

G O L D E N B U L L E T S

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THOUGHT YOU'D LIKE TO SEE (OR SHARE) THIS (Please feel free to share this with a friend who has a business.)

What is a Closely-Held Business? It is an entity in which or where:

- there are a limited number of shareholders or partners,
- restrictions are imposed on an owner's ability to transfer his or her interest,
- there is no listing of the stock or interest on an exchange or regular quotation in “over the counter” markets,
- where the company has an irregular, limited history of being sold or exchanged.

All or any one of these factors not only helps define a closely-held business, they significantly impact on its valuation. The mere fact that such a business has seldom, if ever, been traded and there is little, if any, market for it will be a major determinant of value.

Why Would I Want to Value My Closely-Held Business? There are many reasons why an owner might need or want to value his or her closely-held business. These include:

- planning for estate liquidity,
- making a gift to a family member, a friend or charity,
- assessing worth in a pre- or post-nuptial agreement or a marital dissolution,
- ascertaining worth for loan collateral purposes,
- performing a “fiscal checkup” to test the financial health of, or trends in, the business,
- estimating value should a buy-out be necessitated by death or disability, at retirement, or the sale of an interest in the business to a third party.

What's the Best Time to Set Price? The proper time for setting the price (or better yet, establishing a price-setting formula) where the triggering event occurs at an owner's death or disability is right now! Almost all businesses with two or more owners should have what is called a “buy-sell” agreement, a document spelling out the terms and conditions of what is to happen and who must do what upon certain events.

The best time to create a formula for setting the price is when the buy-sell agreement is drafted by your attorney. Otherwise, the buy-sell agreement guarantees only uncertainty and increases the likelihood of litigation with the other parties to the agreement, and probably with the IRS.

What Criteria Should The Price-Setting Formula Meet? Whatever price-setting mechanism you and your co-owners agree upon (directly or by formula), it should meet four criteria. It should be (1) reasonable, (2) fair, (3) workable, and (4) understandable.

There is no “right” valuation formula or method; the method or combination of methods which should be used depends on the specific facts and circumstances of the case. The more thorough, objective, and rational the process, the more likely it will be respected by the IRS and the courts for both tax and other purposes.

Is it True That a Higher Value Isn't Always The Best Value? A high valuation means that a decedent owner's heirs receive more cash (assuming your agreement was properly and fully funded). It also means the buyers (surviving owners) must pay more for the interest. This seems to lead to higher federal estate taxes. But, keep in mind the impact of an unlimited federal estate tax marital deduction and the big increases in the applicable exclusion amount available under the current transfer tax system.

A lower valuation means less cash is received by the heirs of a deceased shareholder. The corresponding advantage is that the business entity or surviving owners need to make a smaller outlay to buy out the decedent owner's interest.

Is There a Way to “Ball-Park” a Number? Here's a quick “reality check:” Let's assume you and your business associate(s) have knowledge of the relevant facts about the finances of the business. Put two slips of paper in front of each and ask each co-owner to answer two questions:

1. What is the most you would pay for the stock - if I owned it?
2. What is the least you would take for the stock - if I wanted to purchase it?

This “bid and asked” price technique will help establish an acceptable, if rough, ballpark price range, and help everyone to arrive at a realistic figure.

Of course, there's a lot more to the process of valuation—which is best accomplished by a team of your planners working together!

AS ALWAYS, PLEASE FEEL FREE TO CALL TO DISCUSS THESE OR OTHER FINANCIAL ISSUES OF IMPORTANCE!

IF YOU PREFER TO RECEIVE “GOLDEN BULLETS” BY EMAIL, PLEASE SEND A NOTE TO ME AT: rwilson@fraserlawfirm.com. Thank you.

“Golden Bullets” is provided as a source of general information about current developments in the practice of estate planning and related topics. If you have questions regarding this issue or estate planning in general, please contact me prior to taking action.

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