About the Authors/BART BASI, CPA & MARCUS S. RENWICK

Dr. Bart A. Basi is an expert on closely-held enterprises. He is an attorney, a Certified Public Accountant, and President of The Center for Financial, Legal & Tax Planning, Inc. He is a member of the American Bar Association's Tax Committee on Closely-Held Businesses.

With four specific services, The Center provides complete unbiased planning. The Center does not sell any products; its main purpose is to provide advice. Local experts are retained to implement the plans developed by the Center. The Center for Financial, Legal & Tax Planning is located at 4501 W. DeYoung Street, Suite 200, Marion, Illinois 62959. Phone 618-997-3436; Fax 618-997-8370.

Marcus Renwick is an attorney and the Director of Research and Publications with the firm.

Bart Basi

Selecting an Appraiser Under the New Rules

Whether it's due to divorce, illness, or the desire to retire, when it comes time to have your business appraised, your first instinct is to flip open the phone book and randomly choose an appraiser based upon the flashiness of an ad. While this may be your first instinct, that instinct will lead you to a result you may not like or even worse. While the Internal Revenue Service has issued rules regarding appraiser qualifications, the qualifications are to be at best regarded as "minimums" for an appraiser. Even though appraisers now must fill these minimum requirements to hold themselves out as appraisers and do business valuations, these minimums will not necessarily get the client the best result.

The Minimal Qualifications

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,
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 value if the appraiser should have reasonably known of the information. It is also important to realize that the above factors are the minimum qualifications for an appraiser or business valuation specialist. What is common is that appraisals are put up to different challenges whether they are in a court of law or at a negotiating table.

Challenges

Most of the time, a business valuation is not constructed for the mere purpose of placing a fancy book on a shelf never to be viewed again. Business valuations are usually created for some very useful and important purposes such as valuing assets in a divorce case, arranging business for succession transactions, setting up buy/sell agreements, estate planning and estate tax returns. Each purpose contains results in a valuation facing unique challenges.

For instance, when a divorce case proceeds, both parties usually bring forth a valuation of the subject business. The holder of the business will desire a low value, the party hoping to be paid a high price will hope for a high value. Both valuations are done using similar methods; however, one's valuation comes to a much lower figure than that of the other's valuation. Why is this? Did one appraiser cheat? Did one valuator fudge the numbers? The answer is no. When you put together a valuation, certain assumptions are based upon reasonable conclusions of fact and law. One's party in this concluded (biased as it may be) that the value of the company is much less. The second appraiser concludes a high value (biased as well) toward assumptions giving the business a high value. Both values fall into a reasonable range, one high and one low.

The point of this is that ordinary appraisers face issues that go beyond the scope of their expertise. An accountant with experience in material handling business may not be very adept at all of issues that arise in marital dissolutions and when companies break up. Mere knowledge of an industry may not be sufficient in a valuation wherein outside factors need to be considered.

The Thorough Standard

Since business valuations exist for specific reasons, the appraiser should be qualified to assist in whatever purpose the appraiser is being prepared. In the event of divorce, the appraiser would serve the client by being well versed in the issues that are commonly seen divorce cases. Such issues include what is marital property, where the property is affected by community property laws, finding hidden assets, asset division, and child support and maintenance issues. Upon break up of a company, many other issues exist and include issues such as wind up, outstanding tax liabilities, pay out amounts, and the like. Selling and buying companies is not without issue as well. Appraisers should be extremely well versed in tax issues. The tax structure of a purchase or sale is just as important as the sales price itself.

Given the number and complexity of the legal and accounting issues, it is imperative that the appraiser not only be minimally qualified, but also be qualified to anticipate legal and accounting issues while making the valuation. While the appraiser does not have to be an attorney or certified public accountant, having one on their staff or within the firm can be extremely useful.

If the appraiser him or herself is an attorney and/or especially adept at financial planning, the advantage is useful. Having the additional knowledge allows the professional to work as a cohesive synergistic unit, which allows him or her to spot issues as the valuation is determined. If the appraiser has no training regarding the legal, financial, or tax issues, the possibility exists that the issues common to most valuations may first be encountered in court, exactly where you don't want issues to come up for the first time.

Selection Criteria

Selecting an appraiser should ultimately be done according to who is a best fit for the assignment, not merely who is minimally qualified or grabs your attention based upon a phonebook advertisement.

A. In a Divorce or Marital Dissolution, the appraisal may have to withstand the scrutiny of a court proceeding. Generally one appraisal is prepared for the business owner, while another is prepared for the spouse. The two appraisals prepared will generally conclude different values for the business and the court will have to decide the ultimate value. It is therefore best to choose an appraiser who may have a legal background to allow him or her to spot legal issues and come to assumptions that are reasonable and able to be proved in court.

Additionally, couples going through a divorce nearly universally hide assets. While a business appraiser may be aware of issues like this, those trained in law and carrying a Juris Doctor degree will be more adept at discovering and uncovering hidden assets that a business may have.[1] Methods of appraising businesses during a divorce are inappropriate or even illegal in some states.[2] This is not to say an ordinary business appraiser is insufficient, but one holding a legal degree will be more attune of the environment of court proceedings and the generalized chaos that follows.

B. In Selling or Buying a business, tax and financial issues, as opposed to legal issues, are of utmost importance. If you sell stock, the seller may ask for a lower value due to easier tax consequences. In an asset sale, the valuation should reflect a higher value because the tax costs are higher than that of an asset sale. Generally a CPA is desired in this situation.

Financial and legal issues come about as well in business sales and purchases. Many CPAs are trained in this area; however, their expertise is usually limited to personal experience as opposed to actual experience.[3] Attorneys who practice in this area can spot buying and selling issues **while** the valuation or appraisal is being created and in its early stages.[4]

Subchapter C Corporations bring unique issues to the transaction. Double taxation is a big burden on most C Corporation owners, especially if they have been in operation for many years. New tax precedents allow business owners to save a layer of tax upon disposition of certain types of business. This precedent is generally unknown to non-tax practitioners. What is necessary is a separate legal document to divide proceeds into two types of goodwill.[5]

C. Dissolving a company demands legal, financial, and tax expertise. Depending on the goals of the owners, dissolving a business can be a relatively simple transaction or it can be very complex. Further, the balance sheet of the tax return can reveal deeper problems than any of the partners or shareholders imagined. Unpaid loans, negative capital balances, unpaid liabilities, zero basis receivables, and inventory can be a huge burden for the business owners during tax time. It is therefore beneficial to have an accountant that is well versed in tax to maneuver the valuation and avoid tax pitfalls.

D. For Estate Planning, having a trained legal and accounting professional can be invaluable. Estate planning, in its rudimentary form, is half accounting and half legal documents. The accountant prepares the figures and usually attorneys will prepare forms. While the same accounting firm and law firm may not handle the entire transaction, having a legally informed appraiser is never a disadvantage and can assist the attorney in drafting such documents as a buy-sell agreement and/or trust documents.

Conclusion

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 your 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. Be sure the appraiser is knowledgeable in accounting, taxes, and legal matters, as well as the industry involved.

If you have any questions regarding selecting an appraiser, 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 business valuations/appraisals.

---

1 Californiadivorce.info.htm

2 Florida Copiled Statute Annotated

3 CFO.com, David McCann, Rare Career Path: CPA, JD, CFO, April 23, 2008

4 CFP/cp,. David McCann, Rare Caeer Path: CPA, JD, CFO, April 23, 2008

5 The MHEDA Journal Online, Bart Basi & Marcus Renwick, Fall 2007