Court Opinion v. Valuation Practice:

A Discussion of Relevance and Application

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The task of the valuation expert consists of determining the fair market value of a security interest. This determination should be based on financial theory and market data and reflect the cash price a willing buyer is prepared to pay a willing seller. By definition, we cannot know the exact and definite value, unless an actual arm's length transaction has taken place. If such a transaction had taken place, the valuation expert would not be needed to determine the value. Consequently, the practitioner must determine the price when there is no actual data to use or compare to the expert's opinion.

The expert is charged with using market data from comparative entities and transactions to determine the most likely value for the interest. It is the responsibility of the expert to determine a value that would apply to the interest in an actual market transaction. To accomplish this, real-world data and indications are used. In addition, the expert must ensure that the analysis correctly reflects the circumstances of the company on the date of valuation. The value that results from the expert's analysis will incorporate the facts of the company and their impact on value as evidenced by pricing data in the marketplace.

As valuation experts, we are aware that our work may be scrutinized by the Tax Court. As a result, it is tempting to study, and rely upon, the Tax Court's previous decisions as indications of the appropriate methodologies and valuation discounts. However, the Court must make a decision based on the facts that have been presented and sometimes the Court has to make the best out of the evidence at hand. Johnson and Jeffries state that: *"While it is important to study and understand court cases involving discounts and family limited partnerships, practitioners should not arbitrarily rely on the discounts established by court precedents to quantify discounts in their valuation."*[i] The Court's decision is not evidence of market data and should not be used as a value indication for other situations. Maybe the Tax Court said it best: "*The facts that petitioner found several* [court] *cases which approve discounts approximately equal to those claimed in the instant case is irrelevant. Therefore, in deciding the appropriate discounts in the instant case we (...) do not consider the amount of discount applied in other cases by petitioner as persuasive."*[ii]

On the other hand, it could be perilous to pay no heed to the insights that can be gained into the Court's reasoning by studying relevant cases. This article will examine specific issues presented in recent Tax Court cases. The discussion will focus on differences between the valuation expert's position and the Tax Court's decisions.

What was Known as of the Date of Valuation?

When analyzing a company, the appraiser must consider the facts surrounding the company that were known, or knowable, as of the date of valuation. The importance of excluding post- date of valuation information was

discussed in *Lebowitz v. Commissioner*[iii] "events subsequent to the time of purchase that affect the value of the security are irrelevant."

In Hess v. Commissioner[iv], the petitioner's expert made a significant adjustment to the subject company's income statement. This adjustment impacted the methodologies utilized by the expert, which, according to the Court, resulted in a significantly understated value for the company's stock. Based upon the information available at the trial, the Court concluded that this adjustment should not have been made for multiple reasons. First, at the time of the expert's appraisal in 1997, he relied on a memo from certain employees at the subject company concerning a potential overstatement of income that occurred in 1995. The petitioners admitted that at the time of the gift, the amount of the overstatement of income had not been quantified. The Court concluded "the alleged understatement [of the earnings reserve] was not discovered or quantified until 1997, almost two years after the gift of [the company's] stock and after the audit of the petitioners' gift tax returns."[v] The incorporation of this adjustment resulted in a valuation that was substantially lower than that opined to by the respondent 's expert. Additionally, with the inclusion of an adjustment that had not been quantified as of the date of valuation, the petitioner's expert weakened his client's case before the court. The Court commented on the fact that without this adjustment, the value of the company would have been very close to that opined to by the respondent's expert.
Although the Court and the appraisal industry have cautioned against the use of future data, the Court has from time to time utilized information that occurred well after the date of valuation. This application has typically occurred in those cases involving life estates and similar estate planning vehicles. However, in *Couzens v. Commissioner*[vi], the Court stated, *"Subsequent events may serve to establish both that the expectations were entertained and also that such expectations were reasonable and intelligent."* Nevertheless, it is apparent that although the Court allowed the use of hindsight in this case, it was applied to confirm whether or not expectations on the date of valuation were reasonable.

Despite the Court appearing to indicate otherwise in *Couzens,* it is important that only the data that was known or reasonably knowable as of the date of valuation be included in the analysis. Every valuation should be performed as if it were prepared on the date of valuation and using only information known as of that date should be incorporated. The inclusion of future data may have a significant impact on the valuation of the business entity as we saw in *Hess* and could call into question the data utilized throughout the entire analysis as well as the expert's credibility.

The Importance of Due Diligence

Without argument, comprehensive due diligence is the best way to learn about the subject company, its industry and competition, and underlying risks. However, if no due diligence is performed, it compounds the difficulty an analyst faces when trying to support the analysis underlying his conclusion of value, as well as the assumptions made in the course of that analysis.

In *Estate of Adams v. Commissioner*[vii], the Court noted that the respondent's expert did not meet with the management of the subject company. It is unclear from the text of this case where the expert received the information necessary to perform the analysis. It is understood, that given the circumstances surrounding the case, the petitioners may not have provided access to the subject company and its management team. However, it is also apparent that had the expert met with management, some of the analysis' weaknesses might have been avoided. For example, the expert missed information that would have enabled him to better estimate the future compensation of the subject company's president. The expert projected the president's salary based upon compensation of employees who performed tasks that comprised only 10.0% to l5.0% of the president's time, "*ignor*[ing] *the fact that* [he] *did much more*."[viii] Additionally, the salary opined to by the respondent's expert was

not in line with the fact that the president "*was a key employee, and that no one would buy* [the company] *without* [him]."[ix]

The expert derived a salary that was approximately 22.0% of what was actually paid to the company's president. This determination, which was not accepted by the Court, impacted the concluded value of the company and likely would have been closer to that of the petitioner's expert had the president's salary more closely reflected the work he actually performed and his importance to the company.

In *Dailey v. Commissioner*[x] the respondent's expert was criticized for not having reviewed the facts of the case. At trial, the expert could not recall having reviewed the partnership agreement of the subject entity. This lapse in due diligence procedure caused the Court to deem the expert's testimony as unsupported and inapplicable to the facts.

Performing due diligence is fundamental to the analysis. This research into the entity provides the analyst with critical data concerning variations in the company's past and future financial performance. It gives the analyst a chance to meet with management and become more familiar with not only the company and its business, but also aspects of the company that are not evident by review of financial statements. Many times, these factors are important in determining the value of the subject company, but will not come to light in the absence of a meeting with management.

What is Representative Information?

A review of trends and financial ratios will provide the analyst with a clear picture of the company's financial health. This review will also guide the analyst in determining the earnings metrics that will be utilized in the income and market approaches. The analyst should give consideration to the company's growth patterns and business cycle since ignoring these features could result in misleading indications of fair market value.

For a company that has exhibited strong historical growth patterns, the most recent financial metrics will likely be the most representative of future performance. However, this assumption will not necessarily hold true for a cyclical company, and a potential investor would look to some indicator of the company's performance that best represents what could gene rally be expected. Many times, this expectation is derived using some measure of average finance performance over the course of multiple years. However, care must be given when using average financial performance data. The analyst must ensure that in the course of determining the average, that stronger or weaker results are not unduly weighted causing a conclusion that is not meaningful.

In *Estate of Dunn v. Commissioner*[xi] one of the petitioner 's experts utilized a weighted average in determining the net cash flows available to the subject company's shareholders. The Court disagreed saying, "*we think that a weighted average is inappropriate in this case (…)* [t]*he weighted average gives too much weight to the lowest point of the cycle.*"[xii]

It is important that the analyst consider the subject company's performance from both the buyer and seller's perspectives. Management's future expectations must be weighed against the company's historical performance and the outlook for the industry. Determining what is representative will be an exercise in combining information from all sources and concluding what could reasonably be expected based upon what is already known and what is anticipated, balanced against what industry experts believe.

Making Assumptions

Most, if not all, analyses encompass assumptions that are important to the outcome. It is crucial that these assumptions reflect the subject company's operations in an accurate manner. Any assumptions made by the analyst, must be supported in a meaningful way if they are to be accepted by the Court. To make assumptions that are not supported by the facts of the company, as they existed on the date of valuation, will only serve to weaken the valuation analysis and resultant conclusion.

The importance of the cohesion of the analyst's assumptions and the subject company was illustrated in Estate of *Dunn v. Commissioner*[xiii] and the petitioner 's expert's liquidation analysis. In this case, one or methods used by the expert was the asset approach. The use of this approach is appropriate because the subject company was an asset intensive business that rented heavy equipment to companies in the oil and gas industry. Much of the company's value was in its assets, which included cranes, air compressors, and backhoes. The expert "*believed that there was a substantial likelihood of liquidation, given that the company's return at the valuation date was lower than the returns on risk-free investments*"[xiv] Based upon this determination, the expert assumed that a liquidation analysis would result in a meaningful indication of value for the company.[xv]

In the course of their review of the analysis, the Court determined that the expert did not consider all of the costs of liquidation, stating, "[t]*here is no question that* [the expert*] did not consider all the costs of liquidation., such as the costs involved in selling and transporting equipment, and the reduced sales price for equipment*."[xvi] However, the underlying assumption that the company's assets would have been liquidated may not have been in line with the facts of the company and the interest being valued. The interest in question represented approximately 63.0% of the company's outstanding stock and would not have the power to compel liquidation of the assets[xvii]. The assumption of the ability to liquidate the assets was not consistent with the powers inherent in the interest, the desires of the other shareholders, or the current situation of the company. The Court therefore, determined that a liquidation analysis undervalued the company's assets.

Use of Comparable Entities

The use of comparable entities and transactions is one of the cornerstones of the valuation field. The practice of finding transactions in the marketplace, which will result in valuation indications, is widely accepted and used in valuation of both partnerships and corporations. It is always the goal of the valuation ex per t to find market data that is as comparable to the subject entity as possible. In addition, we try to achieve multiple value indications so that we are not relying on just one or two outcomes, which could be anomalies. Unfortunately, in recent court cases the Tax Court has begun to indicate that quantity is more important than quality.

In *Heck v. Commissioner*[xviii] the Court rejects an entire valuation report because of the reliance on one singular company in the market approach. The Court states that the reliance on pricing data from one company is not evidence of market valuation but rather a reflection of that entity's situation where individual characteristics may distort the comparison.

In the case of *Hall v. Commissioner*[xix], the petitioner's two valuation experts as well as respondent's expert all agreed that the one most similar comgggfparable was American Greetings Corp. However, both of the petitioner's experts further selected an additional handful of co m parables that are deemed to be helpful to the analysis. Petitioner's first expert selected five additional companies based on their focus on brand name consumer goods, industry leadership, and other business and financial characteristics. Petitioner's second expert identified 15 additional comparable companies based on factors such as distribution channels, profile and reputation, leading brand names, and products that involved elements of social expression among other issued. A common thread

between the two valuation experts' selection of the additional comparables is care in selecting companies that may be viewed and treated in a similar fashion by the investing population and that have traits that are similar to the subject entity. Respondent's expert on the other hand concluded that American Greetings Corp. was the only comparable publicly traded company and limited the comparable analysis to this one case.

The Court strongly objected to the use of only one comparable, no matter how similar the public company is to the subject entity. It was the Court's opinion that one single company can be affected by unique individual characteristics that may distort the valuation indications and the comparative analysis.

In *McCord v. Commissioner*[xx], the Court favored the use of 62 Real Estate Investment Trusts (REITs) with a broad array of real estate investments over a selection of three publicly traded real estate development companies. The Court stated that "*given the size of the sample, any dissimilarities in the assets and activities of particular REITs in the sample (...) are tolerable*" **.**

Valuation experts agree that the use of a single comparison company can be difficult and may cause the analysis to point to a false conclusion. However, it is with caution that we encourage the use of broad selection criteria. In Hall, the petitioner's experts used some considerable thought and caution when selecting the additional comparables, based on such non-quantitative factors as brand recognition, type of product line and distribution channels. In the case of Hall, the subject entity exhibited characteristics that could be applied readily in an expanded comparables search.

In McCord however, we find the Court's preference for a selection of 62 REITs to be a generous application of the language from Hall and Heck. In McCord, the Court quotes from Heck: "*similarity to the company to be valued decreases, the number of required comparables increases*." It is our opinion that the Court has taken the argument too far in attempting to compensate for the differences between the subject limited partnership and publicly traded REITs by expanding the sample to include 62 records. In a similar situation in *Lappa v. Commissioner*[xxi], the Court slated that the use of a larger sample will "*make tolerable any dissimilarities between the subject entity and the guideline group.*"

The focus should not be on the size of the sample. On the contrary, the comparable group is a starting point from which a thorough comparative financial analysis should be performed. During such an analysis, any differences between the comparable group and the subject will become evident and appropriate adjustments will be made to the valuation metrics. It is the comparative analysis that will derive the selection of pricing multiples from those companies whose performance most closely resembles that of the subject. If, however, the disparities between the group and the subject are too large, the group should be rejected. As an example, a comparison of a private company to the entire NASDAQ index would not be helpful. To use the central tendencies of such a large group would be too broad of a comparison and would result in a meaningless value indication. On the other hand, the comparison of the subject to only one company would be too narrow and would, in the Court's own words, "distort the valuation indications".

It is our opinion that there has to be a balance between quality and quantity in determining the appropriate size of the sample. Clearly, one comparable is not enough, but there is also an upper limit to how many entities should be included in a good quality sample. We will not venture in this article to try to determine what exactly is an appropriate sample size, but the practitioner and the Court must use sound judgment in this area. A large sampling of non-comparable companies produces specious observations regarding the relativity of the subject whether at the median of the metrics or with respect to certain reference points defined by the non-comparable sampling.

Choice of Valuation Metrics

The application of trading multiples to the metrics of the subject company is more art than science. Conclusions drawn from the same data will vary from analyst to analyst, and it is important to provide as much support as possible for the selected multiples. In *Okerlund et. al. v. United States*[xxii] , the Court heard the testimony of two experts concerning the pricing of the subject company. Both experts used substantially the same group of public companies to determine the value of the company. Additionally, they also came to similar conclusions about some of the characteristics of the company relative to their samples of public companies. Further, when applying trading multiples to the metrics of the subject company, they relied upon the same ranges of multiples. However, it was in the selection of the multiples that the experts differed. The Court noted, "*the primary difference between the two expert s' pricing multiples...is that* [one expert) *took ·a far more pessimistic view of the company as a result of certain risk factors."*[xxiii] The Court considered that although the risk factors identified by the expert were not insignificant, they "must be considered in the context of the financial fundamentals of [the company)."[xxiv]

The analyst's conclusions must be based upon not only a thorough review of the subject company's financial performance, but must also take into account the performance relative to that of its peer group. Further, this analysis must also consider the circumstances of the company, as they existed on the date of valuation. Using this information when selecting trading multiples will better support the conclusions of the analysis and the concluded value of the subject company.

The Use of Central Tendency Measures

While the simplicity of applying the average or median from the comparable group is sometimes appealing; it is rarely the method to determine the value of the subject. In a few select cases, the Court has shown a propensity for using this perilous method to determine value. Coupled with the Court's preference for larger samples, valuations rendered by the bench are moving towards a world where all entities have the same valuation metrics, regardless of their attributes.

In *McCord v. Commissioner*,[xxv] the Court is un-persuaded by either experts' argument for a lower and higher than average discount, respectively. Rather than performing their own analysis on the bond and marketable securities portfolios, the Court concludes at the average discount of the sample population.

In Lappa v. Commissioner[xxvi] , the experts, and the Court, agree that the discounts observed in private placements relative to the market price of the unrestricted public stock are appropriate proxies for the illiquidity adjustment. The petitioner's expert used data from and existing study including 197 transactions that took place between 1980 and 1995. From this population, a sample of 39 was extracted. The Court did not warm to this approach as the sample contained, in the Court's opinion, too many technology companies, which seemed to have a greater illiquidity premium. Petitioner's expert concluded a 29.3% lack of marketability discount, which was further adjusted upward to 35% due to the particular hindrances to liquidity in the subject entity.

Respondent's expert relied upon a published study, "*Firm Value and Marketability Discounts*"[xxvii] by Dr. Mukesh Bajaj. While the Court appears to prefer this study over that of the petitioner's expert, it nevertheless points out that the existence of one study is not sufficient to support the conclusions. The Court proceeds to conduct its own determination of the lack of marketability discount using the data from the Bajaj's study as well as work by Hertzel & Smith[xxviii] By using the raw data from these two studied the Court derives a 19.45% starting point for the illiquidity discount and adds 300 basis points for the particular hindrances to liquidity in the subject entity as discussed by the respondent's expert.

In his book "*Investment Valuation*"[xxix],Damodaran states: " *In practice, controlling for these variables [that influence the multiple] can range from the naive (using industry averages) to the sophisticated (multivariate regression models...)*". Unfortunately, in cases such as McCord and Lappo, the Court has shown a propensity for using the "naive" method of averages and central tendency measures in their opinions, without properly adjusting the indication for the subject entity's situation. If taken to its ultimate conclusion, this technique will result in the same adjustments for all entities regardless of the financial condition, the terms of the partnership agreement, the presence of a buy-sell agreement, or any other peculiarity of the subject entity.

The use of medians and means of large groups of somewhat similar entities ignores one of the cornerstones of valuation, the fundamental financial analysis. The valuation expert is a financial analyst whose job is to find all of the relevant facts, perform an analysis that incorporates all the facts, and thereafter draw a well-supported conclusion. It is however, not the expert's job to collect a large sample of available data with questionable comparability, calculate the central tendency indications and apply the result to the subject entity. The securities markets do not evidence such reasoning or pricing patterns. By continuing to use this simplified and non-qualified technique, the Court is ignoring the expertise and experience necessary to perform a valuation and is moving away from simulating market based valuations in its decisions.

What are the Specific Company Risk Factors?

It is also important to consider how the facts affect the company relative to its competition or to a potential buyer's investment alternatives. Facts that could be construed as increasing the risk associated with an investment in the subject company may not be specific to the company in question. The analyst must take into account the occurrence of these issues in other companies in the industry in which the subject company operates. To consider the subject company in a vacuum could result in the erroneous conclusion that the company is inherently more risky than its competition.

In *Okerlund et al. v. The United States*[xxx] the plaintiffs' expert derived a discount rate for the subject company, carefully considering all of the risks inherent in its operations. While the company's operations do encompass these risk factors, relative to other companies in the industry, as well as those with comparable operations, the Court determined that these risk factors are not unique, or represent an increased risk, to the subject company. In fact, the Court believed that some of the risks, such as barriers to entry that were qualified by the plaintiffs' experts actually had some positive attributes. The Court noted that "[t]*he risk factors must be considered in the context of the financial fundamentals of the subject company.*[xxxi]

However, it is important to consider that while most, if not all, companies have certain risks that are inherent in their operations and may be unique in the industry, it is also possible that the subject company may possess an attribute that gives them an edge over their competition. Factors such as patented technology and barriers to entry must also be considered in the analysis. Regardless of the risks or benefits that are included in the discount rate, the analyst must provide ample support for the addition of these factors. It is not enough to simply state that the subject company possesses certain risks. These market risks must be described in detail and quantified using relevant data.

Discount Rate Adjustments

While the company's cash flows are a function of the value of the entity, it is the rate these future cash flows are discounted at that drives the concluded value. Like the selection of pricing multiples in the market approach, the derivation of the discount rate tends to be subjective and the judgment of a group of analysts will results in an

array of discount rates for the same company. However, there are certain inputs that are absolute and the analyst must be careful to ensure that the discount rate used is applied to cash flows that "*have the same tax character*."[xxxii]

In *Estate of Adams v. Commissioner*[xxxiii], the Court made a point to communicate the importance of ensuring that the tax character of the discount rate and cash flows are the same. In this case, the petitioner's expert improperly applied an adjustment to his discount rate when applying it to the company's after-tax cash flows. The expert had applied an adjustment to the derived discount rate to convert it to a pre-tax rate thus matching what he perceived to be pre-tax cash flows. The Court noted that the subject company was an S-corporation, the earnings of which were not taxed. Therefore, the Court contended that the company's cash flows were actually after tax. While there are some analysts who might question the Court's ruling in this case, it highlights the importance of matching the tax character of the discount rate to that of the company's cash flows and comparing apples to apples.

The issue of matching the discount rate to the earnings character has been addressed by Shannon Pratt, Robert Reilly, and Robert Schweihs. In their book *Valuing a Business: the Analysis and Appraisal of Closely Held Businesses, Pratt et. al. state, "we cannot overemphasize how important it is that the discount rate developed must be matched conceptually and empirically to the definition of economic income being discounted*."[xxxiv] In his book, *Cost of Capital*, Dr. Pratt further states, "*Whether costs of capital are estimated by the build- up model, the Capital Asset Pricing Model, or the discounted cash flow method, in all cases they are returns realized after the payment of corporate level income taxes. If the entity being valued is subject to entity-level taxes, then it is inappropriate to apply the cost of capital estimated by those methods to pre- tax return flows.*"[xxxv]

Nexus in Illiquidity Analysis

Most valuation analyses and reports devote proportionally little time and space to the area of marketability. By definition, most of the entities that are valued for gift and estate tax reasons are illiquid and their values are affected by a discount for lack of marketability[xxxvi]. This adjustment can be quite large and commonly reduces the value of a private entity by one-quarter to one-third. Despite the importance of this adjustment, comparatively little time is devoted to the derivation and justification of the size of the discount. The lack of analysis and connection between the data and the lack of marketability discount has been observed in several Court cases.

In *Knight v. Commissioner*[xxxvii] the Court found that the petitioner's expert failed to show how data from seven studies that were used to derive the adjustment related to the subject entity. The Court further found that the expert did not explain how the data had been applied to estimate the adjustment. Moreover, the expert listed seven reasons for the use of an illiquidity discount, but in the Court's opinion, failed to explain how those reasons applied to the case at hand. Unfortunately for the petitioner's expert, the lack of nexus in the determination of the illiquidity discount was the last straw for the judge, and the expert's entire testimony was deemed to be advocacy for the petitioner and the testimony of the expert was disregarded.

In *McCord v. Commissioner*[xxxviii], the Court has provided us with some insight into their reasoning and justification for most of the valuation related decisions. Considerable time and space is given to the respondent's expert's criticism of various published studies that the valuation industry relies on. The expert claims that a recent stud y by Mr. John D. Emory is biased, as it does not take into account the highest pre-IPO price. He further criticized the Willamene studies for not disclosing sufficient data to reveal whether they suffer from the same bias. The Court found the expert's testimony so compelling that the so-called pre-IPO studies were disallowed in the analysis of McCord.

It is unfortunate that the Court decides to completely set aside two well-known series of marketability studies, Emory and Willamette. This decision sets a somewhat confusing precedence for future u se of illiquidity studies and we await the Court's further clarification on this issue.

Performance by Expert at Trial

The valuation expert's effort related to a Tax Court case is separated into two deliverables; the written report and the testimony at trial. In some instances it does not matter how well the report is written and supported, if the expert performs poorly and without conviction at trial, the case can be lost. This was seen in the cases of Knight[xxxix] and Dailey[xl].

In *Knight v. Commissioner*[xli], the Court found that the taxpayer 's expert failed to assist the trier of fact as he assumed the position of an advocate and erroneous assumptions made by the expert cast doubt on the opinion. The Court based this opinion on several issues. First the expert had used a Portfolio Discount because of the purported unattractiveness of the particular asset allocation held by the partnership. The Court however, found no convincing argument that this asset mix was unattractive. Secondly, the Court did not like the closed end mutual funds that the expert had relied upon. Only one of the funds was deemed to have assets that were comparable to the partnership's assets. Despite this almost complete disallowance of the expert's comparable group, the Court agreed that some lack of control discount was appropriate. Lastly, in the determination of the lack of marketability adjustment, the Court found that the expert did not show adequately a nexus between the data relied upon and the subject partnership, nor did he adequately explain how the magnitude of the discount was determined.

When considering all these factors, which taken individually are small but when aggregated apparently gave the Court a different view, the Court decided that the expert's position was in favor of his client and that he had failed to be objective in his work. As a result, the Court disallowed the expert's entire report and testimony.

In *Dailey v. Commissioner*[xlii], the judge found that neither expert was extraordinary, but the taxpayer's expert provided a more convincing and thorough analysis. The IRS's expert made several mistakes at trial. He relied on an unpublished study of which he was one of the co-authors. While not necessarily a problem in itself, the fact that he changed his original estimate of the adjustment from 12.5% in the written report to 14.1% at trial, seems to have caused the Court to doubt the validity of the conclusion. The expert was further criticized by the Court for not having reviewed all the pertinent facts of the case. For example, the expert could not recall having reviewed the partnership agreement. The Court decided that the testimony of the respondent's expert was"...*contradictory, unsupported by the data and inapplicable to the facts.*" As a result, the Court accepted the taxpayer's expert's opinion.

From these two examples we can learn that it is not only important to have a well- written, well-supported valuation report, it is equally important to perform well at trial. This includes being prepared to answer questions, having reliable back-up for the assumptions, the ability to show the nexus between your data and your conclusions, as well as the ability to show objectivity as an expert.

Conclusion

Valuation experts and tax counsel can learn a great deal from the study of court cases. However, we have observed that it can be an unfortunate conundrum when the Court renders an opinion from weak or improper analysis and biased testimony. The outcome of a particular case does not suffice as the cornerstone for future valuation exercises. We can however, learn plenty from analyses of the Court's rationale for their decisions and use that

knowledge in the development of supportable and well developed valuation opinion. The onus is on the professional financial analyst that practices business valuations to use best practice methods without bias, to demonstrate a well supported analysis and reasoned conclusion so that the Court is not left with the task of doing the work themselves.

Endnotes

[i] Bruce A Johnson and Spencer J. Jeffries, *Comprehensive Guide for the Valuation of Family Limited Partnerships*, Partnership Profiles, Inc., 2001, p. 15.
[ii] *Estate of Edgar A. Berg v. Commissioner,* T.C. Memom 1991-279
[iii] *Lebowitz c. Commissioner*, 917, F2d 1314, 1318 (2nd Cir. 1990)
[iv] *Hess v. Commissioner,* T.C. Memo, 2003-251
[v] Supra, p. 19-20
[vi] *James Couzens v. Commissioner of Internal Revenue,* 11 BTA 1040, 1165 (1928)
[vii] *Estate of William G. Adams, Jr. Deceased, George W. Saenger, Executor v. Commissioner Internal Revenue,* T.C. Memo. 2002-80
[viii] Supra, p. 10
[ix] Supra
[x] *Estate of Elma Middleton Dailey, Deceased, Donor, K. Robert Dailey, II, Executor, v. Commissioner Internal Revenue,* T.C. Memo 2001-263
[xi] *Estate of Beatrice Ellen Jones Dunn, Jesse L. Dunn, III, Independent Executor v. Commissioner of Internal Revenue,* T.C. Memo. 200-12
[xii] Supra p. 20
[xiii] Supra
[xiv] Supra
[xv] In Dunn, the expert assumed that the assets would be sold rapidly. As such, the value of the assets held by the company are much lower than they would be had they had been sold over the course of a much longer period of time.
[xvi] *Estate of Beatrice Ellen Jones Dunn, Jesse L. Dunn, III, Independent Executor v. Commissioner of Internal Revenue,* T.C. Memo 200-12
[xvii] The Court noted that "a holder of these shares nonetheless would lack the power to compel a liquidation, a sale of all or substantially all the assets, or a merger or consolidation of the company, all of which would require the approval of at least 66 2/3 percent of the outstanding shares. See Tex. Bus. Corp. Act Ann. Art. 6.03 (West 1991)." See Supra p. 13
[xviii] *Estate of Richie C. Heck, Deceased, Gary Heck, Special Administrator v. Commissioner of Internal Revenue,* T.C. Memo 2002-34, Filed: February 5, 2002
[xix] *Estate of Joyce C. Hall, Deceased, Donald J. Hall, Executor, v. Commissioner of Internal Revenue,* 92 T.C. 312
[xx] *Charles T. McCord, Jr., and Mary S. McCord, Donors v. Commissioner of Internal Revenue,* 120 T.C. No. 13
[xxi] *Clarissa W. Lappo, v. Commissioner of Internal Revenue,* T.C. Memo, 2003-258
[xxii] *Jeffrey L. Okerlund and Lorrie Schwan-Okerlund; David J. Schwan and Diane C. Schwan; Mark D. Schwan; and Paul M. Schwan and Christine H. M. Weigel Schwan v. The United States*
[xxiii] Supra, p. 7
[xxiv] Supra, p. 9
[xxv] *Charles T. McCord. Jr. and Mary S. McCord, Donors v. Commissioner of Internal Revenue,* 120 T.C. No. 13
[xxvi] *Clarissa W. Lappo, v. Commissioner of Internal Revenue,* T.C. Memo 2003-258
[xxvii] Bajaj et. Al. "*Firm Value and Marketability Discounts*", 27 Journal of Corporate L. 89 (2001)
[xxviii] Hertzel & Smith *"Market Discounts and Shareholder Gains for Placing Equity Privately"*, 48 Journal of Finace 459-469 (1993)
[xxix] Aswath Damodaran, "*Investment Valuation*", University Edition, 1996, John Wiley & Sons.
[xxx] *Jeffrey L. Okerlund and Lorrie Schwan-Okerlund; David J. Schwan and Diane C. Schwan; Mark D. Schwan; and Paul M. Schwan and Christine H. M. Weigel Schwan v. The United States*

[xxxi] Supra, p. 9

[xxxii] *Estate of William G. Adams, Jr., Deceased, George W. Saenger, Executor v. Commissioner Internal Revenue,* T.C. Memo 2002-80 p.13

[xxxiii] *Estate of William G. Adams, Jr., Deceased, George W. Saenger, Executor v. Commissioner Internal Revenue,* T.C. Memo 2002-80

[xxxiv] Shannon Pratt, Robert Reilly, and Robert Schweihs; *Valuing a Business: The Analysis and Appraisal of Closely Held Companies;* Irwin Professional Publishing, 3rd Edition, 1996, p. 158

[xxxv] Shannon Pratt, *Cost of Capital*, John Wiley & Sons, Inc., 1998, p. 152.

[xxxvi] In this text the terms "lack of marketability", "lack of liquidity" and "illiquidity" will be used interchangeably

[xxxvii] *Ina F. Knight, v. Commissioner of Internal Revenue* and *Herbert D. Knight, v Commissioner of Internal Revenue*, 115 T.C. No. 36

[xxxviii] *Charles T. McCord, Jr. and Mary S. McCord, Donors, v. Commissioner of Internal Revenue*, 120 T.C. No. 13

[xxxix] *Ina F. Knight, v. Commissioner of Internal Revenue* and *Herbert D. Knight, v Commissioner of Internal Revenue*, 115 T.C. No. 36

[xl] *Estate of Elma Middleton Dailey, Deceased, Donor, K. Robert Dailey, II, Executor, v. Commissioner of Internal Revenue,* T.C. Memo 2001-263

[xli] *Estate of Elma Middleton Dailey, Deceased, Donor, K. Robert Dailey, II, Executor, v. Commissioner of Internal Revenue,* T.C. Memo 2001-263

[xlii] *Estate of Elma Middleton Dailey, Deceased, Donor, K. Robert Dailey, II, Executor, v. Commissioner of Internal Revenue,* T.C. Memo 2001-263