

THE ROLE OF BUSINESS VALUATIONS IN ESTATE PLANNING

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An estimated 90% of all businesses in the U.S. are closely-held family owned businesses. One of the most overlooked assets in many estate plans is the family business and its impact on an owner's estate and the resulting tax obligations. Current tax law requires that the fair market value (typically as of the date of death) of a decedent's interest in a closely held business be included in his or her estate.

Too often, however, it is only after the owner's demise that the true understanding of this asset's magnitude comes to light. In many cases, the tax liability is so exorbitant that other family assets must be liquidated, leaving heirs with nothing more than a non-liquid business and no one to run it.

Estate planning is the process of developing and coordinating the transfer of an individual's property to designated beneficiaries in a manner that will minimize or even eliminate the transfer taxes levied by way of the U.S. Unified Gift and Estate tax program.

Accordingly, there should be a conscious effort in estate planning to focus on the value associated with a retained or, for that matter, continued ownership interest in the family business. By conducting a periodic valuation of the business operations, the owner, family members and even key employees can better understand the nature of the estate tax concerns. The valuation also provides a basis by which the business owner can evaluate the appropriateness of ownership transfers and alternatives; provides a basis for the valuation of gifts; and can even guard against future conflicts with the IRS.

Unlike the appraisal of other assets (viz. real estate), the process associated with valuing a closely held business does not typically enjoy the benefits of readily available comparable transaction data. Rather, this exercise requires an in-depth multidimensional review of the company's operations, its management, industry, financial performance, economic environment, and reputation.

The task is further complicated in that no two companies are exactly alike and a "one size fits all" valuation formula is nonexistent...thus, making the use of any industry data which may be available a delicate assignment. However, through the application of various analytical procedures, employment of reasonable assumptions, consideration of all relevant facts and circumstances and, finally, the use of sound professional judgment, the appraiser's findings should provide the information necessary to structure and complete the estate plan.

While, there are dozens of methods for estimating a company's worth, in today's market, most valuations are driven by the company's earning history and potential.

Like estate planning, business succession planning is equally emotional. Succession requires change, and such change is often met with resistance. The business valuation exercise often

forces the business owner to re-think his/her position on who will carry on the operations once they are gone or no longer able to maintain the leadership role.

Not all businesses are designed, nor have the ingredients, to survive their founders. In many cases the children simply aren't interested. Here, in order to preserve family wealth, business owners must either find an outside manager to carry on with operations or seek a buyer. To do nothing, however, would tragically deplete an otherwise valuable asset...one which took a lifetime of sacrifice and effort to build.

The most successful estate and succession plans are designed by a team of specialized professionals. The business valuation exercise is an integral part of these plans and should not be overlooked. In fact, it may be the first place to start.

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