

The Name of the Game in Estate Planning is Valuation

Interactive Legal Services Webinar
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PRESENTED BY:

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Agenda

- ◆ Fundamental Valuation Principles
- ◆ Typical Valuation Adjustments (Premiums/Discounts/Etc)
- ◆ Asset Types, Factors and Terms Impacting Discounts
 - FLPs
 - Operating Businesses
- ◆ Lack of Marketability Discounts – Methods/Issues
- ◆ Appraisal Report – Working with Appraisers
 - New – Qualified Appraiser and Appraisals
- ◆ What We are Seeing in Audit Area

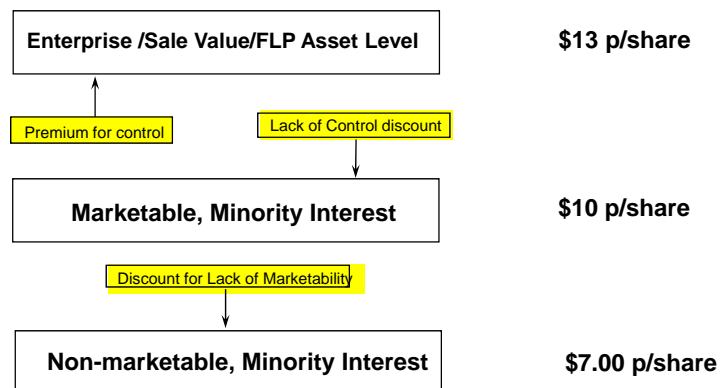
Fundamental Principles

- ◆ Meaning of Fair Market Value
- ◆ Constitutional Limits
- ◆ Regulatory Valuation Rules (sec. 20.2031 and 25.2512)
- ◆ Exceptions/Conventions (Sec. 2032A; Burial Plots; Chpt. 14)
 - Section 2701
 - Section 2702
 - Section 2703
 - Section 2704

3

Typical Valuation Adjustments – Control/Marketability

Total discount level is impacted by where in the “valuation level” chart you start:



4

Typical Valuation Adjustments - Other

- ◆ Built-in Capital Gains – Liability or Discount
 - Jensen; Jameson; Eisenberg; Davis (Court Cases)
- ◆ Partial Interests (TIC) in Real Property (QPRT issue)
 - Ludwick
- ◆ S-corp./Pass-through Entity Premium
 - Gross; Hecht; Adams; and Dallas Cases
- ◆ Blockage/Restricted Stock Discounts
- ◆ Key Man Discount
- ◆ Others as facts and circumstances require

5

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Factors Impacting Discounts - IHCs

- ◆ Investment Holding Companies/FLPs/LLCs
 - Inside discounts impacted by types of assets held
 - ▶ Cash, bonds, dividend paying preferreds – lower discounts
 - ▶ Equities – larger blocks especially
 - ▶ Hedge funds
 - ▶ Private equity investments – higher discounts
 - Outside discounts:
 - ▶ Likelihood of distributions
 - ▶ Likelihood/timing of liquidation
 - ▶ Ownership rights
 - ▶ Ease of transfer or withdrawal
 - ▶ Ease of “borrowing” by shareholders
 - ▶ Other restrictions in agreement
 - ▶ Built-in capital gains in C-corp. holding companies

6

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Factors Impacting Discounts - LP Docs

- ◆ Long Life, No Automatic Termination on Death of Any One GP or Managing Member
- ◆ First Right of Refusal on Sale
- ◆ No Withdrawal Rights
- ◆ No Transfer without Permission – Assignee Interests Only
- ◆ No Vote/Say in Operation by LPs/Members
- ◆ No Guaranteed Distributions of Any Kind
- ◆ Adequate Business Purpose...with Follow-through
- ◆ Not More Restrictive Than Customary
- ◆ Etc.

7

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Factors Impacting Discounts - Op. Companies

- ◆ Operating Companies
 - Control vs minority level of value
 - Size of block
 - Built-in capital gains in C-corporations or S-corps (first 10 years)
 - Attractiveness of company (size, stability, markets, growth, etc.)
 - Likelihood of sale or liquidity event
 - Likelihood of distributions
 - Ownership rights
 - Ease of transfer or withdrawal
 - Ease of “borrowing” by shareholders
 - Other restrictions in shareholder/operating agreements
 - Many other issues.....

8

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Methods of Measuring LOM/LOC Discounts

- ◆ Lack of Marketability
 - Restricted Stock Studies
 - Other Studies – Older typically
 - Quantitative Models
 - ▶ QMDM Model
 - ▶ Option Based Models
- ◆ Lack of Control Discounts
 - Control Premium Studies
 - Closed end investment funds

Appraisal Report - Engaging Appraiser

- ◆ Full Time Employment in Field
- ◆ Experienced as Appraiser
 - Certified (preferably senior) by Major Appraisal Organizations (ASA, ABV & Others)
- ◆ Experience in Appraisal Type and Industry Preferable
- ◆ Free of Conflicts
- ◆ Adheres to Standards of Certifying Organization
- ◆ Qualified as Expert (if in Litigation)

Appraisal Report - Components

- ◆ Purpose and Definition of Valuation
- ◆ Effective Date(s) of Valuation
- ◆ Applicable Standards and Levels of Value
- ◆ Nature and History of the Interest Being Valued
- ◆ Economic Outlook – Industry & Company
- ◆ Financial Condition and Analysis
- ◆ Selection and Application of Valuation Approaches
- ◆ Adjustments to Values
- ◆ Reconciliation of Values & Conclusion
- ◆ Exhibits and Addendum
- ◆ Qualifications of Appraiser

11

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Appraisal Report – Your Review

- ◆ Meet the Needs of the Reader
 - Reasonable disclosure of process and reasoning
 - ▶ Detailed discussions on marketability discounts & adjustments
 - ▶ Not reliant on “averages” of studies
 - Understandable by a reader unfamiliar with business or valuation process (IRS agents or courts)
 - Text and valuation assumptions should be consistent
- ◆ Review Report Carefully, Ask Questions, Understand What is Being Done
 - Appraiser should be able to answer questions to your satisfaction

12

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New: “Qualified” Appraisal and Appraiser

- ◆ Appraisal Requirements Focused on **Charitable** Gifts
- ◆ Changed Over Time
 - American Jobs Creation Act - 2004
 - Pension Protection Act – 2006 - Transitional Guidance
 - Proposed Regulations - IR Bulletin 2008-40
- ◆ Yet to Be Finalized But Used as Guidance
- ◆ May to Be Extended to Non-charitable Tax Related Valuations In Future
- ◆ Guidance on Qualified Appraiser and Appraisals

13

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Qualified Appraisal and Appraiser

- ◆ Qualified Appraisal – Transitional Guidance
 - Appraisal prepared by qualified appraiser in accordance with generally accepted appraisal standards (mentions USPAP as example)
 - Current regs. require the valuation date to be no earlier than 60 days prior to date of **charitable** gift, and no later than the gift date. Proposed regs. indicate effective valuation date should be date of gift, however, if prepared earlier, can be no more than 60 days earlier.
 - Report signing date on **charitable** gift valuation must be no earlier than 60 days prior nor later than the due date (including extensions) of return where deduction claimed.
- ◆ Professional Appraisals – Best Insurance for Meeting Regs.

14

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Daubert Challenges & Court Prospects

- ◆ Any Appraisal Can End Up in Court – Tax/District/Probate

- ◆ Daubert v. Merrell Dow and Kumho Tire V. Carmichael
 - Cases provided for challenging expert witnesses
 - ▶ Daubert – scientific methods – Court becomes gatekeeper (93')
 - ▶ Kumho Tire – Daubert extended to non-scientist technical experts (99')
 - Challenges since 2000's Kumho Tire decision have increased significantly
 - ▶ PWC 2010 study

- ◆ Qualified Appraisals/Appraisers
 - Improve Daubert prospects
 - Improve credibility with courts

15

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What are We Seeing – Planning and Audits

- ◆ Reduced number of FLP/LLCs formed, but updates for additional gifting continuing
 - Typical discounts for combined lack of control and marketability
 - ▶ 25% to 40%
 - Kind of assets put in to FLP impact discounts
 - ▶ Higher discounts for less liquid assets

- ◆ Lots of minority interests in real estate being sold/gifted
 - Typical discounts for lack of marketability in the 30% to 35% range
 - Lack of control can mean larger all-in discounts

- ◆ Gifts/sale of family company shares coming back slowly

16

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What are We Seeing

- ◆ Typically people transfer non-voting stock to retain control and get incremental lack of voting rights discount – 3% to 5%
 - On top of fact that values already at minority interest level
- ◆ IRS audits focused on estates. Almost none on GRATS or gifts
- ◆ Appears to be an uptick in audit disputes in general – IRS in more aggressive revenue collection mode

17

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What are We Seeing – IRS Views

- ◆ IRS views on discounts
 - Investment holding companies (FLPs/LLCs) 25% to 30%...grudgingly higher with special circumstances. Would like to see discounts for lack of control eliminated on strictly family oriented entities
 - Businesses/real estate holding entities – 25% to 35% for lack of marketability, higher if include lack of control
- ◆ Big Tax Court wins for IRS – Senior members treat FLP like own personal piggy bank or put all assets in. Form not respected!
- ◆ Tax Court wins for Tax Payer
 - More recently – Built-in-Gains Taxes

18

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Questions

Jonathan Blattmachr, JD

Jonathan is a member of the Alaska, California and New York Bars, and retired partner from the law firm of Milbank, Tweed, Hadley & McCloy LLP. He has served as a lecturer-in-law of the Columbia University School of Law and an Adjunct Professor of Law at New York University Law School.

He is a former Chairperson of the Trusts & Estates Law Section of the New York State Bar Association and of other committees of the New York State Bar Association and the American Bar Association. Mr. Blattmachr is a Fellow and a former Regent of the American College of Trust and Estate Counsel and past Chair of its Estate and Gift Tax Committee.

He is author or co-author of over 300 articles and five books on estate and tax planning topics including a new book published by the Practising Law Institute on Circular 230. He has been designated as a Distinguished Accredited Estate Planner by the National Association of Estate Planners & Councils.

Mr. Blattmachr also is a co-developer of Wealth Transfer Planning™, an InterActive Legal software system published for lawyers which provides specific client advice and automated document assembly for wills, trusts, powers of attorneys and other estate planning documents.

Scott A. Nammacher, ASA, CFA

Scott has over 20 years of experience in financial consulting and business valuations. He spent six years doing acquisitions, divestitures and special financings for PepsiCo and Marigold Enterprises, a boutique consulting & leveraged buyout firm. His background includes experience with Arthur Andersen & Co., where he managed equity, debt, warrant/option, NOL and intangible asset valuations, along with general financial consulting engagements.

He is an Accredited Senior Appraiser (ASA) with the American Society of Appraisers; and a Chartered Financial Analyst (CFA). He has been and remains active in the American Society of Appraisers and has chaired/co-chaired an annual valuation conference in NYC for over 19 years.

Scott has valued a wide variety of publicly and privately-held companies for acquisitions, share repurchases, financial reporting, estate and gift tax reporting, recapitalizations, and general corporate planning and litigation purposes. He has extensive experience in valuing P/E and hedge fund company interests.

He coauthored a book, *Investing in Junk Bonds; Inside the High Yield Debt Market*, John Wiley & Sons, New York, New York, 1987 (including a Japanese translation published in 1988) and several articles on "junk" bonds.

He has testified in US Tax Court, Bankruptcy Court, Delaware Chancery Court, State Supreme Courts, and arbitration venues in the Northeast, South and Western states.

Scott holds a bachelors degree in Business from the University of Minnesota and an MBA in finance from New York University's Stern School.

Empire Corporate Overview

- ◆ One of the largest independent valuation consulting firms in the U.S. – Staff of 70 people
- ◆ Valuation professionals are MBAs; many have other designations (e.g., CFA, ASA, ABV, CPA, etc.)
- ◆ Extensive estate planning, ESOP and financial reporting valuation background
- ◆ Empire has strong experience working with both private and public early stage and major corporate clients in the U.S, Israel and Europe
- ◆ The firm has provided valuation services on behalf of many of the top law firms, private banks, trust companies in the estate and trust area, as well as all accounting and other estate planning oriented firms around the US and world.

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