Valuable Valuation Developments for Closely Held Businesses

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Agenda

- Entire transfer tax system based on taxing the gratuitous transfer of value—so what the fair market value of property is matters a great deal
- Developments in 2019—Theme of the year was closely held businesses
  - Tax-affecting pass through entities (*Kress* and *Jones)*
  - A defense against Section 2703 in gift tax audits (*Kress*)
  - Section 7491 and Burden Shifting
  - Application of Earnings or Asset Approach
  - Impact of pending transactions CCA (contrast with art case of post facts being an indicator/reality check vs. factored in)
- Developments in 2020:
  - Tax Court rejects IRS aggregation theory to disallow deductions (*Grieve*)
  - Market volatility and the impact of Covid-19

Tax Affecting Background

- The Issue: If a pass-through entity generates $100 in earnings, does the appraiser tax affect; i.e. reduce the earnings by the pass-through tax liability?
- 20+ Year Debate going back to the seminal Tax Court decision in *Gross* about how to value an S corporation (or other pass-through entity ("PTE"))
- Historical Approaches:
  - **Prior to *Gross***: Both the valuation community and an internal IRS Valuation Guide advocated for tax affecting.
  - **After *Gross***: In *Gross v. Commissioner*, T.C. Memo 1999-254, aff'd, 272 F.3d 333 (6th Cir. 2001), the Tax Court denied tax affecting, stating that an appraiser must not ignore the tax savings associated with a PTE; not convinced that tax affecting was appropriate as matter of economic theory. *Gross* was upheld on appeal, but the decision was not unanimous with respect to tax affecting. Six subsequent Tax Court rulings disallowed tax affecting; 2014 IRS S Corporation Job Aid recommends that agents disallow tax affecting unless significant basis/rationale is provided.

Impact of *Gross*

- Large majority of valuation practitioners believed *Gross* went too far.

	C Corp	PTE	Gross PTE
EBT	100.00	100.00	100.00
Entity Taxes	(40.00)	-	-
Entity Net Income	60.00	100.00	100.00
Payout Ratio	100.0%	100.0%	100.0%
Pass-Through Tax Liability	-	(40.00)	
Dividend Taxes	(12.00)	-	(20.00)
Net Cash Flow to Owner	48.00	60.00	80.00

- Do investor tax rates matter?
  - Municipal bond market
  - Recent firm actions in alternative asset management industry
  - Both markets and researchers say YES…

Impact of Gross

- **Why Guideline Public Company data is at the crux of this issue**
  - If you are deriving valuation multiples or discount rates from public company data, you are implicitly going to derive a C corporation equivalent value
  - Thus, many valuation practitioners have lobbied for the "C to S Method", where an adjustment is made to the C corp. equivalent value
- **The taxpayer and the Court both missed the mark in *Gross***
  - Potential remedy offered by Court of Chancery of Delaware in *Kessler* (*898 A.2d 290 (Del. Ch. 2006)*).

	C Corp	PTE	Gross PTE	Kessler PTE
EBT	100.00	100.00	100.00	100.00
Entity Taxes	(40.00)	-	-	(25.00)
Entity Net Income	60.00	100.00	100.00	75.00
Payout Ratio	100.0%	100.0%	100.0%	100.0%
Pass-Through Tax Liability	-	(40.00)		
Dividend Taxes	(12.00)	-	(20.00)	(15.00)
Net Cash Flow to Owner	48.00	60.00	80.00	60.00

Summary of *Kress v. United States*, 372 F. Supp.3d 731 (E.D. Wis. 2019)

- **Gift Tax Dispute:** James & Julie Kress, Plaintiffs, and U.S. Government, Defendant
- **Forum:** Federal District Court; tax refund action brought by Kress Family
- **Subject:** Gifts of non-controlling equity interests in Green Bay Packaging, Inc. ("GBP") made to children and grandchildren in tax years 2007, 2008, 2009
  - GBP was/is a large operating business; a vertically integrated manufacturer of folding cartons, corrugated packaging, coated labels
  - Trial took place in August 2017; decision issued March 2019
  - Taxpayer won on virtually all fronts in a "battle of the valuation experts"

Kress Ruling

How did the Court rule in *Kress*?

- *Major breakthrough…*
  - Tax Affecting was accepted
    - **Notably** – all experts tax affected the earnings of the S corporation, including the Government's expert
  - The C to S Method was accepted
  - Court went further – No S corporation premium applied due to risk factors / disadvantages
- **Takeaways:**
  - Kress provides sound basis for tax affecting the earnings of a PTE; supports C to S Method.
  - Note that there is currently another case pending, *Estate of Mary R. Cecil v. Commissioner*, No. 014640-14 (U.S. Tax Ct. filed June 23, 2014) where both experts tax affected based on the briefs filed.
  - Taxpayers facing challenges to tax affecting in estate and gift tax audits should immediately reference *Kress* (and *Jones*) as basis.
  - Based on recent events there is significant momentum in favor of tax affecting, with a caveat – your appraiser needs to:
    - consider any pass-through entity benefit; and
    - clearly explain the rationale for tax affecting in the report
- **Role of Appraiser Judgment**: "Mathematical calculations may give an appearance of precision even when the mechanical formulae on which they rest depends on assigning arbitrary weights to factors that in truth are matters of prudential judgment…"

Battle of the Valuations (*Kress*)

Topic	Gift Tax Filing - Emory	Taxpayer's 2nd Expert at Trial - Czaplinski	IRS Pre-Trial	IRS Expert at Trial - Burns	Court Ruling - Judge Griesbach
Guideline Public Company Method	Used	Used	NA	Used	Accepted Emory's application
Capitalization of Earnings Method	Not Used	Used	NA	Used	NA
Use of C to S Valuation Method	Yes	Yes	NA	Yes	Yes
Tax Affecting S Corporation Earnings	Yes	Yes	NA	Yes	Accepted
S Corporation Premium	No specific adjustment; considered as qualitative factor in DLOM	Yes; adjusted discount rate downward to reflect after-personal tax return	NA	Yes; method unclear	Determined to be a neutral consideration
Approach to Valuing Non-Operating Assets	Did not value separately; accounted for only to extent included in book value and earnings	Life insurance policies and the personal use of airplanes was considered non-operating	NA	Non-operating assets added as separate component of value; no minority interest discount applied (Judge Griesbach rejected)	Accepted Emory's application
Bylaws Family Transfer Restriction	Considered as qualitative factor for DLOM	Considered a non-factor	NA	Not considered	Excluded from consideration on account of 2703; 300 basis point reduction applied to Emory's DLOMs
DLOM Method	Restricted stock studies; pre-IPO studies	NA	NA	Primarily estimated based on the costs of pursuing an IPO	Accepted Emory's application with one adjustment
DLOM Applied	30%; 30%; 28%	20%; 20%; 20%	NA	10.8%; 11.0%; 11.2% (Judge Griesbach found these DLOMs to be unreasonably low)	27%; 27%; 25%
FMV per share	$28.00; $25.90; $21.60	$30.87; $25.92; $25.06	$45.97; $47.63; $50.85	$38.04; $27.81; $40.05	$29.20; $27.01; $22.50

Notes: NA = not available. Gifts were made over three taxable years; valuations were provided for three years. Judge Griesbach accepted the taxpayer's original expert's opinions with only one adjustment, a 3% reduction to the DLOM in each year.

Estate of Jones v. Commissioner, T.C. Memo 2019-101.

- **Gift Tax Dispute:** Mr. Jones was audited subsequent to gifts he made in 2009; a notice of deficiency was issued in November 2013; Mr. Jones passed on September 22, 2014, leaving his Estate to handle the gift tax dispute.
- **Forum:** United States Tax Court
- **Subject:** Gifts of equity interests in Seneca Saw Mill Co. ("SSC") and Seneca Jones Timber Co. ("SJTC") made to several family and generation-skipping trusts in 2009.
  - SSC produces lumber from raw timber through its three sawmills (established 1954).
  - SJTC owns and manages timberland and is actively engaged in timber growing and harvesting.
  - Trial took place in November 2017; decision issued August 2019.
  - Taxpayer won on all fronts in a "battle of the valuation experts"; taxpayer's expert's numbers accepted.
  - According to the facts presented, the business operations of the two entities were highly interrelated.

Jones on Tax Affecting

- Court did not find IRS arguments convincing as the Court ruled the Service misconstrued the rationale in *Gross* and later cases.
  - Based on the record in Gross, presented with a choice of 0% or 40%
  - *Gallagher* – expert for the taxpayer did not consider benefits of business form
  - *Guistina* – error found in taxpayer's expert's method
- Principal benefit is the reduction in the total tax burden, not the elimination of all tax.
- Choice in Jones of (a) 0% tax rate or (b) tax affecting at 38%, combined with a subsequent premium of 22%.
- Taxpayer's expert has more accurately taken into account the tax consequences of the pass-through structure, so while not exact it is more complete and more convincing than IRS expert's 0% tax rate.

Battle of the Valuations (*Jones*)

Topic	Gift Tax Filing - Columbia / Taxpayer	Taxpayer's Expert at Trial - Reilly	IRS Notice of Deficiency	IRS Expert at Trial - Schwab	Court Ruling - Judge Pugh
Guideline Public Company Method	NA	Used	NA	Used	
Discounted Cash Flow Method	NA	Used	NA	Not Used	Accepted Taxpayer's Expert's DCF
Net Asset Value Method	NA	Not Used		Used	Dismissed NAV Method applied by IRS Expert for SJTC
Use of C to S Valuation Method	NA	Yes	NA	No	Accepted
Tax Affecting S Corporation Earnings	NA	Yes (38%)	NA	No; 0% tax rate.	Accepted
S Corporation Premium	NA	Yes; 22%; considered dividends avoided historically and an empirical study on S corp. acquisitions.	NA	Benefits of business form reflected through 0% tax rate application.	Accepted 22% premium
Proper Treatment of GP Interest		Valued SSC's GP Interest in SJTC based on distributions received by including distributions in the SSC DCF.		Argued that the FMV of SSC's 10% GP interest in SJTC is equal to 10% of SJTC's FMV. Reasoned that the GP Interest is a non-operating asset of SSC.	GP Interest is an operating asset. Accepted Taxpayer's Expert's approach of including distributions from SJTC in the SSC DCF.
Proper Treatment of Intercompany Loans	NA	Treated the intercompany debt as a "clearing account"; treated (did not adjust) interest income and interest expense as operating expenses; did not include in valuation intercompany balances as non-operating assets or liabilities.	NA	Treated intercompany loans as non-operating investments. Argued that SSC had a large receivable from SJTC that should be added to value, and SJTC had a large liability that ought to be subtracted from value.	Did not view the intercompany loan as an "investment". Considered it a "clearing account." Accepted Taxpayer's Expert's approach.
Transfer Restrictions in SJTC Buy-Sell Agreement	NA	Considered as qualitative factor for DLOM	NA	Not considered, but during testimony conceded/guessed a transfer restriction should add 1-2%	Accepted transfer restrictions as a marketability factor
DLOM Method	NA	Restricted Stock & IPO Studies	NA	Restricted Stock Studies	Accepted Taxpayer's Expert's approach, rationale and conclusion
DLOM Applied	NA	35.0%	NA	30.0%	35.0%
Voting/Non-Voting Differential	NA	3.0%	NA	NA	NA
FMV per share: SSC Class A Voting	$325 / $325	$390	$1,395	See Note (B)	$390
FMV per share: SSC Class B Non-Voting	$315 / $207	$380	$1,325	See Note (B)	$380
FMV per share: SJTC LP Units	$350 / $230	$380	$2,511	$2,530	$380

Notes: (A) The taxpayer's gift tax return used values for the SSC B units and the SJTC LP units lower than the values determined by Columbia. The Tax Court opinion does not indicate the source of that differential. (B) IRS submitted a rebuttal report for SJTC, as prepared by Mr. Schwab. IRS did not submit a report for SSC, but rather put forth criticisms of Mr. Reilly's report at trial.

Other Issues in *Jones*

- Asset or Income Valuation Method
- Net Net Gift was used in planning and did not appear to be challenged
- Burden of Proof
- Relying on management forecasts
- Discount for Lack of Marketability
- Intercompany Loans
- Proper Treatment of SSC's general partner interest in SJTC

A Section 2703 Defense in Gift Tax Audit

- Chapter 14 broadly has two parts:
  - Deemed gift provisions (Sections 2701, 2702, and 2704(a))
  - Valuation disregard rules (Section 2703 and 2704(b))
- Sections 2703
  - General Rule (Section 2703(a)): For purposes of transfer taxes, "the value of any property shall be determined without regard to (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or (2) any restriction on the right to sell or use such property."
  - Exception (Section 2703)(b)): Valuation disregard rule does not apply if following three exceptions are met:
    - It is a bona fide business arrangement
    - **<u>It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth</u>**
    - Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction

Rewriting by Regulation

- Section 2703(b)(2):

It is not a device to transfer such property to members of the **decedent's** **family** for less than full and adequate consideration in money or money's worth

- Treasury Regulation Section 25.2703-1 (b)(ii):

The right or restriction is not a device to transfer property to the **natural objects of the** **transferor's** **bounty** for less than full and adequate consideration in money or money's worth

Jurisprudence Supporting Each Position

- Supports Validity of Regulation Provision: 0 cases
- Supports Invalidity of Regulation
  - Dissent in *Holman v. Comm'r*, 601 F.3d 763 (2010). Tax Court did not consider validity as taxpayer did not raise challenge and majority opinion did not consider as it determined it failed Section 2703(b)(1).
  - *Smith v. United States*, No. 02-264 ERIE, 2004 U.S. Dist. LEXIS 14839 (W.D. Pa. June 30, 2004).
  - *Pierre v. Comm'r*, 133 TC 24 (2009): Ignoring valid restrictions under state law for determination of fair market value must be done by Code and not regulatory provisions.
- Practical Planning Point: In a **gift** tax audit, the exception under Section 2703(b)(2) is deemed satisfied because it is not a testamentary transfer.

Burden Shifting under I.R.C. § 7491

- I.R.C. § 7491
  - Where taxpayer has:
    - kept all records required by Code
    - cooperated with reasonable requests by Secretary for witnesses, information, documents, meetings, and interviews
  - And taxpayer is not partnership, corporation, or trust
- Request for privileged materials should NOT be considered reasonable request
- Filing Motion to Quash Summons does not necessarily indicate lack of cooperation
- Court have applied this in two ways:
  - Approach #1: If one party proves a fact by preponderance of the evidence, then I.R.C. § 7491 is not applicable as burden shifting is not necessary (*e.g. Jones*)
  - Approach #2: Court does the analysis and determines I.R.C. § 7491 does apply, but has no impact as one party proves a fact by preponderance of the evidence (e.g. *Kress*)

Valuation of Publicly Traded Stocks

- Treasury Regulation § 25.2512-2(a): "The value of stocks and bonds is the **fair market value per share** or bond on the date of the gift."
- Treasury Regulation § 25.2512-2(b)(1): "In general, **if there is a market** for stocks or bonds, on a stock exchange, in an over-the-counter market or otherwise, the **mean** between the highest and lowest quoted selling prices on the date of the gift **is the fair market value** per share or bond..."
- Treasury Regulation § 25.2512-2(e): "In cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under paragraphs (b), (c), and (d) of this section does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value…"

Chief Counsel Advice 201939002

- Facts
  - Donor was co-founder and chairman of a publicly traded company
  - Donor gifted shares to a grantor retained annuity trust (GRAT)
  - After the gift, the company merged with another company which increased the trading value of the shares
  - Merger talks were ongoing at the time of the gift
- Issue: "Whether, under the circumstances described below, the hypothetical willing buyer and seller of shares in a publicly-traded company would consider a pending merger when valuing stock for gift tax purposes."
- Answer: YES
- Concerns raised by CCA: A hypothetical willing buyer and seller would of course consider the impact of a potential merger—BUT:
  - For a publicly traded company, would that already be reflected in the trading price of the position?
  - How much due diligence is done by a "hypothetical buyer" and how do you value the potential merger based on that information?

Use of Earnings and Asset Approaches for Operating Businesses with Significant Assets

- A fundamental issue regarding valuing interests in a business that has both active business operations and assets of substantial value is what approach or approaches are appropriate to apply
- In such scenarios, it is prudent valuation practice to consider both earnings-based approaches (i.e., the income and market approach), an asset approach, or a combination of both types of approaches
- While this is not a new issue in federal tax valuation, recent matters before the U.S. Tax Court highlight the importance of this issue:
    - *Estate of Aaron U. Jones v. Comm'r*, T.C. Memo 2019-101
    - A pending opinion, *Cecil v. Comm'r*, U.S. Tax Court Docket No. 014640-14

Valuation Approaches, in General

- The American Society of Appraisers (ASA) Business Valuation Standards address the use of valuation approaches, as follows:
  - The appraiser shall select and apply appropriate valuation approaches, methods and procedures.
  - The appraiser shall develop a conclusion of value pursuant to the valuation assignment as defined, considering the relevant valuation approaches, methods and procedures, the information available and appropriate premiums and discounts, if any.
- The income and market approaches to value constitute earnings-based approaches, approaches based on future economic benefits
- The asset approach is based on the value of assets less liabilities

Major Criteria for Consideration in the Selection of a Valuation Approach

- Sufficiency and relevancy of financial and transactional data
- Type and industry of business and nature of business assets
- Stage of business in business life cycle
- Current position in the industry or economic cycle
- Importantly, the Level of Value Associated with the Business Interest
  - Majority interest (controlling interest)
  - Minority interest
  - Interests of limited control (deadlock, stalemate or veto block interests)

ASA Business Valuation Standards

- Asset Approach
  - The asset-based approach is a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods based on the value of the assets net of liabilities.
  - The asset-based approach should not be the sole appraisal approach used in assignments relating to operating companies appraised as going concerns unless this approach is customarily used by sellers and buyers. *In such cases, the appraiser must support the selection of this approach.* (emphasis added)
- Earnings Approach
  - The income approach is a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods through which anticipated benefits are converted into value.
  - The market approach is a general way of determining a value indication of a business, business ownership interest, security or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities or intangible assets that have been sold.
  - The two approaches are interrelated in that they both consider future benefits that are converted to value by an evaluation of risk.

IRS Position: Revenue Ruling 59-60

- Revenue Ruling 59-60 briefly addresses the scenarios under which weight should be accorded to valuation approaches
- Section 5, Weight to be Accorded Various Factors – (a) Earnings may be the most important criterion of value in some cases whereas asset value will receive primary consideration in others. In general, the appraiser will accord primary consideration to earnings when valuing stocks of companies which sell products and services to the public; conversely, in the investment or holding type of company, the appraiser may accord the greatest weight to the assets underlying the security to be valued.

Estate of Aaron U. Jones v. Comm'r

- Question before the Court: Given one of the entities primarily just held real estate (timberland) that it provided to the other company—do you value entity based on the underlying assets or the income stream being produced by it?
- In determining the appropriate approach, Judge Pugh considered both the income approach and the asset approach, concluding that the income approach was appropriate due to the interrelationship of the two entities and the likelihood of the assets of being sold.
- In her determination that the income approach was the sole appropriate approach, Judge Pugh concluded there was no likelihood the assets would be sold
- In reaching her conclusion, Judge Pugh cited the 9th Circuit Court of Appeals opinion in *Giustina* that remanded the case back to the Tax Court with instructions to weigh the valuation of a limited partnership interest in a timber entity as follows: 100% to the income approach and 0% to the asset approach.
- Had the Estate lost in *Jones*, the Tax Court opinion could have been appealed to the 9th Circuit.

Cecil v. Comm’r, U.S. Tax Court Docket No. 014640-14

- Issue for decision involved gifts of minority interests in The Biltmore Company (“TBC”), an entity that owns and operates Biltmore House and Estate in Asheville, North Carolina
  - At the date of value TBC operated 17 lines of business including 8 restaurants, 5 retail outlets, cultivation of livestock and crops. In addition TBC provided support and management services to affiliated companies
  - According to the assertions of the Service at trial, TBC held approximately $180 million in assets, inclusive of $97.9 in real estate and $49.4 in artwork and collectibles
  - For the five years prior to the date of value, TBC’s net income ranged from a loss of $1.5 million to a high of $3.2 million

Cecil v. Comm'r, U.S. Tax Court Docket No. 014640-14, Summary of Briefs

- The taxpayer contends that asset values should not be considered because:
  1. a minority shareholder does not have the ability to liquidate and realize the value of the assets,
  2. the assets will never be sold by TBC
  3. The governance documents and structure of TBC principals ensure that the assets will never be sold
  4. All of the assets are operating in nature, therefore the income approach captures the value of these assets
- The Service contends that:
  1. The taxpayer gives no consideration to substantial assets held by TBC
  2. At least one of the taxpayer's appraisers does not know how to use the asset approach to value TBC as a going concern
  3. the use of the asset approach is not restricted to only those companies that will be sold or have a plan of liquidation
  4. Some assets are non-operating in nature and should be added to the operating value of the business
- The taxpayer used the same methodology that was agreed upon in a settlement of a prior examination involving transfers of 6.6% of equity; the Service did not embrace this methodology for these transfers of 93.4% of equity.

Takeaways - Earnings & Asset Approaches

- The valuation approaches that are applied and what weight a specific approach is afforded may have significant impact on the value conclusion.
- The appraiser should consider both earnings and asset approaches in these scenarios, and provide sufficient explanation as to what approach(es) were used, and why they were used.
- Careful consideration of this issue by legal counsel and the business appraiser at the onset of a valuation engagement will lead to well-supported conclusions and minimize examination risk.

Grieve v. Commissioner Tax Court Memo 2020-28

- Taxpayer gifted 99.8% non-voting interests in two LLCs taking ~35% discount taken for lack of control and marketability
- IRS and expert asserted argument that interest should be valued based on assumption that the purchaser would have or obtain the 0.2% voting interests—asserted discount should be ~1.4%
- This is a variation of the old IRS argument that family control should be aggregated for determining control for transfer tax valuation purposes.
  - Tax Court rejected in Estate of Lee v. Commissioner, 69 T.C. 860 (1978)
  - IRS acquiesced in Rev. Rul. 93-12
- Court in *Grieve* rejected the IRS argument and reaffirmed the hypothetical willing buyer/willing seller test holding: “When a gift of property is made, its value at the date of the gift shall be considered the amount of the gift. We do not engage in imaginary scenarios as to who a purchaser might be.”

How are Private Company Values Affected by the Crisis?

- Value is a relative concept
- Differences by industry
- Equity risk premia
  - Treasury yields may be down, but risk premia have increased; discount rates on equity and debt securities should generally be equal to or higher than at 12/31/19.
- The value and risk of equity in leveraged companies is especially impacted.
- Projections need to be revisited; DCF analyses may need to be converted to multi-scenario approaches.
- Pension plans – some plans may now be underfunded and companies may have catch-up contribution requirements.
- Impact of government programs
  - Small business loans (which might be forgiven fully or partially if meeting certain criteria) would clearly be a positive for borrowers. However, this could indicate severe stress in a business.

What is the Impact on Valuation Discounts?

- Discount for Lack of Control ("DLOC")
  - Closed-End Mutual Funds ("CEFs") are typically used as a metric for Lack of Control Discounts for Investment Partnerships.
  - These discounts increased meaningfully from January to March. Median discounts for equity closed-end funds increased from roughly 5% to 11%; discounts for certain subgroups spiked to approximately 20%.
- Discount for Lack of Marketability ("DLOM")
  - Market liquidity issues
  - Research shows that several factors drive marketability discounts, including:
    - Size – equity market capitalization
    - Volatility of the stock
    - Price-to-book value ratio (think asset coverage)
    - "Holding" period / restriction period
    - Security registration status
  - DLOMs should generally be higher during crisis periods when investors are seeking liquidity, there is a flight to safety, and volatility is high.

Valuation Date Differences

- Hot Button Issue:
  - What if your valuation date is December 31, 2019?
  - What about a valuation date in Q1?
  - Get used to this phrase: “Known or knowable”
  - Pitfalls to avoid:
    - Using forecasts prepared after the crisis onset for pre-crisis valuation dates, and vice versa
    - Assuming full crisis impacts were foreseeable pre-crisis
    - Minimizing the impact on private company values
- Estate representatives need to consider the alternate date of valuation for estates with dates of death after August 1, 2019
- For clients finalizing current gifts or sales, rolling the valuation date forward to a current date may be advantageous
  - Many regular clients that obtain year-end valuations are now requesting a roll-forward to March 31, 2020.

Valuation Snapshot – Highly Leveraged Operating Business

- Publicly Traded Comparables:
  - In Q1 2020, stock prices down by a median of 44%; multiples down 21%
  - Assume these businesses commonly use significant debt financing to carry inventory and fund property investments
- Hypothetical Subject Business:

Case Study #1 - Closely Held Operating Business (thousands of USD, except per share amounts)

Metrics	12/31/2019	3/31/2020	*3 Mth Chg.*
LTM Revenues	205,556	205,556	
LTM EBITDA	12,333	12,333	
EBITDA Multiple	9.00	7.10	*-21.0%*
Enterprise Value	111,000	87,567	*-21.1%*
Less: Debt	55,000	55,000	
Plus: Cash	4,000	4,000	
Equity Value	60,000	36,567	*-39.1%*
Shares Outstanding	*100,000*	*100,000*	
Public Equiv. Value of Non-Voting Stock Per Share	600.00	365.67	*-39.1%*
Lack of Marketability Discount	32.5%	40.0%	
Fair Market Value Per Non-Voting Share	405.00	219.40	*-45.8%*

Valuation Snapshot – Investment Partnership

- Imagine most of a couple's assets and any associated liabilities (e.g., mortgages) are placed into a family limited partnership ("FLP")
- Snapshots of the FLP's balance sheet as of 12/31/19 and 3/31/20 are shown:

Case Study #2 - Family Limited Partnership (thousands of USD)

Balance Sheet	12/31/2019	3/31/2020	*3-Mth Chg.*
Assets			
Cash	2,000	2,000	
Investments	97,000	67,900	*-30.0%*
Other	1,000	1,000	
Total Assets	100,000	70,900	*-29.1%*
Liabilities			
Debt	8,000	8,000	
Shareholder Loans	-	-	
Other	2,000	2,000	
Total Liabilities	10,000	10,000	
Net Asset Value ("NAV")	90,000	60,900	*-32.3%*
NAV - 1.0% LP Interest	900	609	*-32.3%*
Lack of Control Discount	-5.0%	-10.0%	
Public Equivalent Value	855	548	*-35.9%*
Lack of Marketability Discount	-27.0%	-33.0%	
Fair Market Value	624	367	*-41.2%*

Takeaways

- There may be a unique opportunity for high net worth individuals to make wealth transfers now
  - Clients have the ability today to move a far greater percentage of ownership per dollar of exclusion amount relative to just two months prior
    - Asset values have generally declined
    - Discounts have generally increased
- Valuation Date
  - “Known or Knowable”
  - Alternate date elections for taxable estates should be considered for dates of death after August 1, 2019
- Valuation Process – Operating Company
  - Projections require full revisions in most cases
  - Common valuation inputs are being re-assessed
  - Building a solid workfile and documenting expectations/conditions while you are doing the project is critical.
  - Role of appraiser judgment