



Valuation Insights & Updates

3Q2008

Back of The Envelop Valuations Are History: AICPA SSVS No.

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The adoption by the AICPA of their Business Valuation Standard “Statement on Standards for Valuation Services (SSVS) No. 1” which was effective for all CPAs on January 1, 2008 basically precludes any CPA who is not either an accredited business appraiser or a CPA with the specific training and experience to properly execute an appraisal according to this Standard, from performing any business valuation services.

This combined with recent malpractice cases, and successful *Daubert* challenges in US Federal Courts necessitate that your valuation is performed by an accredited professional with either a CVA, ABV, CFA or ASA accreditation and substantive experience to legitimize any valuation positions taken.

Fair Value vs. Fair Market Value: Clearing up the Confusion

Well before Revenue Ruling 59-60, 1959-1 CB 237—IRC Sec 2031, the IRS honored valuations based on a willing buyer, willing seller definition and over the decades that implied a generic buyer and generic seller which resulted in the acceptance that such transactions gave rise to various discounts, including lack of marketability and lack of control. However, many state courts and statutes have asserted a second type of value, *fair value*. Fair value, which has not been defined federally or in any of the appraisal standards, including USPAP or SSVS No. 1, is generally a pro-rate control value based on a market transaction or a person with knowledge of the marketplace. Fair Value is a value basis that generally precludes discounts and may give rise to pro-rata premiums. However, synergies should not be included in arriving at fair value.

Fair Value is the value premise in many shareholder lawsuits and divorce proceedings. Despite the various definitions, it is basically a pro-rata, marketable, control position on a non-synergistic basis (say that three times fast!).

McCord Case: The Most Important Gift Tax Valuation Case in the Last Ten Years

Charles T. McCord, Jr., et ux. v. Commissioner, 120 TC 358, Code Sec (s) 2511; 2512 is a case that anyone involved in estate planning should review. From a valuator's perspective, we find interesting that the IRS expert was willing to impute both a minority discount and lack of marketability discount for what was essentially an FLP containing highly liquid assets (including Dell Computers Stock). For many years there was concern that the IRS would resist recognizing the discountable value of FLPs but this case forced the Service's hand. Another reason that McCord Case is so watched by valuation professionals is the argument that the IRS's valuation expert, Dr. Mukesh Bajaj's analysis was critical of the Pre-IPO Studies which have been a foundation of valuation practice for over thirty years. The McCord Case and Dr. Bajaj's analysis is continuing to be referenced in other Courts and in various subsequent valuation analysis. Highly recommended reading!

Estate & Gift Taxes Continued: Peter S. Peracchio Vs. T.C. , 2003-280

Case concerned a highly liquid FLP funded with \$2.014 MM Cash and Marketable Securities. Taxpayer argued for: Discount for Lack of Control (DLOC) of 5.5% and 7.0% (two appraisals) and Discount for Lack of Marketability 35% and 40%. Commissioners agreed that use of Closed End Funds appropriate for DLOC but had a resulting DLOC of 4.4% and DL0M of 15%. Court ruled DLOC of 6% and DL0M of 25%. Court noted Taxpayer's appraiser didn't "preclude outliers" in DLOC study. Court further admitted that restricted stock studies "certainly have some probative value."

Clarissa W. Lappo V. Cit, T.C. Memo. 2003-258

Case concerned a highly liquid FLP funded with \$3.179 MM Real Estate and Marketable Securities. Taxpayer argued for: Discount for Lack of Control (DLOC) of 30% to 35% for real estate (Based on REITS with upward adjustments) and DLOC for Marketable Securities of 8.5% based on Closed-End Funds. Taxpayer argued for 35% DL0M. Commissioner's DLOC was 6.0% on Real Estate, the 8.5% on Marketable Securities (agreed with Taxpayer!) and 8.30% DL0M based on Bajaj study from McCord Case. Court found DLOC of 19% for Real Estate, DLOC of 8.5% for Marketable Securities and DL0M of 24%. In finding DL0M Court used Bajaj study but rejected findings and adjusted upwards.

Litigation: Simons Case and Not Daubert in Illinois State Courts

Concerning trial testimony, Illinois state courts seem to be in the minority in not adhering to *Daubert v. Merrell Dow Pharmaceuticals* (92-102), 509 U.S. 579 which is the 1993 US Supreme Court decision that has precipitated "Daubert Challenges" due to the inherent "gatekeeper" role that this decision placed on the judge. In *Re Commitment of Simons*, the Illinois high court created a dual standard of review for the admission of expert testimony. In doing so, the Court overruled its prior decisions in *Donaldson v*

Central Illinois Public Service Co and *People v Miller* governing the appropriate standard of review for admissibility of such evidence. This 2004 decision stated that the appellate review of "general acceptance" aspect from the 1923 *Frye* Case is applicable. The opinion articulates a lesser gate keeping role than that of *Daubert* yet still encompasses the imperative that an expert must use methods that are generally accepted within their field.

Unlike *Daubert*, this trial judge must see that the expert is using generally accepted methodologies. While the judge may look for outside sources to conclude whether the expert has used generally accepted methodologies, the trier of fact doesn't not have ascertain whether the results themselves are credible in a *Frye* hearing or whether the expert witness is credible on other merits but whether that witness has used generally accepted methodologies in arriving at their opinions.

If you wish to discuss anything contained in this article, please do not hesitate calling Tony Garvy, CPA, CVA at (312) 324-0340 x2.