PRACTICAL PLANNER
NEWSLETTER
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More Info:

- **Seminars:** Sept. 9 "Divorce: Legal, Tax, Investment, Insurance Planning". Speakers: Martin Shenkman, Esq., John Finnerty, Esq., Kalman Barson. CPA, John Canavan. Marriott Glenpoint, Teaneck, NJ. Call 201-845-8400 for info.
- Sept. 18, 8:30 a.m. "Health Issues in Estate Planning: HIPAA, Chronic Illness, Competency". UJA. Marriott Marquis, 1535 Broadway, NYC. Call 212 836-1531.
- Sept. 18, 3 p.m., "Asset Protection Steps: LLCs, dynasty trusts, and more". NJSSCPA. Mayfair Farms, West Orange, NJ.

Creative solutions that coordinate all your planning goals:
· Estate · Tax · Business · Personal
·Financial ·Asset Protection

PLANNING POTPOURRI

More Discounts: How many discounts for lack of control (DLOC) are there? Appraisals estimate discounts for lack of control based on data from public companies. But a non-controlling minority interest in a private company has a greater risk than a comparable interest in a public company and warrants a greater DLOC. As but one example, the public company has SEC and other governmental oversight, but the private company does not. (Thanks Jay).

Estate Expenses: In most estates it takes months to admit a will to probate, obtain an estate tax ID number, and open an estate checking account. It is common for a family member to advance expenses personally until then. Rather than handling this in the typical haphazard uncorroborated manner, have the estate (even if signed initially by the executor named in the will waiting to be appointed) sign a loan agreement with the family member acknowledging the estate's liability to reimburse for expenses paid on behalf of the estate. Since the amounts and timing are unknown, this can function like a line of credit (a draw down construction loan). Prepare a schedule of the expenses with corroboration and treat each as a request for an advance on the loan.

Beware of Reciprocal Trusts: Dad sets up a trust naming Mom and kids as beneficiaries which owns $1M life insurance on Dad. Mom sets up a trust naming Dad and kids as beneficiaries which owns $1M life insurance on Mom. The trusts are substantially the same. The mirror image nature of the trusts could justify unwinding the two trusts as being economically equivalent to no trust having been established. *U.S. v Grace*, 395 U.S. 316 (1969). This would undermine the intended results. Efforts should be made to differentiate trusts established by spouses: different trustees, different assets (e.g., permanent insurance on husband, term on a different amount on wife), document different and independent planning objectives for each trust, different distribution standards, etc.. If existing trusts might face this issue consider taking corrective action at your annual trust review meeting. Have a trustee resign from one trust, use powers to appoint new trustees, contribute a different asset to one of the trusts, etc. PP

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PRACTICAL PLANNER

Martin M. Shenkman, CPA, MBA, JD

APPRAISALS: KEY TO PLANNING

Summary: Appraisals are vital to many business, estate and litigation transactions. Buyout agreements rely on valuations. The price for disability, death, retirement and other buyouts from a closely held business or professional practice may all be based on different criteria. You can't make $12,000 annual gifts of stock in the family widget company and not value the gift. The stakes are huge. If you sell 40% of a business to a dynasty trust for $20 million and the IRS says its worth $50 million, you might face both a gift and GST tax on $30 million!

Agreement. A written engagement letter should be issued identifying: the background of the valuation, a description of the business (e.g., a NJ C corporation), a list of owners and their interests, the interests to be valued (e.g., a 30% voting common stock interest), the services to be performed (Complete Appraisal, Limited Appraisal, or Valuation Calculations), the purpose of the valuation (transaction, gift tax, estate tax, litigation, etc.), the valuation date (a valuation is valid only 3 months for some purposes), the standard of value (e.g., fair market value, fair value, etc.), the level of documentation (appraisal report or brief letter restricted-use report), timing of the assignment, client and appraiser responsibilities, etc.

Users/Confidentiality. A list of intended users of the report should be indicated. Should the data and report be confidential? Who should be privy to the data? Should your attorney hire the appraiser to bring the appraiser under the wing of attorney-client privilege? Should confidentiality and non-disclosure agreements be signed?

Scope. ◘ Establish the appraiser's services. What will be done? ◘ Is it a "calculation" engagement for which specific methodologies are agreed to, and which has a lower level of analysis and fewer procedures? Is it a full "valuation" engagement? ◘ Are there restrictions (e.g., not to interview key employees)? ◘ Key assumptions.

Value. There are a myriad of ways to define value. An appropriate definition must be established. Tax laws use fair market value. This is defined as the price at which a hypothetical willing buyer would pay a hypothetical willing seller, when both have knowledge of all relevant facts and neither is under compulsion to buy or sell. Treas. Reg. Sec. 20.2031-1(b). If you're selling your business to a suitor looking to expand into your market niche, "strategic value", which may exceed "fair market value," may be used.

Data. ◘ Gather information tailored as to the specifics of the asset being valued, and the purpose for the valuation. ◘ Conduct site visits. ◘ Use questionnaires and interviews as appropriate. ◘ Collect financial statements, tax returns and other reports. ◘ Obtain copies of all key legal documents: shareholders' agreement, buyout agreement, insurance policies, bylaws, certificate of incorporation, key employment, customer/vendor agreements, etc.

Research. ◘ Identify relevant industry and trade association data and compare it to data for the target company. ◘ Identify comparable firms or assets. ◘ Assess general economic trends. ◘ For closely held businesses total compensation (salary, bonus, perquisites, etc.) is a critical issue to address. Identify economic data and/or data from similar types of businesses (whether or not in the same industry) as a touchstone to adjust fig-

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CHECKLIST: APPRAISAL REPORT

Summary: For an appraisal to be respected by the IRS or a court the report must satisfy many requirements. Use this checklist to evaluate a report you intend on using in a divorce, tax plan, etc.

Appraisal Report

√ The report should comply with any appropriate standards such as Uniform Standards of Professional Appraisal Practice or USPAP (general standards endorsed by many). Other standards of specific organizations include those of the National Association of Certified Valuation Analysis (NACVA), ASA, IBA, and the American Institute of Certified Public Accountants (AICPA). AICPA issued SSVS Number 1 to provide guidance and standards for CPAs performing valuations.

√ A statement as to whether the report is a "calculation report" or a "valuation report." SSVS No. 1, §901. A valuation report contains a conclusion as to value based on the CPA's selection of methodologies deemed appropriate. A calculation report uses methodologies selected by the CPA and client.

√ A statement as to whether the report is a "detailed report" or a "summary report"

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ures for the target firm. ◙ Determine rates of return for the industry and comparable businesses. ◙ Identify comparable capitalization rates. ◙ Identify sales of comparable businesses, or market value of public companies in similar businesses.

Analysis. ◙ Review key provisions of the governing documents for the entity to determine how they impact value. ◙ Analyze financial data for 3-5 years or more. ◙ Adjust income, expenses and other items to normalize for unusual years or events (e.g. one time events, insurance recovery, etc.). ◙ Adjust for unreasonable perquisites and inappropriate personal expenses (travel, entertainment costs, "employment" of family members, etc.). ◙ Analyze and adjust for related party transactions. Do they suggest other issues that need to be evaluated? Do they identify related parties that affect the valuation? ◙

History of the Company. Identify trends that affect future prospects, strengths and weaknesses. ◙ Products or services offered (identify industry, and nature of business). ◙ Nature of the industry (is the subject business a significant player?) Future prospects for the industry as a whole help evaluate prospects for the target. ◙ Personnel and management (unionized, contract provisions, tenure, depth of management, etc.). ◙ Analyze revenues and profits by product/service categories. Identify trends that might make separate analysis of lines preferable to aggregate analysis. ◙ Nature and loyalty of customers (size of average company, dependence on large customers, variation in large customers over the years, etc.). ◙ Competition (identification, strengths and weaknesses, impact on future prospects, etc.) ◙ Expenses (e.g., is production at a maximum unless a new facility is acquired requiring a substantial cost increase? What costs are fixed versus variable? How does this impact prospects?) ◙ Regulatory environment (is the business regulated and how does that impact the future prospects of the company? Large increases in costs because of recent regulatory changes will have a very different impact that regulations serving as a barrier to larger competitors). ◙ Financing and credit sources (What sources of financing does the business use and how might this impact future growth and costs?). ◙ Other relevant factors. Every business or asset has unique nuances. While sometimes rules of thumb (2 x gross and other formulas), may be useful checks on a valuation, they are no more than that. Independent and detailed analysis of the financial and non-financial data, and circumstances, and their impact on value are always essential. ◙ Valuations should include an analysis of the factors in Revenue Ruling 59-60 and 68-609. Each of the factors in the Rulings should be addressed.

Valuation Approaches. The three most common general valuation approaches are: ◙ Market. This is a comparison to similar entities. What would it cost to acquire the asset? The guideline pubic company method, guideline company transaction method and the guideline sales of interests in the subject entity method are commonly used. ◙ Income. Estimate future earning streams. Capitalize earnings, etc. What are the expected economic benefits from owning the asset or business in the future? Calculate today's value of future earnings for some time period, and then a present value of the terminal value at that future date. ◙ Asset. Estimate the cost of constructing or replicating the asset or business. Another approach is to adjust each asset and liability of the business to its fair market value.

Terms in red defined in the glossary at www.laweasy.com. For e-newsletter sign up at www.laweasy.com.

Valuation Methodology. Evaluate all relevant valuation methodologies. Accept, modify or reject each based on the particular engagement. Value the business using the appropriate methodologies. If more than one methodology is applied, analyze and reconcile the findings to arrive at a single value conclusion or range of value. If different results are weighted, explain the rationale.

Discounts. Should discounts or premiums be attached to the asset or business interest involved? PP

Review: Andrew Wolfe, CPA, JH Cohn LLP, Roseland, NJ.

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under SSVS.

√ Discuss limiting conditions.

√ If the appraiser did not prepare the financial statements for the business and/or doesn't assume responsibility for them, this should be stated.

√ The report details should include discussion of: ◙ Sources of information. ◙ Assumptions and facts upon which the report is based. ◙ History of the business and entity. Description of the entity (or asset). ◙ Formation of the entity, legal structure, governing legal documents. ◙ Operations of the business (customers, suppliers, personnel, competition, customers, seasonality, etc.). ◙ Analysis of non-operating assets and liabilities (e.g., loan to shareholder). ◙ Analysis of nonfinancial information relevant to the appraisal. ◙ Management. ◙ Equity interest (classes of equity, rights of different classes, etc.). ◙ Entity's expectations for future earnings and growth. ◙ Conditions and expectations (general economic circumstances, etc.). ◙ Analysis of historical financial data and other information. ◙ Valuation adjustments (e.g., normalization of earnings for unusual years, adjustment of key shareholder's salary). ◙ Discounts. ◙ Valuation approaches and methods considered. ◙ Valuation methodologies and procedures actually used. ◙ Analysis, reasons and justification for the conclusions reached. This should include a reconciliation of the various estimates and conclusions of value (e.g., if three different valuation methodologies were applied they should be reconciled to a single figure).

√ Details are vital. The report should evaluate market size and economic information and their relation to growth potential. An appraisal of a local tire shop may quote data about Goodyear and Firestone, but must also address the local situation. If market data is relevant, the report must analyze the data to show what type of growth rates are sustainable. The report should explain how the methodologies were implemented and the basis for any assumptions. Adjustments to the discount rate, historical sales growth rates, changes in profit margins, cash flow, should all be clearly explained. When market methods are used there should be a clear list of possible choices, presentation of criteria for exclusion/inclusion, support for how value drivers were determined, and specifics as to how value was actually determined based on the guideline companies. Weights used in a reconciliation of value must be justified. Boilerplate should be avoided.

√ Representations of the appraiser.

√ Calculations which enable replication of the appraiser's analysis.

√ The report must reach the conclusions required to meet the objective.

√ Specialists. If a specialist was used by the primary appraiser, identify him (e.g., an appraiser values an LLC that owns a shopping mall, but relies on an MAI for the mall value).

√ Certification of the appraiser and signature of the person responsible.

√ Appraiser's qualifications and curriculum vitae. (Thanks Chaim). PP

RECENT DEVELOPMENTS

◙ Listen to your Tax Adviser: The taxpayer's tax adviser recommended not amending tax returns. The taxpayer, instead of heeding the advice of his long time adviser, he sought another practitioner who amended the returns without researching the appropriateness. The Court applied accuracy related penalties which the taxpayer couldn't avoid by claiming reliance on the second preparer. *Larry Wadsworth* , TC Memo 2008-171 (Tax Ct.).

◙ Business Start up and Organization Expenses: The IRS simplified the deduction of these costs under IRC Sec. 195, 248 and 709. TD 9411, 07/07/2008. After 9/6/08 an election to deduct these costs isn't necessary. It is presumed that taxpayers want to deduct these costs unless the taxpayer elects not to.

◙ Partner Merger Rights: Section 121-1102(d) of the NY partnership law provides that a limited partner shall not have the right to attack the validity of the merger except to contest compliance with the provisions of the partnership agreement, or the notice provisions of the statute. Since these exceptions weren't found to apply, the LP's sole remedy when objecting to the merger was an appraisal proceeding. Section 121-1105(b). *Appleton Acquisitions, LLC v. National Housing Partnership*, 10 N.Y.3d 250, 856 N.Y.S.2d 522.

◙ Watch Will Formalities: Were the formalities of signing a will properly handled? The witnesses names were printed instead of signed under that of the testatrix's at the end of the text of the will. However, the testatrix and witnesses did sign the self-proving affidavit that followed. The court held that substantial compliance with the requirements would suffice. The lesson remains, attention to formality is advisable. *Hampton Road Seventh-Day Adventist Church v. Stevens*, 657 SE2d 80 (2008). PP