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Bruce S. Schaeffer, Editor
Bruce@FranchiseValuations.com
 212.689.0400

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Baby Boomers Seek Estate Planning Advice

Estate and Tax Planners Report Uptick

It should come as no surprise that Baby Boomers are seeking professional advice on how to navigate the complexities of exit planning, gifts and wealth management. WealthCounsel, LLC and Trusts & Estates magazine just released a report of the key findings from their Sixth Annual Industry Trends Survey. The survey drew participation from nearly 1,500 industry professionals comprised of estate and business planning attorneys, certified public accountants, certified financial advisors and planners, registered representatives, insurance advisors, and other wealth management professionals. Some key findings from the 2012 survey are:

- 97% expect taxes to increase due to the budget deficit
- 71% experienced growth in their practices in 2012, compared to 59% in 2011
- 57% stated their clients engage in planning primarily to avoid chaos and discord among heirs
- 50% of estate planning clients are 50 to 69 years of age
- 26% of respondents reported that clients took advantage of the \$5.12 million gift tax exemption

Using Family Limited Partnerships (FLPs) to Save on Estate Taxes

FLPs can provide discounts in determining the "fair market value" for tax purposes of closely held businesses. But the outcome of family limited partnership cases continues to be fact-specific. For example, Prof. John Bogdanski (Lewis & Clark Law School) says recent cases concerning family limited partnerships (FLPs) show that the Tax Court is "unpredictable" which means there is no "foolproof blueprint" for securing a win in these cases. Bogdanski cites two cases which he says are hard to reconcile:

- In *Estate of Stone v. Comm'r*, TC Memo. 2012-48, the court accepted the FLP's nontax purpose as the management of the family's timberland. The decision "surprised" many observers, Bogdanski said, because the partnership did not engage in a business or investment activity, had no liquid assets or bank account, and did not change the nature of the property.
- In the court's final decision in *Estate of Turner v. Comm'r*, 138 T.C. No. 14 (2012), however, it included the entire fair market value of the FLP assets (passive investment securities) in the decedent's gross estate with no discount. Among other reasons, the court noted that the operative documents used "boilerplate" language in stating the partnership's nontax purpose and found to be not credible, testimony from the advisors that tax advantages were not an element of formation.

But if properly done - and documented - substantial discounts can be achieved, as the table below on FLP discount cases shows. [A PDF version of the table may be found here.](#)

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The information provided in this newsletter is for informational purposes only and should not be construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

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Discounts Allowed in Family Limited Partnerships Cases

Case	Approximate Discount Allowed
<i>Strangi v. Commissioner</i> , U.S. Tax Court, CCH Dec. 54,135, T.C. No. 54,135, 115 T.C. No. 478, 115 T.C. No. 35, (Nov. 30, 2000)	31%
<i>Knight v. Commissioner</i> , U.S. Tax Court, CCH Dec. 54,136, T.C. No. 54,136, 115 T.C. No. 506, 115 T.C. No. 36, (Nov. 30, 2000)	15%
<i>Estate of W.W. Jones II v. Commissioner</i> , U.S. Tax Court, CCH Dec. 54,263, T.C. No. 54,263, 116 T.C. No. 121, 116 T.C. No. 11, (Mar. 6, 2001)	44%
<i>Estate of Dailey v. Commissioner</i> , U.S. Tax Court, CCH Dec. 54,506(M), T.C. Memo. 54,506(M), 82 T.C.M. 710, T.C. Memo. 2001-263, (Oct. 3, 2001)	40%
<i>Estate of William G. Adams, Jr. v. Commissioner</i> , U.S. Tax Court, CCH Dec. 54,696(M), T.C. Memo. 54,696(M), 83 T.C.M. 1421, T.C. Memo. 2002-80, (Mar. 28, 2002)	54%
<i>McCord v. Commissioner</i> , 120 T.C. 358 (2003)	32%
<i>Lappo v. Commissioner</i> , T.C. Memo 2003-258	35.4%
<i>Peracchio v. Commissioner</i> , T.C. Memo 2003-280	29.5%
<i>Estate of Deputy v. Commissioner</i> , CCH Dec. 55,191(M), 85 T.C.M. 1497, T.C. Memo. 2003-176, (Jun. 13, 2003)	30%
<i>Estate of Green v. Commissioner</i> , U.S. Court of Appeals, Eighth Circuit, CCH Dec. 55,384(M), 86 T.C.M. 758, T.C. Memo. 2003-348, (Dec. 29, 2003)	46%
<i>Estate of Thompson v. Commissioner</i> , U.S. Court of Appeals, Third Circuit, CCH Dec. 54,890(M), 84 T.C.M. 374, T.C. Memo. 2002-246, (Sept. 26, 2002)	40.5%
<i>Estate of Webster E. Kelley v. Commissioner</i> , T.C. Memo 2005-235	32%
<i>Holman v. Commissioner</i> , U.S. Tax Court, CCH Dec. 57,455, 130 T.C. No. 170, 130 T.C. No. 12, (May 12, 2005)	22.5%

Valuations: Discounts, Premiums and Goodwill

Selection of Proper Discounts and Premiums Is Key

In a very useful article[1] Paul R. Hyde, EA, MCBA, ASA, MAI, CBA, the President of Hyde Valuations, Inc., offers considerable information and insight for litigators and expert witnesses with valuation disputes:

The standard of value used in the valuation process has a very large impact on the magnitude of any applicable discounts and premiums- and on whether or not discounts and premiums should even be applied at all. Using the fair market value standard of value, the specific ownership interest being appraised is being valued "as is," including any control or marketability characteristics of the ownership interest. Because of this, minority interests in closely-held companies are valued to reflect their lack of control and lack of marketability characteristics [footnotes omitted]. In some states, family law courts use the investment value standard of value. In these cases, the appraisal problem is to identify what is called "value to the owner" or the marital community instead of "value in exchange" as is the case in a fair market value standard of value. In cases such as this, when the company is family owned, there may be no minority discount for a minority owner because through family attribution, the owner is assumed to be part of a control group [footnotes omitted].

Examples of entity level discounts and premiums are key person and environmental liability discounts. Shareholder level discounts and premiums are most commonly encountered in business appraisals. The most frequent are control premiums, minority interest discounts (perhaps more clearly referred to as discounts for lack of control), and marketability discounts (also known as discounts for lack of marketability).

Mr. Hyde also offers a very useful discussion on the appropriate discounts or premiums, in his opinion, for the following valuation methods:

1. Income Method with a Control Income Stream

2. Public Company Transaction Method
3. Adjusted Book Value Method
4. Direct Market Data (Transaction) Method
5. Excess Earnings Method
6. Guideline Public Company Method
7. Income Method with a Non-Controlling Income Stream
8. Prior Transactions (in the stock) Method

New York Appellate Court Affirms Discount for Lack of Marketability and for Built-In Gains

In a "fair value" case brought by a dissenting shareholder of a not-so-happy family-owned corporation that owned 19 apartment buildings, the Appellate Division of the New York State Supreme Court: affirmed a lower court's holding[2] allowing a discount for lack of marketability; clarified that there is a further discount due to corporate ownership of real estate rather than outright ownership; and accepted a present-value discount for taxes on built-in gains.[3]

Auditors Struggling with "Fair Value" Measurements Reports PCAOB

At the end of 2012, the Public Company Accounting Oversight Board (PCAOB) released inspection reports criticizing three of the largest audit and accounting firms: Deloitte, Grant Thornton, and Ernst & Young. The reports found problems with the audit firms' methods of testing for fair value and/or disclosure related to hard-to-value assets and goodwill.

For example, DeLoitte was cited for failing to identify when an issuer inappropriately allocated a portion of the purchase price of a group of assets to goodwill rather than to a definite-lived asset; Grant Thornton was cited for five major deficiencies, including the firm's failure to test the issuer's assumptions underlying its projections regarding the value of certain deferred tax assets; and its failure to challenge the issuer's use of dated financial information to support its forecast when more current, available data would have contradicted the projected growth rate.

Ernst & Young was cited for failures to audit the valuation of certain long-lived assets as well as leases and derivative contracts; and also faulted for consistently failing to sufficiently test an issuer's internal controls as well as its management projections and fair value measurements.

A Professor's Opinion on Valuation of "Goodwill"

"There is no asset on a company's balance sheet that wreaks more havoc on valuation and good sense than goodwill," Prof. Aswath Damodaran of the NYU Stern School of Business wrote in a blog post last month. "The first problem with goodwill is that it sounds good, and when something sounds good, people feel the urge to pay for it. The second problem is that, notwithstanding claims to the contrary, it is not an asset but a plug variable that measures everything and nothing at the same time."

IRS's Non-Acquiescence in Using Formula Valuation Clauses: the Wandry Decision

In *Wandry v. Commissioner*[4], the Tax Court upheld the use of a defined-value clause (i.e., giving \$5 million worth of property without specifying the ownership percentage) in the context of a charitable gift. The IRS subsequently appealed to the 10th Circuit and then withdrew its appeal, but published a notice of "non-acquiescence."[5]

According to Ron Aucutt, an attorney with McGuireWoods, "The fairest summary of *Wandry* is that it undeniably extends the scope of prior cases concerning a charitable 'poulover' clause." But unlike those cases, Aucutt argues, "*Wandry* does not represent a consistent body of Tax Court and

appellate court jurisprudence, and, as even the charitable cases show, the IRS does not approve of the defined-value technique. Because it is also fair to speculate that many year-end 2012 gifts have followed the pattern of a 'Wandry formula,' we should not be surprised to see future cases involving Wandry types of defined-value gifts."

[1] "Which Discount and/or Premium Applies?" Originally published in the First Quarter 2010 issue of *Business Appraisal Practice*.

[2] *Giaino v. Vitale*, 2011 NY Slip Op 50714(U), Supreme Court, New York County, April 25, 2011

[3] *Giaino v. Vitale* 2012 NY Slip Op 08778, Appellate Division of the Supreme Court of New York, First Department, December 20, 2012

[4] *Joanne M. Wandry v. Commissioner; Albert D. Wandry, a.k.a. A. Dean Wandry, Donor v. Commissioner.*, U.S. Tax Court, CCH Dec. 59,000(M), T.C. Memo. 2012-88, 103 T.C.M. 1472, (Mar. 26, 2011)

[5] Nonacquiescence Announcement, I.R.B. 2012-46, November 12, 2012