA, CVA

Why This Matters Right Now

Large estates face IRS examination rates above 20%. And when the IRS examines a return, the valuation of closely-held business interests is almost always where they focus first.

The problem most people miss: valuation disputes aren't usually about math. They're about legal-structural issues that were baked into the valuation before a single number was calculated. The appraiser applied a discount. The IRS challenged the basis for it. And the attorney's left defending a position that was vulnerable from the start.

The six issues in this guide are the ones we see triggering IRS pushback most often. Not theoretical risks. Actual examination triggers that show up in case after case.

For each one, we'll walk through what it looks like in practice, why it creates exposure, and what you can ask right now about a case on your desk.

ISSUE 1 OF 6

Assuming §2031 Always Controls

What This Looks Like

You've got a client transferring minority interests in a family entity. The appraiser applies the standard fair market value framework, takes minority and marketability discounts, and delivers a clean report. Everything looks straightforward.

Except the entity involves transactions between family members. And nobody checked whether Chapter 14 applies before the valuation started. The appraiser defaulted to the general rule because that's what they always do.

Why It Creates Exposure

Section 2031 gives you fair market value as the default. But §§2701 through 2704 can override that default entirely when family-controlled entities are involved. These provisions exist to prevent undervaluation of transfers between related parties.

If Chapter 14 applies and your valuation ignored it, the IRS doesn't need to argue about discount rates or comparables. They challenge the entire valuation framework. That's a much harder position to defend than a disagreement over methodology. You're not debating numbers at that point. You're debating whether the valuation was even conducted under the right rules.

Ask Yourself

Think about the family entity transfers you're working on right now. Before anyone started running numbers, did someone confirm whether §§2701 through 2704 apply?

Or did the valuation just default to §2031 because that's how it's always been done?

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Relying on Removable Entity Restrictions

What This Looks Like

Your client's LLC operating agreement says minority holders can't transfer their interests without majority consent. The appraiser looks at those restrictions, concludes the interest is genuinely illiquid, and applies a significant marketability discount.

It sounds right. The restrictions are real. They're written into the agreement. But the family members who control the LLC could vote to remove those restrictions tomorrow. And the IRS knows it.

Why It Creates Exposure

The IRS has learned to look past the document to the control reality. If the same family that benefits from the discount also has the power to eliminate the restrictions justifying it, the IRS will argue those restrictions aren't real market constraints. They're voluntary limitations that exist for tax purposes.

One of the most common examination triggers, and one of the easiest to miss. The restrictions are real in a legal sense. They just aren't durable in the way the valuation assumes. A restriction the controlling family can remove at will isn't the same as one imposed by an unrelated party or by statute.

Ask Yourself

Pull up the operating agreement for a family entity you're working with. Are the restrictions that support the valuation discount ones that the family members themselves could vote to change or remove?

If a third-party buyer looked at those restrictions and knew the family could eliminate them at any time, would they still treat them as real limitations on value?

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Treating Family Buy-Sell Agreements as FMV

What This Looks Like

Your client's family business has a buy-sell agreement with a formula price. Maybe it's book value. Maybe it's some multiple of earnings that was set years ago. The appraiser uses that formula price as the fair market value for estate or gift tax purposes.

The logic seems sound. There's a binding agreement between the parties. It sets a price. Why would fair market value be anything different? Because the IRS doesn't take family buy-sell agreements at face value.

Why It Creates Exposure

The IRS applies a three-part test to buy-sell agreements between family members: bona fide business arrangement, not a device to transfer value for less than adequate consideration, and comparable to similar arm's-length arrangements.

Family buy-sell agreements fail these tests far more often than people expect. A formula price set once and never updated. Terms no unrelated party would ever agree to. An agreement that conveniently caps value right before a large transfer.

When a buy-sell agreement fails the test, the agreed-upon price gets thrown out entirely. Now you're defending a valuation with no agreed framework underneath it.

Ask Yourself

When was the last time your client's buy-sell agreement was benchmarked against what an unrelated party would actually accept?

Could you make a straight-faced argument that the formula price reflects what a willing buyer would pay in an arm's-length transaction today?

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Ignoring Retained Rights in Recapitalizations

What This Looks Like

A senior family member recapitalizes the family business. They keep preferred interests or voting control and transfer common or non-voting interests to the next generation. The transferred interests get valued at a steep discount because they're non-voting, non-controlling, subordinate to the preferred.

On paper, the math works. The transferred interests really are worth less because of their subordinate position. But the structure of what was retained is what creates the problem, and it's often overlooked until the IRS raises it.

Why It Creates Exposure

Section 2701 exists for exactly this scenario. When a senior family member retains preferred or control rights while transferring junior interests, the IRS can recharacterize the value of what was transferred.

The retained rights may be treated as having zero value unless they meet specific qualified payment requirements. That means the transferred interest gets assigned a much higher value than the appraiser calculated. The discount that looked defensible on paper evaporates because the statute says the retained rights don't get counted the way the valuation assumed.

Ask Yourself

In any family recapitalization you're advising on, what exactly is the senior generation retaining? Have those retained rights been tested against §2701's qualified payment requirements?

Or are you relying on the appraiser to sort that out after the structure's already in place?

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Using Boilerplate Discount Language

What This Looks Like

The valuation report applies a 25% minority discount and a 30% marketability discount. The rationale section reads like it could apply to any company in any industry: "The subject interest lacks voting control and cannot be readily sold on a public market. Studies of restricted stock transactions and pre-IPO discounts support the selected discount levels."

Nobody questions it because the language sounds authoritative and the discount levels fall within normal ranges. The report looks professional. The numbers are reasonable. But the IRS isn't looking at the numbers first. They're looking at the reasoning.

Why It Creates Exposure

The IRS has read hundreds of these reports. They know what boilerplate looks like. And their first move is to test whether the discount rationale is actually tied to the specific entity, the specific interest, and the specific restrictions that apply.

Generic discount language fails because it doesn't address what the IRS is actually asking: are these discount factors legally durable? Can the family unilaterally change the restrictions? Are the control limitations real or just structural window dressing?

A discount that's technically defensible but generically supported is an easy target. The IRS doesn't have to prove the discount is wrong. They just have to show the rationale doesn't hold up under the specific facts.

Ask Yourself

Read the discount section of the last valuation report you received. If you removed the company name and replaced it with any other family-held business, would the language still work exactly as written?

If the answer is yes, the rationale's too generic to survive examination.

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Valuing Form Over Control Reality

What This Looks Like

Your client holds a 20% interest in the family LLC. On paper, that's a clear minority position. The appraiser applies minority discounts accordingly.

But your client's spouse holds 15%. Their adult children hold the remaining 65%. At every family meeting and every major decision, the family acts as a unit. Nobody's ever voted against anyone else. The 20% holder effectively participates in controlling the entity through family consensus, even though the ownership certificate says minority.

Why It Creates Exposure

The IRS looks past percentage ownership to how control actually operates. If family members collectively control the entity and act in concert, the IRS can argue that minority discounts are inappropriate regardless of what the ownership certificates say.

The IRS has been making this argument for years. Family attribution and implied agreements are exactly what examiners are trained to look for. And in many family entities, the evidence of collective control is everywhere: meeting minutes, bank authorizations, decision patterns, years of operating history showing the family's never actually disagreed.

Ask Yourself

For the family entity interests you're valuing, does the ownership percentage tell the real story?

If an IRS examiner looked at how decisions actually get made, who signs checks, and how the family operates day to day, would they agree this is a genuine minority position?

How Many of These Apply to a Case You Are Working On Right Now?

If you recognized even one of these patterns in a current matter, you're not alone. These issues show up in the majority of estate and gift valuations involving family-controlled entities.

The good news: every one of them is avoidable. But only if they're identified before the valuation is issued, not after the IRS sends an examination notice.

The fastest way to pressure-test a case is a quick conversation.

Schedule a Complimentary 20-Minute Strategy Call

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Scott Abels, CPA, CVA brings 35+ years of corporate finance (Dell, Motorola) and CFO consulting experience to estate, trust and gift tax valuations. ETG delivers IRS-defensible business valuations for Texas families and their advisors.