

Q&A FOR TAX CUTS AND JOBS ACT (THE “ACT”) AND IMPACT ON BUSINESS VALUE

What provisions in the tax law have the largest impact on business value?

The two that are applicable to all tax paying firms and individuals are the tax rate change and the accelerated depreciation of fixed assets. The tax rate change is expected to have the largest impact followed by the tax benefit of accelerated depreciation. Both of these will increase value. Other provisions that are expected to impact business valuations include: the interest deduction cap (for highly levered firms), the change to a territorial tax systems (for multi-nationals), R&D capitalization beginning in 2022 (for research intensive firms) and the NOL deductibility changes (for firms with large NOLs).

What is the impact of the higher estate tax exemption amount (doubled to \$10.98 million for individuals and \$21.96 million for married couples) for estate planning?

The higher exemption amount allows individuals to gift up to the new exemption limit and to lock-in the exemption amounts. It is uncertain if the current exemption amounts will be renewed or allowed to sunset depending on actions of future administrations. If not renewed and allowed to sunset, transfer tax exemptions could drop to approximately \$6.3 million for individuals and \$12.6 million for married couples in 2026 assuming a 1.5% annual inflation rate.

What is the definition of “service” firms for pass-through tax rates?

The definition of a “service” business (per the law) is one who provides specified service activities per the following definition:

A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

What will be the impact of the tax reform on investment and real estate holding companies?

We expect no changes to the holding company discounts for lack of control or lack of marketability, however, some the assets held may change in value.

How will tax reform affect firm cost of capital?

In the short term, tax reform will increase the after-tax cost of debt, especially highly levered firms in cases where the interest deduction is capped. In the longer term, if firms become delevered, the increased equity used to finance firms could also increase the cost of capital. We do not anticipate equity or risk-free rates to change materially due to tax reform. However, the impact of the effects of an increased cost of capital in most cases will be more modest than the increase in after tax cash flow from reduced rates and accelerated depreciation.

TAX CUTS AND JOBS ACT (THE “ACT”) AND IMPACT ON BUSINESS VALUE

What are the impacts of the tax-reform on long-term growth?

Expected long-term growth rates remain consistent with risk free rates and expected inflation. However, short- and long-term growth rates may increase if companies use increased cash as a result of the tax reform to invest in projects to improve efficiency or grow their companies.

At what leverage levels does the limitation on interest deductibility begin to impact value?

The interest expense deduction is capped at 30% of EBITDA through 2021. Assuming an interest rate of 6%, the cap begins to take effect at a debt/EBITDA level of around 5 times. To the extent that interest rates are higher than the 6% used in this illustrative example, a lower debt/EBITDA ratio would trigger the limitation.

Empire Valuation Consultants is a national leader in estate and gift tax valuations. Our experts have broad experience in the preparation of business, partnership and LLC appraisals in this important segment of our valuation practice. In addition, we have extensive experience with large estate and gift tax engagements involving multiple entities and complex tiered structures, including engagements with interests in over 100 entities.

The directional change for each variable assumes all other variables held constant. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for tax, legal or accounting advice. Please consult with your own tax, legal and accounting advisors before engaging in advisory services. Empire Valuation Consultants is not a tax advisor.

Experience Excellence



www.empireval.com

Rochester
585.475.9260

New York
212.714.0122

West Hartford
860.233.6552

Boston
617.535.7785

San Francisco
415.659.1860