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Special points of interest:

- Shelley A. Drury is now Certified in Financial Forensics (CFF) through the American Institute of Certified Public Accountants (AICPA). The CFF credential encompasses fundamental and specialized skills in forensic accounting.
- Our staff accountant, Danene Spaeth, recently completed all of the necessary requirements to become a Certified Valuation Analyst (CVA) through the National Association of Certified Valuation Analysts (NACVA).

ESTATE & GIFT TAX VALUATIONS

Marketability Discounts—Where Are We?

Written By: W. Cary Deaton, CPA, ABV, CVA

Although the U.S. Tax Court has recognized the appropriateness of applying a discount for lack of marketability (DLOM) to interests in closely-held companies, FLPs and LLCs, the *calculation* of that discount remains one of the most difficult parts of a valuation.

An article in the Sept/Oct 2008 issue of *The Value Examiner*, published by the National Association of Valuation Analysts, entitled "Marketability Discounts—A Comprehensive Analysis"[1], provides a helpful overview of the history and current thinking relative to the calculation of marketability discounts.

Empirical Research – The Studies

The generally accepted studies fall into three main categories:

- *Restricted Stock Studies*
- *Pre-IPO Studies*
- *Cost of Flotation Studies*

The studies, which utilize data from 1966 through 2007, suggest a range of discounts from 20% to 50% with the majority falling in the 30% to 40% range.

Relevant Tax Court Cases

In addition to the studies, major court decisions provide insight on the court's thinking relative to these discounts and the nature of evidence deemed acceptable in those decisions.

The courts have made it clear that the valuator must "slice and dice" the empirical studies in order to make the data extracted as comparable as possible to the entity being valued.

In ***Estate of Mandelbaum v. Commissioner*** (69 TCM. (CCH) 2852, 1995) the court outlined a number of specific factors to consider in the calculation of marketability discounts. The factors, which became known as the "Mandelbaum Factors", include:

- Financial statement analysis
- Dividend policy
- Nature of the company, its history, position in the industry, and economic outlook
- Management
- Amount of control in the transferred shares
- Restriction on transferability
- Holding period for the stock
- Company's redemption policy
- Costs associated with a public offering

A similar list of "marketability factors" was identified in ***Estate of Barge v. Commissioner*** (TC Memo 1997-188, April 23, 1997), which include:

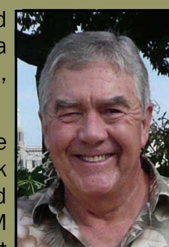
- Base value
- Expected holding period
- Expected growth rate of value
- Expected dividends/distributions
- Required holding period return

While court decisions are fact-specific, they still provide some guidance for discount determination. In the more notable cases, discounts have ranged from 10% to 35%. The current trend is toward allowing larger discounts.

[1] Contact Tina Mungaray, DSLV Office Manager, at (253) 573-9500, or tina@litvalexperts.com, if you would like a complete copy of this article.

Farewell to Frank Ault

Written By: Shelley A. Drury, CPA, ABV, CVA, CFF



In October, the legal and accounting community lost a well-respected professional, Frank Ault.

Frank started his career at the CPA firm KPMG Peat Marwick in 1966 doing auditing and tax work. He worked for RSM McGladrey (formerly Knight Vale & Gregory) from 1978 through 2004. Cary and I worked with Frank for 5 years at RSM and he later joined us at Dock Street Litigation and Valuation for nearly 2 years before deciding to work out of his home in Port Orchard.

Frank was well known in Pierce and surrounding counties as a trusted financial expert and advisor. He was also committed to serving his community and, for many years, volunteered and served on the boards of the Werlin Reading Team, Tacoma Rotary 8, and Tacoma Goodwill.

Frank was a mentor to me and was instrumental in my career. He encouraged me when I needed it and knocked me down a peg when I deserved it. He loved to tease and rarely resisted an opportunity to share funny and/or embarrassing stories with anyone nearby. I used to tease Frank that he was the "wind beneath my wings", which always made him laugh.

He was honest, hard-working, loyal, funny, gruff and endearing all at the same time. We miss him and feel privileged to have worked so closely with him for many years.

Our Services Include:

- Assistance in Marital Dissolution, Including Collaborative Divorce
- Personal Economic Loss Calculations
- Business Loss Calculations
- Fraud Investigation & Forensic Accounting

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Providing comprehensive litigation & valuation services to the legal community throughout Western Washington.

Owner Replacement Compensation: Why We Fight About It

Written By: Shelley A. Drury, CPA, ABV, CVA, CFF

The most significant single factor in a business valuation is often "owner replacement compensation". Experts often disagree on this figure and the impact on valuation can be huge.

To demonstrate the possible disparity in experts' conclusions, assume two experts are valuing a law practice. Expert A utilizes a replacement salary of $100,000. Expert B utilizes a replacement salary of $150,000. Assuming all other things being equal (no other differences in adjustments between the experts), a $50,000 difference in owner salary translates to a $200,000 difference in value (based on an average earnings multiple of 5).

So how do experts determine owner replacement compensation? The first step is to round-up everything the owner receives including salary, fringe benefits, personal items, quasi-business items and discretionary items to determine "total compensation to the owner" (this can be a major chore). Then, this compensation total must be adjusted to a "market replacement salary". This would be the amount the owner would be paid as a non-owner employee, with the same education, experience, credentials, skills, duties and work hours. Put another way, what would it cost to truly replace this owner with a "non-owner clone", able to run the business just as successfully?

Matching owner compensation to the particular individual is key. Setting compensation at a level that is commensurate with this individual's experience, education, certifications and years in the industry is very important. In my opinion, this is where experts sometimes miss the mark. The temptation is to apply a salary range for a "typical employee" with a similar job description. It's not likely this figure is appropriate for a successful owner's experience, duties and hours. Finding the appropriate salary figure is difficult, time-consuming, and in the end, requires professional judgment.

Now Offering Valuations for Estate & Gift Tax Purposes!

Continuing Legal Education

Special thanks to those of you who attended our December 3rd CLE event, "The Effective Litigator: Ethics, Experts & E-Discovery" at the Hotel Murano in Tacoma.

Attended by over fifty area attorneys and litigation consultants, this year's seminar included topics such as: Professionalism in the Courtroom, Accounting 101, Working Effectively with Experts, Spoliation, and E-Discovery.

If you have particular topics you would interested in for next year's seminar or suggestions for ways to improve our annual seminars, we would love to hear from you!

We are also available throughout the year to present at your firm or association meetings. A listing of CLE topics we have presented in the past can be found on our website (www.litvalexperts.com).

If you, or your firm, are interested in hosting a CLE seminar or would like additional information about our annual events, please contact Tina Mungaray, DSLV Office Manager, at (253) 573-9500 or tina@litvalexperts.com.