TAX AND BUSINESS SUCCESSION PLANNING
The Role of the Appraiser

By: Anthony F. Mollica, MAI, ASA, CBA

The Revenue Reform Act of 1990 and Revenue Ruling 93-12 clarified the family attribution rules and minority discounts. Tax attorneys, financial planners and trust departments are currently inundated with clients asking for information and services in estate and business succession planning using their real estate and business interests in formulating tax planning vehicles.

A large part of our valuation work is in estate planning and the greater part of that work is in business succession planning. In most cases, an appraiser with expertise in real estate, business and fractional interests is required.

The genre of the day for tax planning and business succession is the family limited partnership (FLP). When FLPs are combined with grantor retained annuity trusts (GRATS), significant assets can be transferred to the next generation without consequential tax impact.

Tax planners are also suggesting grantor retained unitrusts (GRUTs), grantor retained income trusts (GRITs), and qualified personal residence trusts (QPRT's). Added to these are skip-generation trusts, freezes using non-voting stock, charitable foundations and charitable remainder trusts. There is truly a plethora of tax planning vehicles and they are being used independently and in combination to achieve good tax and business succession planning.

The validity of all of the tax planning vehicles relies on defensible valuation work. Each of the tax planning vehicles requires appraisals to evaluate the market value of the underlying assets and the application of discounts for minority/limited interests. The size of the discounts are dependent upon an appraisal of limited (minority) interests and their restrictions including, but not limited to, a lack of control over cash distributions, rights to a fair market value of the interest upon withdrawal or repurchase, no participation in management decisions, the lack of ability to force liquidation and/or the lack of control over the sale of the gifted/limited (minority) interests. Without control over the underlying assets or cash distributions, the value of the limited (minority) interests are less than prorata.

The value of limited partnerships, GRITs, GRATS, non-voting stock or other tax planning vehicles, relies on an appraiser with special skills in valuing the underlying assets, which can include real estate, marketable securities, partnership interests, shares in private corporations and fractional interests in tax planning vehicles. Since these can be combined (minority interests, restricted marketability interests, restricted participation interests, etc.) with control passing to the legatee upon an event (death or a certain time period), ***it takes an appraiser with special training in business valuation matters to prepare appraisals that will meet IRS requirements or stand the test of litigation.***

In tax and business succession planning matters, legal and valuation services are inexorably tied. Appraisers work closely with attorneys in order to fully understand all of the covenants, restrictions, and timing matters used in tax planning vehicles. Attorneys call upon appraisers to give preliminary valuations under different tax planning vehicles to determine which tax-planning vehicle will meet the goals of the client.

Tax attorneys know that the proper valuation of assets will produce the best results in estate planning. ***The collective efforts of an attorney and appraiser can give a client comfort in knowing that his or her business and estate planning objectives will be achieved in this ever changing world.***

A new area of planning that is growing in popularity is known as "marital dissolution simplification planning." Briefly, it involves mutual structuring by both spouses of each of their personal and business assets and future financial needs, in a fair and equitable manner, so that should their marriage suffer a breakdown leading to marital dissolution, the spouses have positioned themselves to take advantage of an uncontested dissolution of marriage procedure. A mutual tax and business succession plan should be thoroughly discussed with a tax attorney, appraiser and the concerned parties. This new area of planning indicates that besides tax objectives, non-tax motivated objectives can be a part of one's overall business and estate planning objectives.

Early in the planning stage, attorneys and appraisers are contacted to formulate a tax vehicle which will best reach the client's objectives. Since the value issues vary based upon the purpose of the valuation, a clear understanding of the valuation terminology is necessary to both the client and the attorney.

The most common valuation terms used in tax and business succession planning are market value, fair market value, and fair value.

Market value is generally defined as the value of an unencumbered property or an entire enterprise. Fair market value is generally used in valuing a partial interest and the courts have held that this fair market value assumes a hypothetical buyer and seller and it is generally agreed that it requires a discount from the pro rata share of market value. Fair value is a legal term and is interpreted as a pro rata share of market value.

Tax and business succession planning can be a complex process if one's estate is large and his or her business and estate planning objectives are many. Legal considerations serve as the foundation for every type of estate planning, small or large, making attorneys and appraisers essential members of the professional planning team.

Whether your estate is large or small, an estate plan is warranted. The first step is to contact a tax attorney or financial planner who is familiar with all aspects of estate planning and with their help, you can choose a tax and business succession plan that will best fit your needs. Carefully select your appraiser as all appraisers are not qualified by experience or training to appraise partial interests in real estate and business entities.

Anthony F. Mollica, MAI, ASA, CBA, is both a real estate and business appraiser. He holds the MAI designation in the Appraisal Institute; the ASA designation in business valuation and urban real estate; and the CBA designation in the Institute of Business Appraisers. Mr. Mollica has over forty years of experience in all types of real estate and business valuations and is one of approximately twenty persons in the United States who holds both the MAI and ASA designations in real estate and business valuation.