Value Your Business

The Perspective Changes Swiftly and Radically When You Try to Value a Business for Tax Purposes

When you sell a business in real life, two people—a real seller and a real buyer—negotiate and hammer out a real price. If the two parties can’t agree, the seller will simply walk away and look for another buyer.

When you try to value the same business—that you would have sold in the real world—for tax purposes, the entire perspective changes. It’s almost like walking behind “Alice in Wonderland’s Mirror.” Indeed, things do get “curiouser, and curiouser.” Is this necessary? . . . Probably not.

Let’s set the scene: Bang, bang Mr. Contractor—you are dead. Thirty years of experience has taught me that two out of three family owned businesses are transferred to the next generation. The business is not sold to an outsider. But, the tax law forces you to determine a “fair market value” for estate tax purposes.

Now we are forced to evaluate a real business that is to be sold by an imaginary seller (You, the real seller, are dead; you are represented by your heirs or an executor) who will sell to an imaginary buyer . . . And guess what our simple mission is?

All that we have to do is come up with a “real” price to be used for tax purposes—a price that was determined in an imaginary deal that was made between imaginary people. Unfortunately, the estate tax that must be paid is a real tax that must be paid with real dollars.

Crazy as it sounds that is the way it is.

Every contractor whether he or she likes it or not, must some day face up to the fact that someone will have to value the business for tax purposes.

It can be done voluntarily during life or it will be done in an involuntary situation, after death, by the IRS. The only “out” is to sell your business in a real transaction during your life.

For most business people, selling doesn’t make sense for many reasons. The most common reason is that the typical founder of a family business wants a place to work (he usually verbalizes that he doesn’t) until he is called to the big business in the sky. Furthermore he wants to keep control.

Sounds as if, the “little guy in business” is trapped. Not so. The answer is to have your business professionally appraised. Then arrange to keep control (and your job) of your business by holding the non-growth voting stock, usually called “preferred stock.” The “common” or “growth” stock goes to the kids. Now you can live to be 100. The value of your business has been frozen in your controlling preferred stock for estate tax purposes.

My advice—do it. Do it now. Inflation is driving up the value (in dollars, not intrinsic worth) everyday.