

Overview of Valuations of Business Interests for Estate and Gift Taxation

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Estate and Business Planning Council of Baton Rouge

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Fair Market Value

- The amount at which the equity interest would change hands between a willing buyer and a willing seller, each having reasonable knowledge of the relevant facts, neither being under any compulsion to act.



Entity Description

- Asset holding entity vs. operating company
- Privately Held
- Minority Interests



Steps in the Valuation Process

- Gather Company data
- Site Visit / Management Interview
- Research economic and industry information
- Analyze company financial statements & appraisals
- Tests of Valuation
- Discounts, Premiums and Value Conclusion



Information Needed

- Organizing documents
- 5 years of tax returns or financial stmts.
- Real estate appraisals or other asset appraisals
- Nature and history of the operating company
- Expected distribution policy
- Outlook



Adjustments to Financial Statements

- Balance Sheet
 - Separate assets by type
 - Market Value versus Book Value
- Income Statement
 - Non-recurring items
 - Add backs
 - Deducts
 - Tax Adjustments



Approaches to Business Valuation

- I. Asset-Based Approach
- II. Market Approach
- III. Income Approach



I. Asset-Based Approach

- Net Asset Value
 - Total market value of partnerships' assets less liabilities
- Subject ownership interest should be able to cause the sale of company's assets
- More appropriate for valuing controlling interests or asset holding companies



II. Market Approach

- Previous Sales of or Offers for the Company's Equity
- Sales of Similar Companies
- Sales of Stock of Publicly Traded or Publicly Listed Companies
- Rules of Thumb



III. Income Approach

- Quantify future benefits
- Determine appropriate rate of return to discount future benefits to present value



Correlation and Conclusions

APPROACH	MINORITY	CONTROL
ASSET		Liquidation
MARKET	Public Company	Merger
INCOME	DCF/Cap of earnings	

The Relative Levels of Value



Synergistic Value

Premium for Synergy

Control Value

Premium for Control Minority Discount

Marketable, Minority Value

Lack of Marketability Discount

Nonmarketable, Minority Value



Synergistic Premium

- Reflects the value to a specific buyer
- Synergistic buyer can pay more due to perceived earnings benefits from a merger
- Not appropriate consideration in determining “fair market value”



What Discounts/Premiums Apply in Valuing Shares in a Closely-Held Company

- Control Premium
 - Appoint or remove management or determine their compensation;
 - Set policy or change the course of business;
 - Acquire or liquidate assets;
 - Make acquisitions of other companies;
 - Liquidate, dissolve, sell, or recapitalize the company;
- Registering the company's stock for an initial public offering;
- Force the sale of the stock to the Company (stock redemption);
- Determine the amount and timing of any dividends to shareholders; or
- Amend the Articles of Incorporation/ LP Agreement.



Premium for Control and Discount for Minority Interest

- Size of control premium is influenced by many factors but most frequently falls in the 10% to 40% range.
- This equates to a minority discount range of 9% to 29%.



Marketability Discount

- Securities of privately owned companies are not readily tradable on an established exchange and do not have access to an organized secondary market and may require a discount for their lack of marketability.



Quantification of the Marketability Discount

- Restricted Stock Studies
- Pre IPO studies
- FMV Restricted stock database
- Rate of return studies



Valuation in a Post Katrina World

- Is it a bubble or is it here to stay?



New AICPA standards

- SSVS-1
- Applies to engagements entered into after Jan. 1, 2008



Pension Protection Act-2006

- Section 6695A
 - Appraiser penalties



2007 Cases

- Rhett and Alice Smith et al, T.C. Memo 2007-368, December 17, 2007 Qualified Appraiser
Charitable Donation
- Estate of Jelke et al v. Commissioner, 05-15549, US Court of Appeals for the 11th Circuit, November 15, 2007 Trapped-in Gain
C Corporation
Dollar for dollar reduction
- Estate of Josephine T. Thompson et al. v. Commissioner; Nos. 06-0815, 06-1132, 2nd Circuit, August 23, 2007 Appraiser
qualifications
Accuracy related penalty
- Kevin B. Kimberlin and Joni R. Steele v. Commissioner, 128 T.C. No. 13, May 8, 2007 Warrants
Appraiser Credibility

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