Legacy M&A Advisors LLC

M & A UPDATE®

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Why Should I have my Business Appraised?

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Introduction

A business is unlike a car or a house. It is not fully tangible or movable, or even sometimes, apparent in its existence. To value a car or house, typically market value can be established quite easily by looking online or in books for comparables. The value of these two objects is fairly straight forward. A business, on the other hand, is not so easy. For instance, can you tell the difference in value between a McDonald's and a Burger King that may be across the street from each other? While the two have different monetary value, undoubtedly, it takes a professional to spell out and calculate the differences.

So then, what is the need for a professional valuation? The answers are numerous, but following explains why a business should be valued by a professional on an annual basis.

Business Succession (Sales and Purchases)

Purchases or sales of a business to or from a third party require valuations that represent the fair market value of the business with variations reflecting investment value, unique circumstances, and motivations of the buyer or seller. Fair market value in this context is a relative term and IRS standards, statutes, and common law standards are not necessarily applicable in all situations.

In these types of valuations, sellers will see their businesses as being worth more to them based on their own feelings and thoughts about the business. This is called "intrinsic" value. However, the seller must also recognize the fact that the market will view the business from a different, perspective.

Buyers tend to see businesses as being worth less than what the seller thinks the business is worth. Buyers also tend to comparison shop, and have different motives for buying a business. For example, sometimes buyers will merely want the real estate which a business sits on and have absolutely no interest in the actual business being conducted. Not only must buyers recognize their reasons for valuing a company, they must also take into account the sellers "intrinsic" value for the business. When valuing a business you must be aware of the seller's perception as well as the buyer's reasons for the purchase as well.

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A CASE STUDY

Trademarks and Trade Names

IRS Chief Counsel announced recently that intangible items such as trademarks, trade names, mastheads and customer-based intangibles can qualify as like-kind property. In order to qualify, they must be described and valued separately from goodwill. If this requirement is met, then these intangibles will qualify as like-kind property for an exchange under Internal Revenue Code Section 1031. Intangible assets are generally amortized under Section 197 of the Internal Revenue Code. Being they are intangible, like kind exchange was generally more difficult or impossible to achieve.

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Mike Ertel is a Certified M & A Advisor and a Principal Broker with Legacy M&A Advisors, LLC, a full-service M & A Advisory firm with an office in Tampa, Florida specializing in representing sellers and buyers of small- to mid-sized companies. Prior to joining Legacy M&A Advisors, LLC, Mike's business career spanned 30+ years with Fortune 500 and Fortune 1000 Companies, with senior management roles in Marketing, Operations and Logistics. Mike also served as President, COO of a mid-sized Manufacturing company headquartered in Tampa. Mike also holds a BS in Electrical Engineering and an MS in Industrial Administration, both from Purdue.

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Estate Tax Planning

Valuations are necessary for estate as well as tax planning purposes. This area of valuation is largely dictated to appraisers by the IRS and court precedent. Precedent for valuing assets for estate and tax purposes is the most plentiful of any appraisal purpose, for the obvious reason that there is plenty of room for tax avoidance. Much of the precedent for this comes from Revenue Ruling 59-60 and related rulings. In the Revenue Ruling, the IRS states that Fair Market Value is the applicable standard in these types of appraisals. Generally, fair market value is what a willing buyer under no compulsion would pay for the business. Even though it is simple to state, many complex methods are used to arrive at the value and no one formula can be used. Specifically, at least two methods must be used. However, in reality, several methods are observed together with a trend analysis of earnings and cash flow for up to five years. When valuing a business for estate planning, be sure to use a recognized expert in the field.

Buy Sell Arrangements

This is typically agreed upon when a business is created, bought or sold and multiple partners or married couples are involved. When a married couple or any other pair or group of people create, buy, or sell a business, it is absolutely imperative to have a buy sell agreement. This prevents a court from having discretion as in a valuation for litigation purposes. Generally, buy-sell agreements will be followed unless they are declared to be fraudulent, unconscionable, or subject to another contractual offense. The methods used can be anything that is agreeable to the parties. However, the parties should not leave the methodology to be determined at a later date. That is when problems arise. When the Buy/Sell Agreement is written is the proper time to state the methodology in the agreement. Too often, a general statement is made and then when problems arise, more money is spent arguing over what methodology should be used to value the business. If you have a Buy/Sell Agreement, review it and, if a valuation methodology is not stated, redo the buy-sell agreement and state the methodology before trouble occurs.

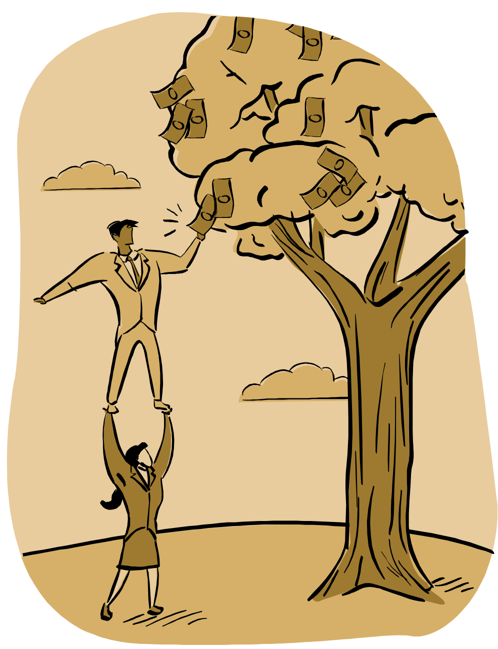
Conclusion

As you can see, many reasons exist to have a business valued. Using a simple multiple and some arbitrary revenue or income number will not adequately value a business. It is therefore necessary to have your business appraised from time to time, especially given estate planning and retirement considerations and the suddenness at which they may occur. If you have questions, please feel free to contact The Center at (618) 997-3436.

Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.

Points of Interest

- **To value a car or house, typically market value can be established quite easily by looking online or in books for comparables.**
- **Buyers also tend to comparison shop, and have different motives for buying a business.**
- **Using a simple multiple and some arbitrary revenue or income number will not adequately value a business.**



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A CASE STUDY CONTINUED:

Editor's Comment: This is a complete reversal in position by the IRS. Previously, the IRS held the view that trademarks and trade names were part of a larger asset of a business, such as goodwill. According to IRS regulations, the goodwill of a business is so unique and inseparable that it cannot be of like-kind to the goodwill of another business. As a result, these items did not qualify for a like-kind exchange under Code Section 1031. However, with this change in position, the IRS has opened up new possibilities for many businesses.

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VALUE DRIVERS TO MAXIMIZE THE SELLING PRICE OF YOUR BUSINESS – PART 4

This is the fourth in a series of articles outlining the steps any business owner can take to maximize the value of his/her business when it comes time to sell. If you'd like to see previous articles in this series, visit our website at www.lmaallc.com. If you'd like a copy of the complete list of value drives, e-mail me directly at mertel@lmaallc.com and request the Value Drivers list.

11. Be Prepared to Hang a Lantern on Your Problem

No business is completely flawless, but the mistake many business owners make is assuming that if they hide their flaws perhaps the buyer won't discover or notice them. This almost never happens, and when the buyer suspects that he/she was deliberately deceived, this can undo months of confidence and rapport building between the seller and the buyer. It frequently leads to an 11th hour reduction in the buyer's offer, and not infrequently kills the whole deal.

In my experience, a much better approach is to take charge of the disclosure of these aspects of your business right up front, or at least very early in the process. Several advantages accrue to the seller when you do it this way. First, right out of the gate you establish a reputation of being a straight shooter who has nothing to hide. Second, you control the news, and have an opportunity to put it in perspective, and explain what steps you're already taking to remedy/minimize it. For example, "When I started the company I sold and serviced most of our larger accounts myself. However, I recently hired a VP of Sales and started taking more time off. Now when our customers need something, they call him."

12. Last, but not least, a Clean, Well-Ordered Workplace

This last point may seem trivial and unimportant, or it may seem so obvious as to go without saying; however, in my experience there's no denying the positive impact that a clean, well ordered workplace has on a buyer. First, it creates/promotes an environment of pride, quality and efficiency. Second, it creates floor space/ counterspace/ storage space which translates to more capacity. Lastly, all other things being equal, what owner or employee wouldn't prefer to come to work in a clean, well-ordered workplace?

***If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation with us, have them contact me at** mertel@lmaallc.com*

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Frequently Asked Questions…

Q: If I have tax issues, can I discharge the tax debt in bankruptcy?

A: Generally, tax obligations are not dischargeable in bankruptcy. However, the use of the bankruptcy code can be beneficial in some tax situations. The automatic stay can release wage levies and the bankruptcy can also be utilized to make a payment plan that the IRS must accept.

Q: If I have an unpaid tax liability, what can I do?

A: For a business or individual to have an unpaid tax liability is within normal operation. Many people and businesses have tax debts which can carry for quite some time. The best thing to do in the situation is to face the issue head on rather than avoiding it. There is no one solution that trumps or is applicable to all situations. Sometimes a simple payment plan is used, and at other times complex legal devices must be used to make sure the taxpayer does not suffer hardship.

Q: I own a business containing real estate, but would like to retire. What are my options regarding exiting my business?

A: Real estate tends to present some challenges when selling a business. A lot of times, buyers are interested in the business, but not the real estate and vice versa. Addressing the issues early on with your advisor is one key to advancing to your goals of retiring or otherwise moving on.