MERCER CAPITAL'S

Value Matters™

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MERCER CAPITAL

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Gift and Estate Tax Valuation

Managing Complicated Multi-Tiered Entity Valuation Engagements

High net worth business owners, and in particular baby boomers, who have created substantial wealth are becoming increasingly concerned with the orderly transfer of their assets. Planning for effective wealth transfer in the prevailing uncertain tax environment has complicated and confused many wealthy individuals and their counsel. As of the writing of this piece in late 2010, there is no estate tax and the gift tax rate is 35%. However, without out new legislation, in 2011 the estate and gift tax rates both return to 55% and are applicable to transfers greater than $1 million.

Much of today's accumulated wealth has been generated by legacy operating businesses and investments, and, through prior gifting programs and other estate tax planning activities, has been transferred into investment vehicle entities or reallocated into other assets.

For many high net worth individuals and family offices, modern estate planning and investment practices have resulted in complex ownership structures, typically involving multi-tiered entity organizations and businesses with complicated ownership structures and governance.

Mercer Capital has been performing complicated tax engagements for decades. This article is offered with the intention of informing referral sources and their clients about the processes that lead to credible and timely valuation reports.

These processes make for smoother engagements and minimize the surprise and/or resistance to furnishing the information necessary to mitigate potential IRS scrutiny. With evidence of increasing audit risk in many regions and with rising appraisal requirements, high net worth individuals and their advisors need a thorough, proactive understanding of how to contribute to a high-quality, well-informed appraisal work product.

Inside

Defining the Engagement and Collecting Information

Defining the valuation project is an important step in every engagement process, but when multiple or tiered entities are involved it becomes critical.

It is generally insufficient to define a complicated engagement by limited reference to the top-tier entity in a multi-tiered organizational structure. The appraiser needs a complete understanding of the scope of the valuation project in order to design the deliverable work product and to plan the underlying due diligence and analytical framework.

Working with the appraiser, the referral source needs to define the problem in such a way that the appraiser understands if he/she needs to perform an appraisal at each level of a tiered structure or if certain entities and their underlying net assets can be valued using a collapsed or consolidated analytical framework. In many cases, there is a little of both.

Simplifying assumptions and appropriate asset bundling often lead to better, more comprehendible, and forthright opinions. Multi-tiered minority interest appraisals can be particularly prone to error via inappropriate or cumulative discounting and/or other valuation treatments that may fail to retain the qualities of fair market value.

During the initial discussion of the engagement, the appraiser will usually request certain descriptive and financial information (such as governing documents, recent audits, compilations, and/or tax returns) to determine the scope of analysis needed to render a credible appraisal for the master, top-tier entity and the underlying entities and assets.

Full and complete disclosure of all requested information, as well as other information believed pertinent to the appraisal, will aid the appraiser in preventing double-counting or otherwise missing assets all together.

In some instances the requested information, in tandem with client/referral communications, will inform the appraiser and allow him/her to deliver a work product that can save the client time and money. For example, if ten similar dry cleaning entities need to be appraised, it may be possible to write a single report narrative explaining the big picture and furnish ten sets of valuation worksheets demonstrating the specific valuation of each entity.

The Engagement Letter

Once the business appraiser and the client's advisor have agreed on the specifics of the engagement, the appraiser will craft an engagement letter specifying the key elements of the appraisal assignment. The engagement letter will provide a descriptive project overview, the qualifications of the appraiser, and set forth the timetable and fee agreement. Upon receipt of the signed engagement letter and retainer, the information collection process begins in earnest.

Often a comprehensive request for information will accompany the engagement letter. The initial information request generally includes each entity's historical financial statements, as well as detailed operating and structural information about the businesses and the markets in which they operate.

"With evidence of increasing audit risk in many regions and with rising appraisal requirements, high net worth individuals and their advisors need a thorough, proactive understanding of how to contribute to a high-quality, well-informed appraisal work product."

Businesses with an organized set of financial and operating information are easier to analyze and, therefore, easier to value than those that do not keep good records. Fee structures are generally inversely correlated to the amount, availability, and organization of underlying business information. The more complete and timely the business information is, the better the opportunity for fee efficiencies in the appraisal process. Additionally, information quality almost always promotes a more predicable outcome with the IRS and with other stakeholders.

Reviewing the Draft Appraisal

Multi-tiered entity structures are typically years, if not generations, in the making. For their creators and insiders, the entity organization is second nature. To an outside appraiser, it can seem a complicated web of assets and liabilities lacking a cohesive or comprehendible structure. As discussed previously, starting with a plan and identifying a simplified (albeit sufficiently comprehensive) reporting framework and analysis are the first steps to a successful project. However, clients and their advisors must not take the upfront effort for granted by failing to adequately review the draft report and analysis.

No parties are more equipped in multi-tiered or otherwise complicated entity structures to review for completeness and factual accuracy than the creators and insiders of the subject entity(s). Appraisers value assets and cash flow streams and they do their best to capture the intricacies of legal entity structure. However, clients of valuations involving complicated, multi-tiered entities owe themselves a thorough inquisition of the draft report with numerous questions in mind:

» Does the valuation analysis appear to reflect the economic nature and value of the core assets at each respective entity level?

» Are the respective collections of assets and liabilities at each entity tier adequately described and captured in one form or another?

» Do insiders and advisors recognize their entity creation within the outside appraiser's report document?

» Does the project reflect a reasonable top-down or bottom-up sequencing that facilitates quality reviewing and ease of comprehension to lay reviewers? Could you teach an outsider what this collection of entities and the underlying assets are by way of the valuation report?

» If there has been any collapsing or combining of entities for valuation purposes, do the groupings makes sense in terms of the nature of the assets and their operational character? Do the valuation methods applied seem reasonable and consistent from one asset grouping to another?

» Are cross-entity assets and liabilities reconciled or adjusted? One entity's asset may be another entity's liabilities. As such, do the valuation treatments and results reconcile from one entity to the next?

"It is generally insufficient to define a complicated engagement by limited reference to the top-tier entity in a multi-tiered organizational structure."

» If valuation discounts are used, are they applied in defendable fashion and at the appropriate place(s) within the tiered entity structure?

» Does the report say what it does and does it do what it says?

The Final Report

Engagements involving complicated entity and operational structures are not easily shoe-horned into an appraiser's typical reporting formats and presentation. Unique entity and asset attributes will suggest unique solutions and presentation standards.

Despite the tailored requirements of advanced appraisal work, the final report document and the underlying valuation analysis must be both comprehensive and concise. In some cases there are no easy shortcuts, thus a certain amount of analytical intricacy is required. Such situations require adept and skillful execution and detailed explanation in the report.

Conclusion

Mercer Capital has significant experience dealing with large, complicated, multi-tiered entity engagements.

Our experience ranges from the closely held domain of the family office to large, sophisticated corporate enterprises and investment funds. Mercer Capital takes pride in differentiating our services and approach through careful pre-engagement planning in order to provide enhanced fee and timing expectations.

We are committed to delivering value in a fashion that improves the planning and decision-making processes of our clients and their advisors.

To discuss in confidence any engagement requiring Mercer Capital's customized valuation solutions, please contact us.

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What's New at Mercer Capital

Mercer Capital's web site is updated frequently and contains the most up-to-date information on what is new at Mercer Capital. Please visit often at www.mercercapital.com.

Nick Heinz Promoted to Senior Vice President

Mercer Capital is pleased to announce that **Nicholas J. Heinz, ASA**, has been promoted to the position of Senior Vice President. Nick joined Mercer Capital in 2000 and is a senior member of Mercer Capital's investment banking and corporate valuation division. "In his decade with the firm, Nick has been consistently fervent in his efforts to make the greatest possible contribution to Mercer Capital," said Mercer Capital president **Matthew R. Crow, ASA, CFA**. "We are fortunate to be able to position him to contribute at a more senior level."

New Hires in 2010

Mercer Capital is pleased to announce the addition of **Alex M. Barry, Chaya C. Glendon, and Whitney L. Faust** to our professional staff as a Financial Analysts. In their capacity as Financial Analysts at Mercer Capital, Alex, Chaya, and Whitney provide business valuation and financial consulting services to a broad range of companies and financial institutions across the nation.

2011 Hiring Season About to Kick-Off

Mercer Capital will be hiring in 2011. We are preparing now to begin the recruiting process. We are putting the finishing touches on a dedicated website, www.mercercapitalcareers.com, to help recruits understand the firm – what we do and our corporate culture. We look forward to continuing to grow our professional staff in 2011.

Hamner Has Earned Right to Use CFA Designation

Brooks K. Hamner has earned the right to use the Chartered Financial Analyst (CFA) designation from the CFA Institute. This designation is recognized around the world as the premier designation in the finance profession. Brooks is a Senior Financial Analyst at Mercer Capital. Earning the CFA designation requires four years of qualifying work experience and the successful completion of three six-hour examinations. A successful candidate must also adhere to the CFA Institute *Code of Ethics and Standards of Professional Conduct*.

SELECTED LIST OF RECENT & UPCOMING SPEAKING ENGAGEMENTS

November 10, 2010
"Buy-Sell Agreements"
BVR/Georgetown School of Law Summit on Valuation, Tax, and Estate Planning
Washington, D.C.
Timothy R. Lee, ASA

November 16, 2010
"The Equity Risk Premium: Perspectives on the Data"
Memphis CFA Chapter Meeting
Travis W. Harms, CFA, CPA/ABV and
Matthew R. Crow, CFA, ASA

January 13, 2010
"Buy-Sell Agreements"
Tuscaloosa Estate Planning Council
Tuscaloosa, Alabama
Timothy R. Lee, ASA

January 20, 2010
"Fair Value Measurements and Disclosures (Topic 820) Explored"
Knowledge Congress Webcast
Travis W. Harms, CFA, CPA/ABV

January 30, 2011
"Exploring Employee Stock Ownership Plans: Alternatives for Liquidity & Capital While Maintaining Independence"
Acquire or Be Acquired Conference
Scottsdale, Arizona
Andrew K. Gibbs, CFA, CPA/ABV and
Jay D. Wilson, Jr., CFA

To see a complete list, visit the Speaker's Bureau section of our web site at www.mercercapital.com. To inquire about engaging a professional from Mercer Capital to speak to your group, contact Barbara Walters Price at priceb@mercercapital.com, or by calling 901.322.9724.

A GENTLE PLUG FOR OUR FIRM

MERCER CAPITAL is a business valuation and investment banking firm serving a national and international clientele. Our reputation for excellence is based on an ability to solve complex financial problems expeditiously. We convert over 25 years of experience, including thousands of assignments, into solutions for the issues of today.

Mercer Capital provides a broad range of independent valuation and financial advisory services, including:

- Litigation Support Services and Expert Testimony
- Valuation for Corporate Tax Matters
- Valuation for Corporate Income Tax Issues
- Valuation for ESOPs
- Purchase Price Allocations
- Goodwill Impairment Testing
- Valuation of Employee Options
- Portfolio Valuation Services
- Valuation of Intangible Assets
- Fairness Opinions

Mercer Capital's investment banking professionals specialize in providing merger and acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, we assist clients in industry consolidations, roll ups, and refinancings.

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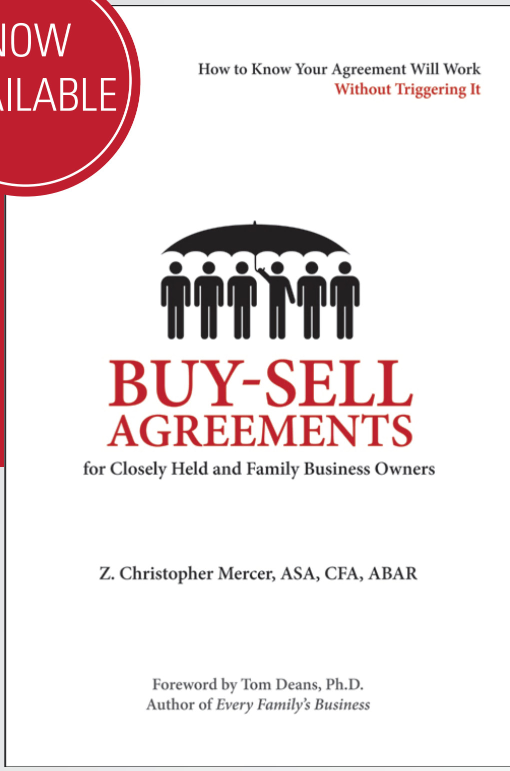

BUY-SELL AGREEMENTS

for Closely Held and Family Business Owners

"The business owner's self-defense manual"

– Stephan R. Leimberg, Leimberg Information Services, Inc.

Chris Mercer's book on buy-sell agreements is a grand slam. Because it uses plain language to explain complex terminology related to buy-sell agreements, attorneys and CPAs will find it to be a very helpful resource when advising their clients about buy-sell agreements, especially the pitfalls of various agreements. I was so impressed with the book that I ordered additional copies and sent them to tax attorneys who we work with on a regular basis.

James A. Koerber, CPA/ABV, CVA, CFE, CFF
The Koerber Company, PA.

This book is very well-researched, easy to understand, and contains numerous helpful examples. It reminds us in great detail how many of the components of a buy-sell agreement cause more problems than they solve. I particularly liked the charts that succinctly presented the advantages and disadvantages of the important elements of a good buy-sell agreement. Also, this book is not just for valuation analysts. Business owners should read it too. It is also a must-read for CPAs, financial planners, attorneys, and anyone else who advises business owners.

James R. Hitchner, CPA/ABV/CFF, ASA
Managing Director, Financial Valuation Advisors
Chief Executive Officer, Valuation Products and Services
President, Financial Consulting Group

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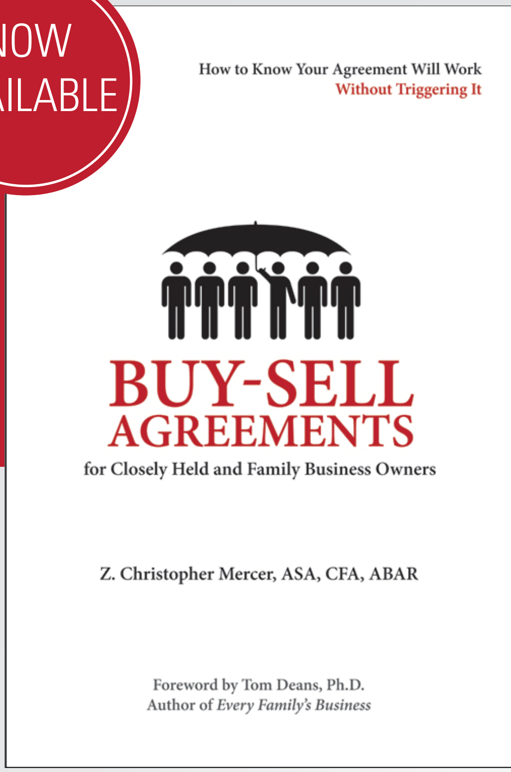

BUY-SELL AGREEMENTS

for Closely Held and Family Business Owners

by Z. Christopher Mercer, ASA, CFA, ABAR

Buy-sell agreements are among the most common yet least understood business agreements, and many are destined to fail to operate like the owners expect. Many, in fact, are ticking time bombs, just waiting for a trigger event to explode. If you are a business owner or are an advisor to business owners, this book is designed to provide a roadmap for business owners to develop or improve your buy-sell agreement.

WHAT IS THE DIFFERENCE BETWEEN THIS BOOK & CHRIS MERCER'S LAST BOOK ON BUY-SELL AGREEMENTS?

This book is written specifically for business owners. It is conversational in tone, straight to the point, and contains resources and recommendations every business owner subject to a buy-sell agreement requires.

If you are a business owner, you need a copy of this book. If you advise business owners, purchase copies as gifts for them as a way to begin a conversation about their buy-sell agreement. It will mean more business for you and will be of great benefit to your clients by potentially saving them from a buy-sell agreement that won't work.

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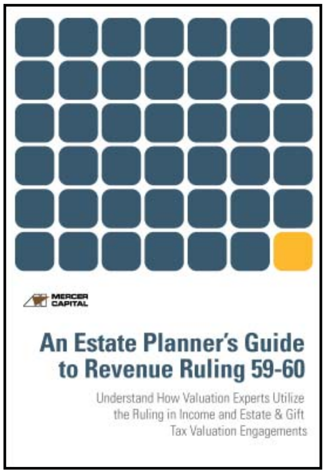

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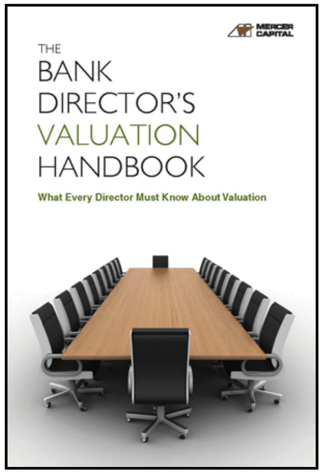

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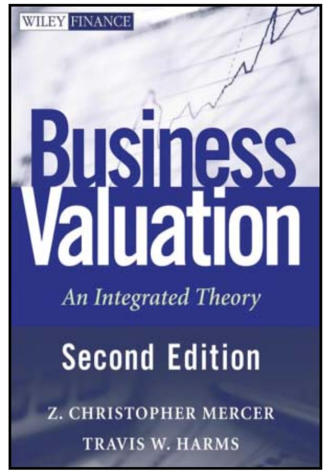

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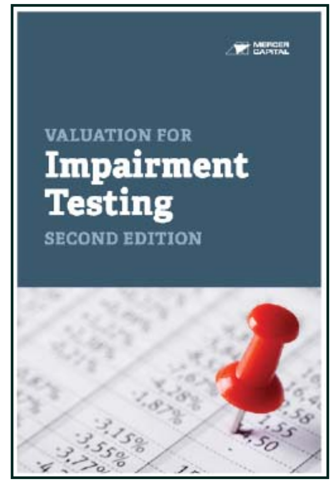

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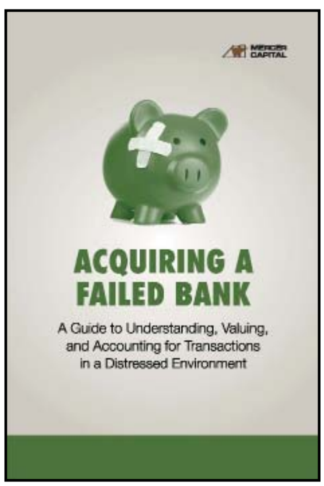

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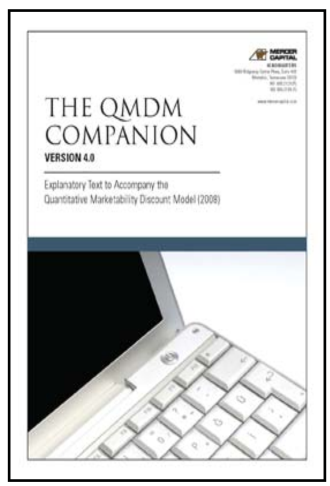

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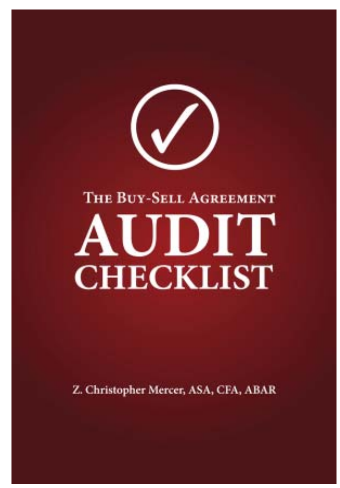

The Buy-Sell Agreement Audit Checklist

$9.95 *via e-mail*

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