

*Commonly
Asked Questions
about
Business Valuations...*



I. Valuation 101 for Gifts and Estates

A. Gifts of closely held stock could be opportunity to transfer wealth at discounted amounts:

- 1. Value of Company = \$1,000,000*
- 2. Transfer of 15% would normally mean having \$150,000 charged to your unified credit equivalent ignoring gift exclusion.*
- 3. What if we could transfer that \$150,000 of value without anything charged?*

II. What is a Valuation Engagement?

A. Valuation = an estimate of value of an ownership interest at a certain point in time.

*B. Discuss the **purpose** of the valuation.*

- 1. Gift Tax*
- 2. Estate Tax*
- 3. Ruling 59-60 and Tax Court Rulings*

C. Watch for timing issues (year end gifts)

III. Are there standards a Valuation Analyst must follow?

A. Various organizations setting professional designations:

- 1. AICPA – ABV*
- 2. NAVCA – CVA*
- 3. IBA – CBA*
- 4. ASA - ASA*

B. USPAP and AICPA and others

IV. Are there different types of reports?

A. Reports vary depending upon engagement.

- 1. Long-form reports.*
- 2. Short-form reports.*
- 3. Oral reports -- Advisory setting.*

B. Full Valuations

C. Consultant Valuations

V. What is Value?

A. FMV (Fair Market Value) = “the price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties have reasonable knowledge of the relevant facts.”

B. Value definition could be different under various other standards (Fair Value/Intrinsic/Investment).

VI. Why are business valuations performed?

- A. Acquisition or divestiture of business.
- B. Estate and gift tax planning.
- C. Determination of damages.
- D. Litigation support.
- E. Succession planning.
- F. Employee benefit programs.
- G. Preparation of Form 706 and 709

VII. Are there commonly used valuation methods?

- A. Methods are numerous:
 - 1. Asset Approach (Net Asset Method)
 - 2. Income Approach (Discounted Cash Flow, Capitalization of Earnings Method)
 - 3. Market Approach (Guideline/Transaction)
 - 4. Hybrid (Capitalization Excess Earnings)
- B. Valuation analyst selects methods appropriate for valuation.
- C. Watch for industry trends.

VIII. What items affect value?

- A. Methods selected affect value.
 - B. Discounts: **Marketability & Minority**
 - C. Shareholder agreements.
- BUT KING IS THE INCOME STREAM!
DISCOUNTS THEN BECOME THE CREAM!*

IX. Discount & Capitalization Rates -- what are they?

- A. Discount Rate =
- B. Capitalization Rate =
- C. Importance of these rates and their development.

X. What data would you be gathering.

- A. Financial Statements.
- B. Tax Returns.
- C. Industry Data.
- D. Case Law.
- E. Economic Factors.
- F. Management Structure.
- G. Other Empirical Data.

XI. How did the IRS get involved?

- A. Anybody ever hear of prohibition?
 - 1. Revenue Ruling 59 - 60.
- B. Updated Revenue Rulings.
 - 1. Revenue Ruling 93-12- family attribution
- C. Case law analysis from the tax court.

XII. What adjustments are typically made?

- A. Balance Sheet and Income Statement.
- B. Appraisals -- Real Estate.
- C. Fair market value of other assets.
- D. Normalization issues.
 - 1. Owner salaries
 - 2. Discretionary Expenses

XIII. What does a valuation cost?

- A. Nature of business / Risk assessment.
- B. Report to be issued.
 - 1. Compilation-Consultation Report
 - 2. Review-Business Valuation Estimate
 - 3. Audit-Litigation Full Valuation Report
- C. Examples.

XIV. DISCOUNTS

- A. Marketability Discount (Lack of Market)
 - 1. Pre-IPO Study
 - 2. Restricted Stock Study
 - 3. Results=20%-60% Discount
- B. Minority Discount (Lack of Control)
 - 1. Benefits of Control (BOD, salary/dividend)
 - 2. Empirical Data (Mergerstat)
 - 3. Results=10%-80% Discount
- C. Multiplicative and not Additive

XV. Different Levels

- 1% interest = 60% Market & 80% Minority
- 5% = 60% & 60%
- 10% = 50% & 60%
- 20% = 45% & 35% (five equal partners)
- 34% = 40% & 40%
- 40% = 40% & 20%
- 50% = 30% & 20%

XVI. First Slide Example

- Value of the Whole \$1,000,000
- Marketability Discount @ 40% 400,000
- Control Nonmarketable Value \$ 600,000
- Minority Discount @ 40% 240,000
- Minority Nonmarketable Value \$ 360,000
- Value of 7.5% \$ 27,000
- December 31/January 1 transfer = 15%
