

# The Case of the Unnecessary Appraisal

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An investment banker wanted to retain us to appraise a private company whose owner wished to transfer a minority interest to a trust. This would have been a routine engagement (value the company and determine appropriate minority interest discounts for lack of control and marketability) except for one thing:

### **The investment bank was in the middle of selling the company!**

At the time of the request, the investment bank had distributed more than 100 prospectuses to potential buyers and had received “expressions of interest” from about 30. An auction was planned. The investment bankers, however, had told their client (and us) that they were highly confident of an all-cash selling price of \$30 million and that the sale would close within six months. They based this on initial indications of price from the interested buyers as well as market comparables and discounted cash flow analyses. Moreover, the investment bank had successfully sold more than 20 firms in the client’s industry, and was well-known for its expertise in it. Given these considerations, their assessment of the sale price and timing had high credibility.

The investment banker was anxious to proceed with the appraisal and to complete the minority interest transfer before the sale closed. The client’s attorneys and accountants were certain that significant minority interest discounts could be justified. The client would have the best of both worlds: a discounted interest transfer value for estate tax purposes and a full (undiscounted) value when the company was sold.

We asked the investment banker how comfortable she was with this plan, and she admitted to considerable anxiety about it. It seemed to her that the client was having his cake (a discounted minority interest value for tax purposes) and eating it, too (a full value when the company was sold). But she could not articulate the cause of her anxiety, except that “it did not pass the smell test.”

We agreed that the plan would not pass this all-important test, and here is why!

The attorneys and accountants were correct in believing that the minority interest would transfer at a discounted value to the trust under normal circumstances ... but these circumstances were anything but normal! Something else was going on: the impending sale of the company with a fairly confident estimate of its price and timing.

Revenue Ruling 59-60 is the foundation statute for federal tax valuation. Section 3, Paragraph 3 of the statute states that “information available [that is, known or reasonably knowable] as of the valuation date is relevant. (Bracketed words added for emphasis). In this case, it was known that the company was being sold. The price and timing were reasonably knowable, based on the investment bankers’ highly credible estimates. Many court cases have affirmed that, subsequent to the valuation date, events that indicate value are relevant. The investment banker and her client were in a situation where this doctrine most certainly applied.

### ABA Solution

An appraisal that ignored the known sale and reasonably knowable price and timing would be defective as it would run afoul of RR 59-60 3.03. ABA advised the investment banker that an appraisal of the value of the company and the minority interest, however technically valid, would in this case waste time and money because the subsequent sale would supersede its findings. We suggested that the client not seek to justify lack of control and marketability discounts for the minority interest.

We did suggest and were retained to opine that, since the sale price and timing were not guaranteed, a small discount to the value of the minority interest for these uncertainties was justified. Our fee for this assignment was a fraction of what a full appraisal would have cost, but still yielded material and justifiable tax savings to our client.

ABA members are well-versed in RR 59-60 and its many nuances. Moreover, we pride ourselves on our ability to see the big picture, to work with you on a straightforward and honest basis, and to recommend cost-effective and justifiable valuation solutions to you.