Sooner or later every closely held business must be valued—either for sale or for tax purposes. A tax purpose valuation must be faced during life if you give away any of your stock or recapitalize your company. When you are called to the big business in the sky, your executor must value your closely held stock for estate tax purposes.

If there is an area in the field of taxation where lack of certainty is the hallmark, it is the area of valuation of an interest in a closely held business. This causes frustration to accountants, who are used to adding and subtracting precise numbers that produce sheets which are in balance. This also frustrates lawyers, who are used to finding cases in point that, when taken in series, product a brief that neatly proves their client’s case. Probably the most frustrated of all is the poor taxpayer client—uncertainty reigns supreme.

Placing a value on the stock of a closely held corporation often leads to serious conflict with the Internal Revenue Service. The IRS is your adversary. Valuation is a sort of game—a game without clearly defined rules. The score is kept in dollars—your dollars. Unlike publicly traded stock, whose value is published in the daily paper, the value of closely held stock, must be individually determined. All too often such determinations run as follows:

a. By the IRS . . . . Much higher than the value reported by the taxpayer.
b. By the taxpayer . . Much lower than the value claimed by the IRS.
c. By the courts . . . . Somewhere in between.

Huge tax payments often hinge on the outcome of such disputes. Professional fees to fight are high. Business liquidations (at sacrifice prices) sometimes become necessary to pay estate taxes.

Every company to be valued has its own sets of facts and circumstances and each valuation is unique and different from every other valuation. Two companies in the same business with almost identical numbers can have significantly different values because of just one fact difference. No set of general rules or volumes of books can bring out the importance of unique facts.

The valuation process is an art, not a science, but just as art has its discipline, so too does valuation. The discipline lies mainly in approaches and techniques. The IRS, in Revenue Ruling 59-60, details its approach to valuing a closely held business.

This ruling is a must reading when you want to value your business for tax purposes. But it is only the starting point. Other rulings, regulations and a host of case law must be added to the pile of material needed to properly value a closely held business.

Let’s try to simulate a real life scenario: Suppose you have a stack of stock certificates sitting in front of you—oils; such as Exxon, Shell and Standard of Indiana. The morning paper gives yesterday’s stock market value at $1,000,000. A call to your broker will bring $1,000,000, less commissions, to you in cold cash in four business days.

Same scene—but now suppose you have $1,000,000 worth of Your Company stock just valued by the appropriate techniques as required by Revenue Ruling 59-60. Worth $1,000,000? Well, maybe. Somebody out there . . . . when you find him . . . will pay you the million . . . . over maybe five to seven years . . . . at 10% (with prime at 17%) . . . . oh well, you get the idea. No way is your company stock going to bring a real million dollars in cash or equivalent on the valuation date. Logic tells you, a discount is in order. How much? The courts consistently allow a discount for “general lack of marketability.” How much? The discount varies with the circumstances, but a safe range is 10% to 30%.

How to value a closely held business is a big subject. You should learn more about the valuation techniques that can be used to value your business. However, in the end, you and your family’s best interests will be served by working with an experienced business appraiser.