



Selecting an Appraiser to Value Your Company

Introduction

Recently, a father called to discuss the issue of gifting stock in his company to his son. The son had actively participated in the business for several years and the father wanted to reward him by gifting him some stock. I told him to carefully consider how he determines who will do the appraisal and whether or not he wanted to gift and not sell the stock to his son. The Internal Revenue Service has recently stated that a “qualified appraiser” needs to be hired for determining the value of all donations and sales of property, especially stock in a closely-held business, that exceed \$5000.

Who is a qualified appraiser?

According to an IRS notice released in August of 2006, that became effective on August 17, 2006, a qualified appraiser is a person who has

A) Earned a professional designation from an approved organization or
B) Has approved education in the valuation field and,

1) Has experience in the industry of the company for at least two years, and

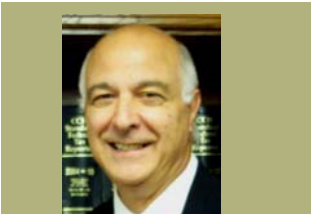
2) Regularly performs appraisals for compensation, and

3) Has not been disqualified from practicing in front of the IRS during the past three years.

It is important to realize that the appraiser can be held liable for a substantial and gross misstatement of a fact if the appraiser should have reasonably known of the information.

When I spoke with the father, the key factor was to be sure to retain a person who knew his industry and regularly did appraisals in the industry. Finally, I explained

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Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the *Financial, Legal & Tax Advisory* which may be read in various industry-specific trade publications.

A CASE STUDY

In a Notice, the IRS has established its own definition of “covered employees” for the \$1 million executive compensation cap. In the past, the IRS’s definition of a covered employee coincided with the definition of the SEC. That definition included principal financial officer or someone of similar capacity. The IRS’s new definition includes

a) principal executive officer, b) an individual acting as principal executive office, or c) any employee with compensation among the three highest compensated officers for that year.

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that gifting stock might not be the way to reward the son.

The Problem with Gifting

Gifting presents many problems. The more serious problems occur when the value of the company increases. In this situation, the number of shares that can be given, decreases. Thus, the percentage of the company that can be gifted decreases each year

In addition, the donor is responsible to file a gift tax return with the federal government and be subject to an audit for a three year time period. This is in addition to the fact that if the valuator applies a discount, (such as the case with minority interests) must be disclosed to the IRS and be subject to proof and verification.

Finally, because the transaction involves a transfer from a father to a son, special tax and valuation rules apply that could cause difficulty with the IRS accepting the end result, if the appraiser is not familiar with the special tax and valuation rules.

Conclusion

As a result of the consultation, the father decided to have the company valued by a "qualified appraiser" and sell stock to his son, instead of gifting stock to his son. In this fashion, no gift tax return needed to be filed and the special rules did not apply since the transaction had to meet the general test of "fair market value". The father decided to reward his son for years of service through a sale of stock, rather than gifting company stock.

Readers are cautioned when considering any transfer, whether it is a gift or sale of stock in a closely held company. Know whether or not the appraiser meets the qualifications of the IRS and also know that there are special tax rules governing valuation of stock when family transfers are involved.

If you have any questions regarding selecting an appraiser or determining the value of your company or wondering how to transfer the company in a succession plan, contact the specialists at the Center as we have knowledge and experience in your industry, meet all the requirements set forth by the IRS and know the tax and valuation rules that apply to family transactions.



WHICH STANDARD OF VALUE SHOULD YOU USE WHEN SELLING YOUR BUSINESS?

When it comes time to sell your business, it's important to realize that your business may be valued differently by different prospective buyers. Furthermore, it's important to understand what standard of value will likely be used by a qualified business appraiser who is asked to perform an independent business valuation.

There are many standards of value, such as book value, replacement value, insured value, assessed value, etc., each of which is applicable in its own specific circumstance. The two standards of value that are particularly relevant when selling your business are: Fair Market Value and Investment Value.

Fair Market Value is the standard that most people are familiar with, and the legal standard used in most valuations. It relates closely to real estate appraisals performed by comparing a property to comparable properties sold recently. However, by definition, fair market value is hypothetical, and is not swayed by what a particular interested buyer might pay, and may or may not be achieved if the business is transferred.

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Editor's Comment:

The \$1 million compensation limit can be overcome if it is reasonable to pay an executive a level of compensation over and above \$1 million. This newest definition expands the reach of the IRS concerning who they will now examine in companies with highly paid executives. The Center has developed a formula for proving whether executive compensation over and above \$1 million is reasonable or not. If you have any questions about compensation whether it is this cap, constructive dividends, or company loans, be sure to call the Center for assistance in your tax planning.

POINTS OF INTEREST

- ❑ **The Internal Revenue Service has recently stated that a "qualified appraiser" needs to be hired for determining the value of all donations and sales of property.**
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Continued Which Standard of Value Should You Use when Selling Your Business:

The definition of fair market value adopted by the professional appraisal community has as its foundation IRS Revenue Ruling 59-60, and is published by the American Society of Appraisers as: "The amount at which property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts." NOTE 1: The "amount" is always assumed to be cash without terms. Adjustments must be made for the value if terms are involved.

Investment Value on the other hand, represents the value to one particular interested buyer or investor. It is generally higher than fair market value. RATIONALE: The buyer presumably has specific reasons for acquiring the property that motivate him to pay a premium over fair market value.

Our goal when representing the seller is to find that particular interested buyer who might be willing to pay a reasonable premium over fair market value.

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free consultation with us, have them contact me, or any of the M&A professionals at www.bradwaygroup.com

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Frequently Asked Questions...



Q1: Due to the recent changes in charitable contributions, can a donor deduct the fair market value of a vehicle which is donated to a charity.

A1: The new rules are a bit more restrictive than the old rules regarding charitable contributions of property. In the case of a donated car, the vehicle is only deductible to the value in which the charitable institution sells the property. However, if the charitable institution is one in which the purpose of the institution will be furthered by the donation itself (i.e. one that provides vehicles to the needy), or the vehicle is worth less than \$500, then the vehicle can be deducted at FMV irregardless of what a sale could or does bring.

Q2: Do you have to have an appraisal of multiple items of property to charities accumulated over \$5000, yet no one single item totals over \$5000?

A1: Yes, obtaining an appraisal to substantiate deductions totaling over \$5000 in a given year is necessary.

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