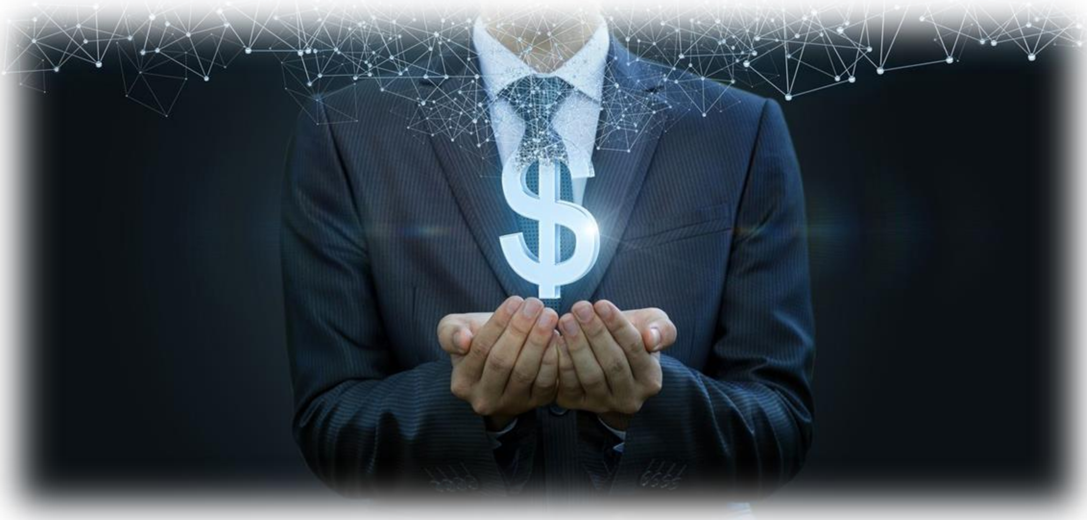


The Business Owner's Guide to Business Valuation

KRS CPAs, LLC

We Follow Through. You Succeed.

Contents

Introduction

Determining the value of a business is a complex process, the ultimate result of which is based on many factors specific to the business being valued. Some of things considered in valuing a business are

- Historical and projected financial results
- Competition
- Business risks
- Industry outlook
- Economic outlook
- Market conditions.

This guide is intended to provide general understanding of these and other factors considered in valuing a business and does not include all the procedures and processes required to value a business.

If you need to know the value of a business for purchase, sale, or estate and gift tax, reach out to a business valuation professional who can review your specific situation and help you determine value.

> Note that the advice in this guide is meant to be general, and may or may not apply to your specific situation. Always consult your tax or accounting professional for formal advice and opinion.

Why You Need a Business Valuation

When is it necessary to have a business valued? There are more reasons than you think!

1. The most common need for a valuation arises in the **purchase or sale of an existing business**. Whether the entire business or a partial interest is being sold, a good valuation is a necessity. We at KRS CPAs are often approached by physicians and attorneys who have been offered the opportunity to become partners in the practices where they work. In these cases, the proposed purchase price is not based on any valuation, and is often significantly higher than the actual value of the interest. We have had situations in which purchasers actually saved money because they were able to negotiate a better price based on our valuation.

2. Business valuations are also necessary for **business plans and agreements** such as buy-sell agreements (see #6 below), stock compensation plans, and even pre-nuptial agreement to be enforceable, for example, full disclosure of the value of each person's assets is required. When one of the assets is a closely held business, this usually requires a business valuation.

3. With planning, **estate taxes** can be saved by selling or gifting minority ownership business interests, rather than waiting to transfer the interest upon the business owner's death. The reason is that a minority ownership interest in a business is worth less than a controlling interest. The Internal Revenue Service knows and accepts this, but requires a business valuation report to estimate the value of the business and the appropriate minority interest discount.

4. The value of a business or business ownership interest is important in **divorce proceedings**, and is usually the subject of dispute. You will not be surprised that when each party hires a valuation expert, the two experts never agree on the value, so a third is usually hired to resolve the discrepancy. Time and money can be saved by agreeing on a neutral valuation expert because you will be paying for one valuation instead of three.

5. One of the most frequently overlooked needs for a business valuation is in **business succession planning**. To maximize the selling price of the business, an initial valuation should be performed as many as five years prior to the anticipated sale. In performing the valuation, the expert's analysis will help the business owner understand what drives the value of the business, and what actions to take to increase that value. Annual updates to the valuation will help the business owner measure the progress towards increasing the business value.

6. Business valuations are critical components of **buy-sell agreements**, both when the agreement is drafted and when a triggering event occurs. In many agreements, the purchase price of the business interest is determined based on a rule of thumb, such as five times sales or two times net income. These types of agreements are the source of countless disputes, many of which are resolved by expensive and time-consuming litigation. Rather than using a formula, it is better for the buy-sell agreement to require valuation of the business, often by an expert selected in advance.

What is Risk? How Does it Affect Business Value

According to dictionary.com, risk is defined as “the chance of injury or loss; a hazard or a dangerous chance.” In the business valuation context, risk refers to the possibility of financial loss or drop in asset value.

In layman’s terms, **the risk in buying a business is that you will overpay for it**. The more risk that is associated with an investment, the higher the return that is demanded by the investor. The higher expected returns are achieved when the market places a lower value on a business that is perceived as having higher risk.

In estimating the value of a business, the analysis is based on expected cash flows and the risk that such cash flows will not be received as expected. An astute buyer seeks to minimize risk, through careful evaluation and understanding of the business he or she is considering buying or investing in. As I have said in previous blogs, the evaluation of a closely held business is no different than the evaluation done in purchasing 100 shares of a public company:

- **Will the company continue to pay dividends?**
- **How much will those dividends be?**
- **What will the shares be worth when you are ready to sell them?**

Certain risks, such as the economy in which the business operates, are uncontrollable. Some risks, such as future competition, may be anticipated but others, such as technological obsolescence may come as a complete surprise. Many years ago, a client purchased a chain of successful photographic film developing labs and continued to operate them successfully until the advent of digital photography. The client certainly did his homework, but did not see the change that was coming. Neither did Kodak and look what happened to them!

Controllable Risks to Consider

If you are buying or selling a business, what are some of the controllable risks that you should look out for? Here are a few of the more common ones:

- **Poor accounting records** – A company's accounting records should tell the full financial story of the business. With all the low-cost accounting software that is available, there is no reason that every business should not have great accounting records. A company's books should speak for themselves; the more stories, explanations, and exceptions, the greater the perceived risk.

- **Customer concentration** – Is the continued success of the business dependent upon a single customer or a few customers? If the loss of any of these customers would negatively impact the business, that is a significant risk.

- **Supplier concentration** – Is the business dependent on any suppliers that cannot be quickly and easily replaced? This could be a problem if anything happens to one of those suppliers.

- **Key employees** – Is the business dependent on the services of one or more employees? Are there enforceable employment contracts and non-compete agreements in place with them? If the business does not have these agreements (signed by all parties and on file), what would happen if those employees went to work for your competitor?

- **Foreign competition** – Can the product or service offered by the business be purchased at a lower cost from a foreign provider? Everything from tax preparation to manufacturing to technology consulting can be outsourced overseas these days. If this hasn't affected your business yet, chances are it soon will. What are you doing to remain competitive?

Taking these factors into account, what are the risks in your business, and what can you do to reduce them?

Using Rules of Thumb in Valuing a Business

From time to time, I receive a call from someone who wants me to tell them the value of a business that they want to buy or sell. They provide a few items of information, such as last year's sales or net income and expect that I will apply a multiple to quickly and easily come up with a value*. What they are asking me to do is apply a rule of thumb.

Old Wives' Tale

Rules of thumb are the old wives' tale of business valuation. **Even in the same industry, every business is unique**. Application of an industry-based multiple (rule of thumb) relies on the incorrect assumption that all businesses within an industry are the same.

As an example, let's consider two local hardware stores that are identical in every way. Each has $2 million in annual revenue which results in $250,000 of income. For the last ten years, each store has shown 2.5% annual growth. Using a rule of thumb to estimate the value of these stores would yield similar results, regardless of whether the multiple relates to gross or net income.

However, what the rule of thumb does not consider the fact that in three months, a Home Depot store is opening across the street from one of the stores. Is it likely that the rule of thumb is still valid and the stores are of equal value? Probably not!

Factors to Consider

Experts consider a number of factors in estimating the value of a business, **the most important being future cash flow and risk**. Of course, historical operating results are used to help project the future, but the **blind application of a rule of thumb will almost never yield a correct result**. Even if sales or net income can be projected, rules of thumb do not consider risks specific to the company being valued. Customer or supplier concentration and the effect of the local economy on the business are just a few of these risks.

What is Your Business Really Worth?

Your business is probably the most important and valuable asset that you own. When you need to know its value, do not short change yourself by using a rule of thumb. Have your business valued by an expert, who will use proper methods to come up with the correct value and help you understand how to increase value. You may be surprised to learn that your business can be worth even more than you think!

*A valuation multiple is simply an expression of market value relative to a key statistic that is assumed to relate to that value. To be useful, that statistic – whether earnings, cash flow or some other measure – must bear a logical relationship to the market value observed; to be seen, in fact, as the driver of that market value. (UBS Valuation Multiples Primer)

Struggling to determine what your business is worth?
KRS CPAs can help.
Contact Jerry Shanker at 201.655.7411
or gshanker@krscpas.com.

Goodwill and Your Business

What is Goodwill? How is it measured? Why is it important? Goodwill is often misunderstood by owners of closely-held businesses.

An Intangible Asset

According to the American Institute of Certified Public Accountants' Statement on Standards for Valuation Services, goodwill is "*that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified*."

The Internal Revenue Service defines it as "*The value of a trade or business attributable to the expectancy of continued customer patronage.*

This expectancy may be due to the name or reputation of a trade or business or any other factor, and in the final analysis, goodwill is based upon earning capacity. The presence of goodwill and its value, therefore, rests upon the excess of net earnings over and above a fair return on the net tangible assets."

What does this mean in English? **Goodwill is the value of a business, over and above the value of its identifiable tangible assets**. It is the expectancy of future earnings. As a simple example, assume a distribution business's only asset is inventory with a value of $100, but someone is willing to purchase that business for $500. The $400 paid over and above the value of the inventory is payment for goodwill.

The Value of Goodwill

Why would someone pay more for a business than the value of the tangible assets? Because they expect to use those assets to earn a profit. In the distribution business or any business, goodwill may include customer relationships, supplier relationships, reputation, location, trade secrets, or any other factor that causes the business to earn income above and beyond a fair return on tangible assets.

How can you **create or increase the value of goodwill** in your business?

1. By earning consistent (and hopefully increasing) net income, which is supported by good accounting records.

2. By establishing consistent and well-documented procedures, which will hopefully support continued future profitability. After all, someone who buys a business is not doing so because of what happened last year, he or she is buying it with the expectation of what will happen next year.

Who Owns Goodwill?

If goodwill is based on customer relationships, is the goodwill owned by the business or the employees who maintain the relationships? This is an area of controversy because it has significant tax ramifications in the sale of some businesses, but the courts have generally held that goodwill is owned by the employee unless he or she has executed a restrictive covenant or employment agreement with the company. If no such agreement exists, and the employee is free to work for a competitor and bring the relationship there, then the company does not own the goodwill. However, if you are considering selling your business and do not have restricted covenants or employment agreements, consider very carefully whether or not they are necessary.

For more information on this subject, please see the article, Business Sales and Personal Goodwill on the KRS website.

How to Increase the Value of Your Business

The value of a business is based on two factors: the expected future cash flow of the business and the risk that future cash flow will occur when and in the amounts expected.

Cash flow and risk are the meat and potatoes of business valuation. The valuation report that is produced is just a detailed analysis of these factors.

What Is Future Cash Flow?

It is the amount of cash available for periodic distribution, plus the amount that will be received from the sale of the company, whenever that sale is expected to occur. This is no different than considering the purchase of 100 shares of stock of a public company. The factors in that consideration are the dividend payment and price appreciation—what the stock will be worth when you are ready to sell it. If you think the stock price will go up, you buy it; if you think it will go down, you don't.

What Is Risk?

Risk is the likelihood that the expected cash flow and distributions will not occur, or the company value will either remain static or will decrease. Staying with the 100 shares example, the risk is that the company in which you purchased stock experiences a decline in profits and stops paying dividends, or the stock price goes down and the shares are sold for less than the amount you paid for them.

If the investment has a higher risk, the typical investor will demand a higher return as compensation for taking that risk. This higher return is achieved by paying a lower price for the investment.

How Can You Increase the Value of Your Company?

Back to our two key factors: by increasing cash flow, and reducing risk!
You may be thinking that you are already doing everything you can; what else can you do to improve cash flow?

- **Increasing profitability by reducing expenses** is the most obvious step. Take a look at your controllable operating expenses and see where you can cut or do things differently to save money right away.

- **Improving accounts receivable collections** will also yield quick results. For example, if your company's sales are $100,000 per month and your customers' average payment period is 60 days, your accounts receivable average $200,000. If you can reduce the payment period to 45 days, average accounts receivable will drop to $150,000 and your company will have $50,000 more in cash.

- **Managing your inventory** will also have a positive result on company cash flow. Does your company have any slow moving or obsolete inventory? Or, do you have too much inventory on-hand for your expected sales? If the answer to either of these questions is yes, you have money tied up in inventory that could be in cash or put to more productive use in the business. It is better to dispose of obsolete inventory at reduced prices than continue to tie up cash and incur carrying costs to keep it.

What Are the Risks Specific to Your Business and How Can They Be Reduced?

Customer or supplier concentration, dependence on key employees, changes in marketplace conditions, and poor accounting records are just a few of the risks that may reduce the business value. Every business is different. What risks would a potential buyer of your business be concerned about? Do you have concerns now about your company's future cash flow or risk?

Buy-Sell Agreements

Buy-sell agreements are the most important, but perhaps most overlooked agreement that a business can have. These legal documents protect business owners when one owner leaves the company for any reason.

Although many businesses have buy-sell agreements, they were likely drafted when the business was formed many years ago and have not been looked at or updated since. If your business has a buy-sell agreement, take it out, read it, and ask your accountant to calculate what would happen if the agreement were triggered today. Evaluate the results from both sides, as a buyer and as a seller.

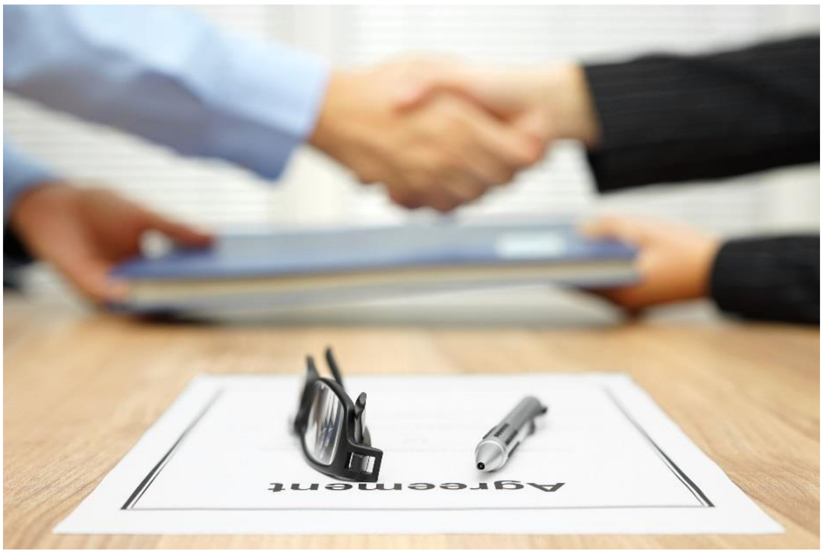
1. The first question is, **is the price calculated pursuant to the agreement fair to all parties**? If is unfair, it is time to execute a new agreement. (By the way, don't assume that the younger party to the agreement will be the buyer, or that the older party will be the seller. Owners may leave their businesses for many reasons.)

2. Another important issue in buy-sell agreements is the **payment terms**. Does the agreement require a lump sum payment or payments over an extended period of time? If a lump sum payment is required, how will that payment be funded? If funded by insurance, is the policy still in force and is the amount sufficient to make the payment? That $1 million term policy that was purchased when the business was formed may not be enough to cover the price today if the business has grown. Also, term insurance expires at certain ages, perhaps leaving no funding for the agreement.

3. If the agreement requires that the business be valued, it should **specify the standard of value to be used**. There are big differences between fair market value and fair value. I once served as an expert in a dispute in which the agreement used the term "value." The standard of value issue was eventually resolved, but not before the parties spent a lot on legal fees.

Don't Pay the Price for No Agreement

Not having a buy-sell agreement is a different kind of agreement—one to spend a lot of money, perhaps hundreds of thousands of dollars, on professional fees, and years to resolve the issues.



Companies without an agreement end up letting a judge or a jury decide what will happen to the business that they worked so hard to build.

Although it is often an uncomfortable conversation to have with your partner, it is a much easier conversation to have now, when you are both healthy, your interests are aligned, and retirement or disability is not on the horizon. It is a far more difficult to reach an agreement after a triggering event, especially when that conversation is with a widow or children who are not at all concerned with fairness.

These are just a few of the issues surrounding buy-sell agreements. For more, read **Business Divorce, Valuation and the Importance of a Buy-Sell Agreement,** available on KRS partner Gerald Shanker's bio page.

Valuation Considerations in Selling a Business

The most important tools in helping evaluate cash flow and risk are good accounting records. If the business has five or more years of good accounting records, the buyer's perception of risk is reduced, because the records will tell the story of the company's cash flow, and make it easier to project future cash flow.

It is unlikely that any single action will result in a significant increase in cash flow, but here are some areas where improvement may be achieved:

Expense Reductions – Review your financial statements line by line. Can the company operate with less payroll? Fewer vehicles? Can you reduce your space and related rent expense?

Have employee contributions to health insurance costs kept up with rising premiums? I once assisted with a business sale in which the owner's mantra was "find an expense reduction or become one." Every dollar that is added to the bottom line may increase the value of the business.

Revenue Increases – Can the customer base be expanded? How will the company's market share be affected by a price increase? What about a price decrease? Can the company take on new product lines?

Accounts Receivable – Can customer payments be accelerated? Money that is not in accounts receivable will be in your bank account, available for the business to use. For example, a business that has $10 million of annual sales will gain approximately $385,000 of cash by reducing its average collection period by 14 days.

Inventory – Are you carrying obsolete or slow moving inventory? If so, it should be sold at a discount to reduce inventory and raise cash. This step is also necessary so that prospective buyers of the business will have an accurate picture of normal inventory levels.

Common Risk Factors

Although different businesses may have different risks factors, some risks are common to all businesses. In evaluation of risk, we identify factors that may cause cash flow to not be received in the amounts expected and when expected. Following are some risks common to many businesses:

Customer Concentration – Is the business dependent on sales to one or a few customers? What would happen if one or more of those customers were lost?

Supplier Concentration – Are business operations dependent upon one supplier? If that supplier ceased to exist, could it be replaced?

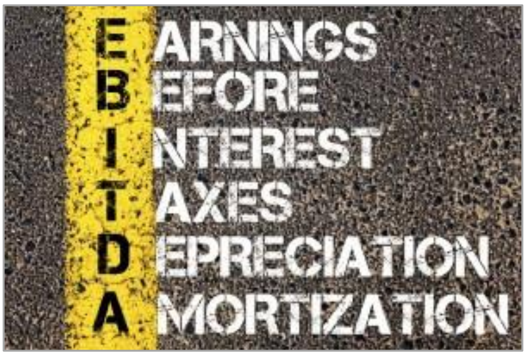
Key Employees – Do the key employees have employment agreements and/or non-compete agreements? If not, and they went to work for a competitor, would the business suffer?

Obsolescence – Are your products or the processes used to produce your products approaching obsolescence, or are you updating your products and processes to stay competitive?

To understand the value of the business and how to increase it, a business owner considering selling should have the business valued. This will help him understand the factors that drive the value of the business. If this is done long before the contemplated sale, this will give the owner and management team more time to make the changes necessary to increase the value of the business.

What is EBITDA and Why Do I Care?

EBITDA is an acronym for *E*arnings *B*efore (deduction of) *I*nterest, *T*axes, *D*epreciation and *A*mortization.



It's a way of evaluating a company's operating performance without considering financing or accounting decisions, or the tax environment. Stated another way, EBITDA is actually **the operating income of the company**, not affectedby non-operating expenses like equipment, purchases, or financing decisions resulting in additional interest expense.

Why is EBITDA Important?

Are you buying or selling a business? **An EBITDA calculation represents debt-free, pre-tax cash income** and allows someone to compare the efficiency of a company with its competitors, minus the influence of capital structure.   It's one of the operating measures most used by analysts in commenting on a company's financial health.

EBITDA is not the same as free cash flow, because adjustments are made to EBITDA to arrive at cash flow. For example, if the company repaid debt or purchased equipment, those transactions would not affect EBITDA. That's why interest is added back, because it allows comparison on a debt-free basis.

EBITDA and Leveraged Buyouts

When purchasing a business in a leveraged buyout; that is, when you pay for one business with another's earnings, EBITDA is the starting point in determining the debt repayment capacity of the target business.

- If EBITDA is low, it will not support large debt payments and the buyer will most likely offer a lower amount to purchase the business.

- If EBITDA is high, it will support more debt and the buyer therefore will be willing to pay more for the business.

This makes sense, because the purchaser of a business is paying for the expectation of future earnings. **The greater the expected future earnings, the more valuable the business.**

The Good News

The good thing about **EBITDA is that it is in the control of management**.

How can it be increased? There are two ways, and they are very simple. The first is to increase revenue, and the second is to decrease expenses. It is essential that you review your financial statements each month to identify expenses that may be reduced. Accurate monthly financial statements are one of the best tools in managing your business and increasing EBITDA. If you don't receive timely monthly financial statements, talk to your CPA. If he or she can't help you, call us. After all, your business won't manage itself.

Structuring a Business Sale to Minimize Income Taxes

Many of the considerations in structuring a business sale are dependent upon the type of entity that operates the business.

In a business sale, the seller prefers to sell the stock representing the business ownership, but the buyer prefers to purchase the assets of the corporation. The seller wants a stock sale because it generates a capital gain, taxed at a 20% rate. The buyer prefers to purchase the assets because the full purchase price is allocated to the assets purchased, creating tax deductions for depreciation and amortization.

In a stock purchase, the buyer steps into the seller's shoes, receiving no tax benefit from the price paid until the business is sold. This issue is usually resolved by compromise, sometimes involving a price adjustment.

C Corporation vs. S Corporation Asset Sales

There is a significant difference between an asset sale by a C corporation and an asset sale by an S corporation. Sale by a C corporation results in double tax because the selling corporation is taxed on the gain on the asset sale, and the shareholders are taxed on the distribution to them by the corporation. Sale by an S corporation that has been an S corporation for at least five years preceding the sale is subject to only one level of tax. Because S corporations are pass-through entities that do not pay federal income tax, the entire gain is passed through to the shareholders for inclusion on their personal income tax returns.

If your business operates as a C corporation and you are contemplating sale, you should consider making an S corporation election. This will allow you to avoid a double tax, but only if the corporation has been an S corporation for at least five years prior to the sale. If the five-year requirement is not met, the S election will be disregarded for purpose of the sale and the sale will generally be treated as having been made by a C corporation.

In certain circumstances, a sale transaction can be structured in which the seller is taxed at favorable capital gains rates and the buyer receives ordinary deductions for a large part of the purchase price. This would occur if seller had personal goodwill, such as customer or supplier relationships not owned by the corporation. In this structure, the seller would recognize capital gain and the purchaser would deduct the price paid for the goodwill over fifteen years.

Learn More About Selling a Business

For more information on this, see my Business Sales and Personal Goodwill article, which was written for the NJ State Bar Association.

Considerations in Buying a Business

I have helped many clients purchase businesses, and probably advised just as many to walk away from deals. What makes a deal good and what are the important factors in evaluating the purchase of a business? If you are considering purchasing a business, **your goal should be to minimize the risk that you will overpay for the business**.

Buying a business is an investment decision, no different than buying stock in a publicly traded company. When investing in public company, you consider two factors; how much can you expect to receive in dividends and what do you expect the stock price to be when you sell.

Not all stocks pay dividends, but absolutely no sane person would purchase stock in a company if they expected the share price to go down during their period of ownership.

It is the same when you buy a business. The important factors are how much income will be available for distribution to you (the dividend) and how much will the business be worth when you are ready to sell (the share price). The problem is, there is usually more uncertainty (risk) in a private business than in a public company. As a purchaser, what can you do to understand and minimize the risk?

Consider the Risk

Accounting records tell the story of a business, and speak for themselves. If the business does not have good accounting records that go back at least five years, that is risk. **The more explanations and stories that are needed to support the accounting records, the greater the risk.** I always tell clients that they should only pay for what the seller can prove. As far as we are concerned, if income isn't reflected on the books and reported on the tax returns, it does not exist.

Concentration risk is another important consideration. If the business is economically dependent upon a single customer or a few customers, a single product supplier, or a few key employees, the future of the business is risky. What would the business look like if the important customer was no longer a customer, the single supplier could no longer supply product, or some key employees went to work for a competitor? Could the business continue profitable operations if one or more of these events occurred?

More Than a Salary

If you buy a business and the only thing you get is a salary for working there, you are not buying a business, you are buying a job. **Take the emotion out of your decision.** You would be better off getting a job somewhere else and not putting your investment at risk. However, if you expect the business to grow, allowing you to receive more money in the future, and eventually sell the business for more than you paid, that is a different story and should be your goal.

I have touched on a few of the many things that must be considered in the purchase of a business. Before you buy any business, you should conduct thorough due diligence, which is usually performed by CPAs and attorneys experienced in business purchase and sale transactions. This will help you understand the business, its risks, and provide the information that will allow you to estimate the value of the business.

A Few Considerations Before Acquiring a Small Business

Whether you are buying a retail store, a franchise, or a service business, your due diligence and valuation process is not much different than that employed in purchasing a multi-million-dollar business.

The three main things you want to know when you're considering purchasing a small business are:

1. **What is the amount and timing of money you expect the business to generate in the future?**

2. **When you are ready to sell the business, how much will you be able to sell it for?**

3. **What is the risk that items 1 and 2 will not occur as expected?**

As evident from these questions, the thing to focus on is the future. Although the seller will certainly focus on past performance, what happened twenty, ten, or five years ago is of little significance; you want to know what will happen in the future.

It is not uncommon for small business buyers and sellers to agree on a price based on an industry "rule of thumb" formula such as three times net income or 80% of gross revenue. Unfortunately, rules of thumb are nothing more than old wives' tales. Every business is unique and no business should be purchased based on a formula purported to be applicable to an entire industry.

Sometimes a buyer thinks that he or she is buying a business, but they are really buying a job. On the most basic level, the value of a business is based on the amount of money you can earn above and beyond the value of the services you provide to the business. For example, if you earn $100,000 per year as an employee and you have the opportunity to purchase the business where you are employed, the purchase would make sense only if it gave you the opportunity to increase your earnings. Investing in a business is risky. If you purchased the business and continued to earn the same $100,000, you would not receive any return for taking the risk, and would be better off investing your money elsewhere.

Get Professional Advice Before Buying a Small Business

Professional advisors understand the issues; know the questions to ask and procedures to employ to help you understand the business you are considering and what it is worth. The earlier in the process that you get professional advice, the better off you are. Even if you just ask your CPA to look at the last few years' tax returns of the business and offer comments and questions, you will save a lot of time and money, and get unbiased advice from an experienced professional.

For more about understanding how to value a business you're considering purchasing, refer back to "Why You Need a Business Valuation" on page 4.

Set the Standard of Value in Shareholder and Partnership Agreements

Defining "value" can help you avoid negative consequences.

Do the valuation provisions of your shareholder or partnership agreement specify a standard of value? If they do, is the standard of value "fair value," "fair market value," or something else? If the standard of value is not fair value or fair market value, does the agreement define the standard of value to be used in the event a valuation of the business is required?

The Internal Revenue Service defines fair market value as "The price at which property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."

Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

Depending on the characteristics of the ownership interest being valued, minority and marketability discounts may be applied in valuing the ownership interest under the fair market value standard. The amounts of these discounts are fact sensitive, but discounts between 30% and 40% are not uncommon.

The Impact of Brown vs. Brown

The fair value standard was created in New Jersey in the case of Brown v. Brown 348 N.J. Super. 466, which is basically fair market value without discounts. The Court's logic in this divorce case was that since the business was not being sold, the nontitled spouse should not suffer discounts in the distribution of marital property.

I have also been involved in a situation in which the agreement used the term "value" without definition. The parties in that dispute spent a significant amount of money on professional fees that resulted in an arbitrator deciding on a definition.

As you can see, the use of the single word "market" in the standard of value may have a huge impact on the valuation result. What does your agreement say, and is that what you intend? Although discussing this issue and updating business agreements may be uncomfortable for some, it is far better than ignoring this issue, because doing so may very likely end up in litigation.

About KRS CPAs

We Follow Through. You Succeed.

Paramus, New Jersey-based KRS CPAs was founded over 10 years ago with an entrepreneurial spirit, high standards, and solution-oriented expertise. Our team believes that clients benefit the most when they have a trusting working relationship with an accountant who "has their back" in both personal finance and business matters.

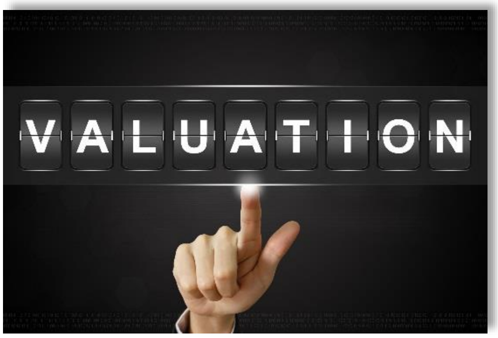
We are known for being responsive and following through for clients. Our goal is to make it as easy as possible for clients to get the advice and counsel they need so they can focus on living their lives and running their businesses.

Learn more.

Visit the KRS CPAs Insights page for more resources and tools. Check out our blogs for insider tips, insights on trends, and more.

Clients value that the KRS team is proactive in giving them expert guidance on their most challenging business issues, so that they can make real-time decisions.

If you're ready to work with a firm that understand business valuation inside and out, give us a call at 201.655.7411.



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