

WHO SAYS THAT BUSINESS APPRAISERS AGREE ON EVERYTHING?

10 Burning Issues Within the Business Appraisal Profession
for Consumers of Business Appraisal Reports



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Co-Author of *A Reviewer's Handbook to Business Valuation:
Practical Guidance on the Use and Abuse of a Business Appraisal*

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He has spoken at programs sponsored by a number of law schools, including Duke, Georgetown, NYU, Tulane, Loyola (N.O.) and LSU, as well as many other professional organizations, including AICPA and NACVA.

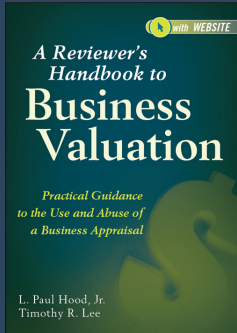
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A Reviewer's Handbook to Business Valuation



L. Paul Hood &
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A Reviewer's Handbook to Business Valuation is a collaboration of an attorney and a business appraiser emphasizing the practical side of business valuation. As the sub-title states, it contains practical guidance to the use and abuse of a business appraisal.

The book focuses on the pragmatic aspects of business valuation that arise in the context of a tax valuation, examining concepts and topics including the level of value, the role of estate planners in the business valuation process, the use of appraisers in estate planning and litigation, and the appraiser identification/selection process.

- **Part I (Foundations of Business Valuation)** provides the reader sufficient information to be an informed user/reviewer of a business valuation report without requiring the reader to become a business appraiser.
- **Part II (Business Valuation Standards)** contains a helpful overview of the professional standards from each major business valuation association. Therefore, the reader can check to see if their appraiser is following his/her own standards in their appraisal product.
- **Part III (Lessons from the Trenches)** is a practical, hands on treatment of problems encountered in business valuation reports. Full of case citations for our attorney friends, this section provides useful information not found in any other business valuation text.

The appendices contain even more useful resources for the reader.

A Reviewer's Handbook to Business Valuation is a practical resource designed for users of business valuation reports – specifically estate planners, estate planning attorneys, accountants, business owners, business appraisers, and other stakeholders in business valuation reports.

Public Service Announcement

- » Today, I represent the **consumers of tax valuation reports**
- » There is a **huge disconnect** between the knowledge possessed by appraisers and the knowledge possessed by us
- » This is a source of **consternation** for us and our clients because we must blindly rely upon these reports
- » For a detailed discussion of each of these ten burning issues, see Chapter 19 of ***A Reviewer's Handbook to Business Valuation: Practical Guidance on the Use and Abuse of a Business Appraisal***

Where You Stand On An Issue Depends On Where You Sit!

- » That's a little Southern wisdom
- » Business appraisers make numerous judgment calls on these very issues each and every time they write an appraisal report
- » Most business appraisers rarely ever explain these choices in the report, or explain why another position is not tenable

Little Did We Know ...

- » That business appraisers argue so much amongst themselves on such key doctrinal issues
- » We, users of business appraisal reports, blithely assume that all matters in a valuation report used “generally accepted appraisal principles”
- » The IRS says, until further notice, USPAP is it
- » But USPAP is silent on virtually all these issues
- » So where does this leave us?

So Many Issues, So Little Time ...

- » Each of the ten burning issues mentioned here could, by themselves, take up an entire program
- » We're not going to solve anything here today, however...
- » My purpose is to give business appraisers food for thought about how they present these issues when they write appraisal reports

Inherent Problems With “Fair Market Value” as a Standard

- » Hypothetical buyers and sellers
- » *Res tantum valet quantum vendi potest*
- » Perhaps best expressed by a range, yet the tax system requires one number
- » Are judges qualified to appraise? They do anyway!
- » The appraiser’s task is a tough one
- » Good advisors prepare clients for it

Generally Accepted Appraisal Principles, Anyone?

- » Frighteningly little is out there on an accepted way to deal with most appraisal substantive issues
- » The various appraisal standards promulgated to date certainly do not do so
- » Given the various turf battles that rage within the business appraisal industry, I see little chance of this happening

Discount for Lack of Marketability

A typical user of business appraisal reports who has been confronted with the myriad of methods to determine a discount for lack of marketability



Discount for Lack of Marketability

» DLOM Approaches

- Numerous and growing like weeds
- The pros and cons of the selected approach (and why another approach was not used) are rarely, if ever, discussed in an appraisal report
- There are an awful lot of turf battles in this arena. Everyone seems to have something to sell

For a complete discussion, see pp. 276-286 in *A Reviewer's Handbook to Business Valuation*

Discount for Lack of Marketability

» DLOM Approaches (in no order of preference or importance)

- Pre-IPO Studies (Willamette, Valuation Advisors and Emory)
- Restricted Stock Studies (FMV Opinions, Management Planning, Silber, Willamette, Institutional Investor Study, Gelman, Trout, Moroney, Maher, LiquiStat and Standard Research Associates)
- Black-Scholes Option Pricing Method (Chaffe application)
- QMDM (Mercer)
- Longstaff
- Private Placement Method (Bajaj)
- LEAP (Trout/Seaman)
- Practical Scoring Method (Curtiss)
- Bid-Ask Spread (Chipalkatti)
- Time Model (Stockdale)
- Finnerty
- Meulbroek
- Tabak
- Mandelbaum (Judge Laro's ten factor test)
- Abrams

Discount for Lack of Marketability

» An example

- I received a report that computed DLOM using the following weights:
 - Pre-1990 restricted stock studies-30%
 - Pre-IPO studies-35%
 - LEAP-35%
- Then factored through some additional factors
- How could this be justified or explained to the satisfaction of a court?
- Beats me

Discount for Lack of Marketability

» *Daubert* Considerations

- Can so many different DLOM approaches ever give rise to a truly successful compliance with *Daubert* and its progeny for any of these methods?
- In light of the disparate positions within the appraisal community, the answer arguably is “no,” yet a few of these approaches seemingly have passed muster under the *Daubert* test

Discount for Lack of Marketability

- » What's coming next?
 - Examining the entrails of a chicken?
 - Seriously, what will the next DLOM approach be?
 - No doubt that it will be published soon

DLOM Applied to Controlling Interest

- » Case law clearly has permitted this
- » But is this position correct from the standpoint of valuation?
- » Appraisers disagree here
- » How large should this discount be relative to DLOM for a minority interest?

For a complete discussion, see pp. 286-288 in *A Reviewer's Handbook to Business Valuation*

Discount for Built-In Capital Gains

- » Disparity between what the Tax Court is doing and the “bright line” test enunciated by the two courts of appeals that have dealt with this. Supreme Court didn’t take the case in *Jelke* (11th Circuit).
- » Is the bright line test too good to be true?
- » What should the rule be?
- » Could the appraisal community agree?

For a complete discussion, see pp. 288-289 in *A Reviewer’s Handbook to Business Valuation*

Looking for Private Companies

- » Databases of private transactions are being aggressively marketed
- » There is scant tax case law, which makes me nervous due to a lack of public track record
- » There are significant criticisms in the appraisal literature of each of the private databases
- » There is something attractively appealing to using private company data, but the lack of guidance and the criticisms give me heartburn

For a complete discussion, see pp. 289-290 in *A Reviewer's Handbook to Business Valuation*

What is the “Small Firm Effect,” If Any?

- » There are two schools of thought here
- » This added increment of risk usually is added without any discussion in the appraisal report of why or that there is another school of thought

For a complete discussion, see pp. 290-300 in *A Reviewer's Handbook to Business Valuation*

Are Synergistic Buyers Properly Included Within the Definition of “Hypothetical Buyer?”

- » Judge Laro says yes. Is he correct?
- » I think not, but who in the Sam Hill am I?
- » If synergistic buyers were included within the hypothetical willing buyer, then lots of potential willing buyers would be excluded because they wouldn't pay what a synergistic buyer would pay

For a complete discussion, see pp. 291-298 in *A Reviewer's Handbook to Business Valuation*

For a complete discussion, see p. 298 in *A Reviewer's Handbook to Business Valuation*

The Levels of Value

- » Appraisers disagree over the levels of value charts that end up in appraisal reports, although there are majority and minority schools of thought
- » Where you stand on this issue could mean a **huge** difference in a conclusion of value
- » This is rarely, if ever, discussed in appraisal reports !

S Corporations: To Tax-Effect or Not?

- » Disparity between what most appraisers seem to be doing and what the Tax Court is doing!
- » Again, too much “my model is better and your method ain’t worth a damn”
- » There seems to be no way to reconcile the differences of opinion here per Shanon Pratt
- » Very little discussion of competing approaches in appraisal reports

For a complete discussion, see pp. 299-301 in *A Reviewer’s Handbook to Business Valuation*

Financial Statement Adjustments to Be Made When Valuing a Non-Controlling Interest

- » These adjustments usually are material
- » There are two schools of thought on this issue
 - One says make the adjustments because one should assume a well-run company
 - The other says that if the minority shareholder can't force the adjustment, then don't make it
- » This is rarely discussed in appraisal reports

For a complete discussion, see p. 301 in *A Reviewer's Handbook to Business Valuation*

Validity of CAPM in Valuing Closely Held Companies

- » This forms the basis for a lot of appraisers' estimation of the proper risk level
- » It apparently is difficult to explain to courts
- » It also has some doctrinal difficulty in its application to closely held businesses
- » I've never seen the caveats associated with this method discussed in an appraisal report

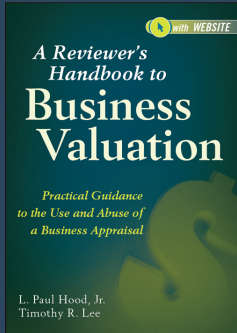
For a complete discussion, see pp. 301-303 in *A Reviewer's Handbook to Business Valuation*

Where Do We Go From Here?

- This presentation formed the basis for a book, *A Reviewer's Handbook to Business Valuation*
- If you are a business appraiser or a consumer of business appraisal services and have been frustrated by any of the issues mentioned, consult *A Reviewer's Handbook to Business Valuation*
- The book contains practical guidance to the use and abuse of a business appraisal
- Visit www.bvreviewershandbook.com for more information, copies of the business valuation standards from each professional appraisal society, current case law as it pertains to the subject, and fresh articles from the authors

Book the Authors to Speak

Authors Paul Hood and Tim Lee are frequent speakers on legal and business valuation topics for professional and trade associations throughout the country. Paul and Tim believe that one of the greatest benefits of writing this book has been the opportunity to speak to groups of business owners, financial planners, attorneys, accountants, and business appraisers to share experiences that can help others. Paul and Tim are available to speak on topics included in *A Reviewer's Handbook to Business Valuation*, as well as other topics related to business appraisal and tax valuation.



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