



**MERCER CAPITAL**

# What RIAs Need to Know About Current Estate Planning Opportunities

**Brooks K. Hamner, CFA, ASA**  
hamnerb@mercercapital.com

**Zachary W. Milam, CFA**  
milamz@mercercapital.com

October 28, 2020

# Topics for Today's Webinar

---

1

**Proposed Tax Law Changes**

2

**Valuation / Interest Rate Opportunity**

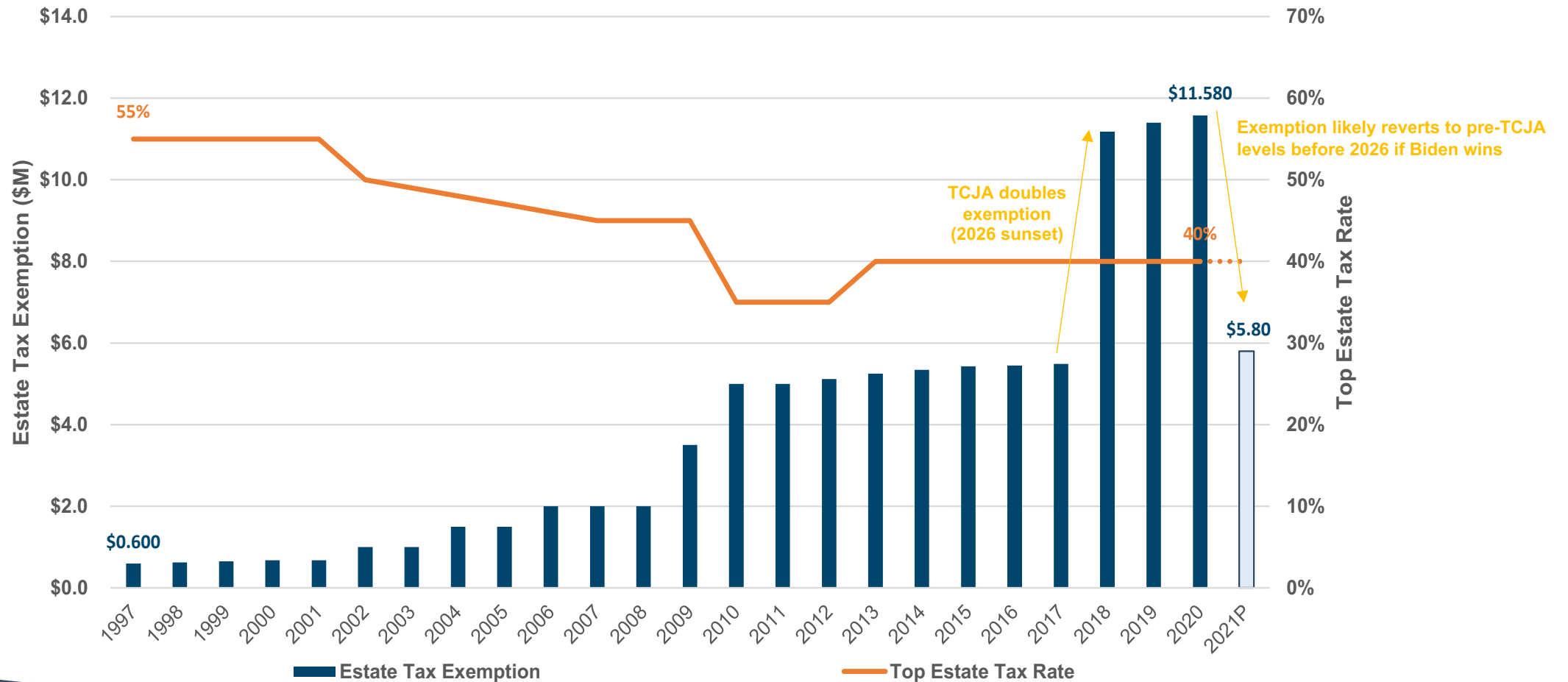
3

**Illustrative Financial Impact of Current Opportunity**

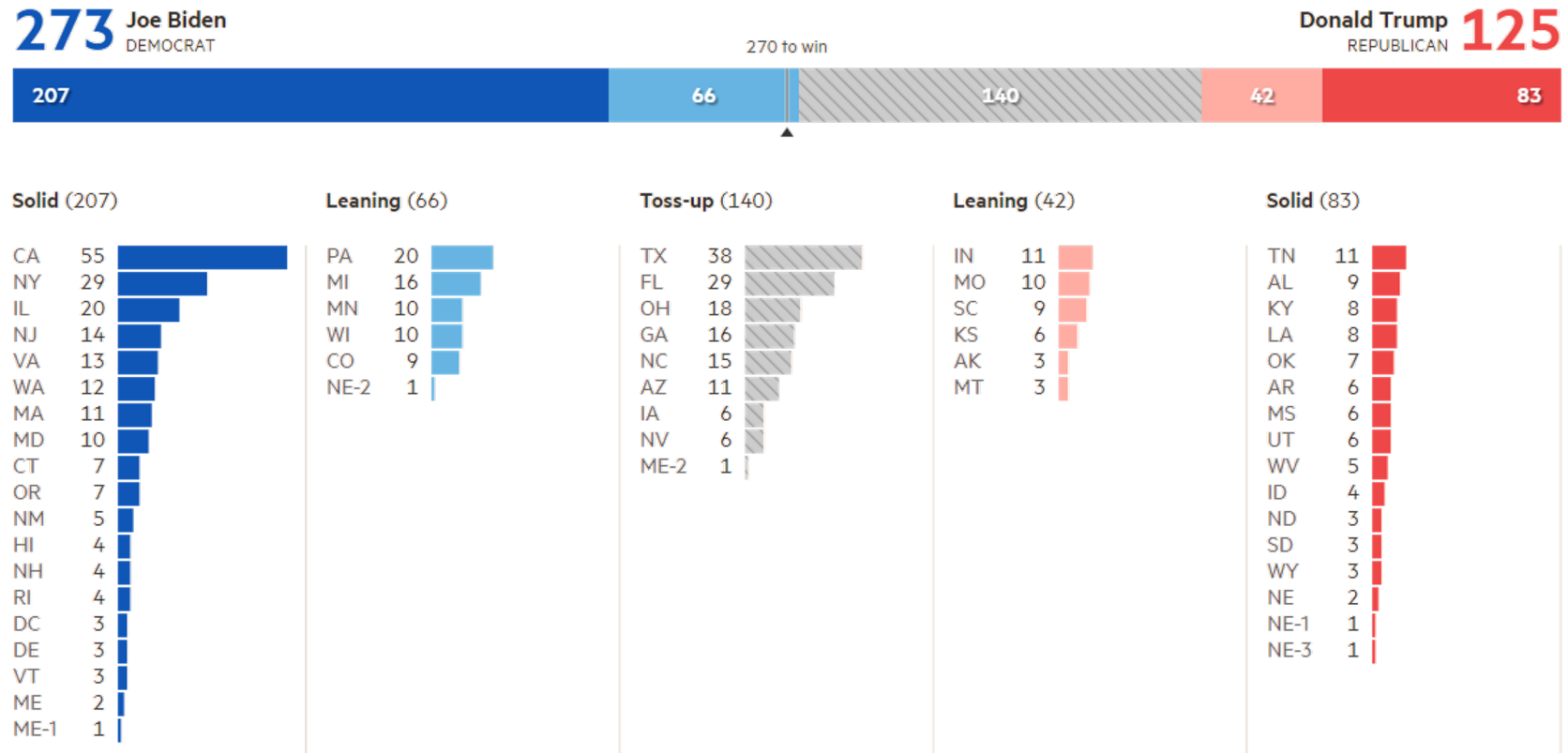
# Proposed Changes

	Current	Biden Proposal
Unified Tax Credit	\$11.58 million	~\$5.8 million?
Capital Gains Tax	20%	Ordinary income rate – 39.6% (income > \$1M)
Step Up in Basis	When asset owner dies, beneficiary inherits asset with cost basis equal to fair market value	No step up in basis; built-in gain taxable at death?
Personal Income Taxes	37% (single filer income > \$510k)	39.6% (income > \$400k)
Corporate Income Tax	21%	28%

# Historical Context for Current / Proposed Estate Tax Exemption



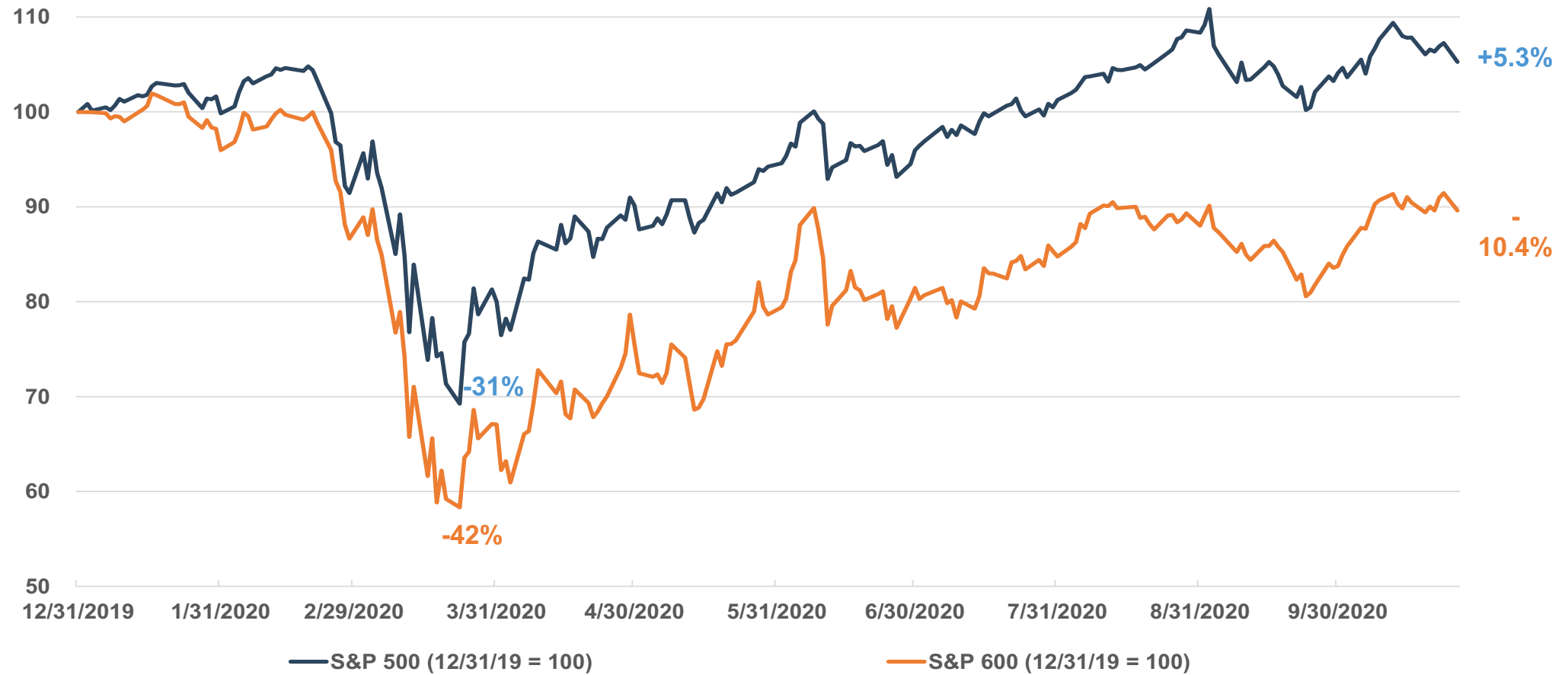
# Current Polling Suggests Biden Victory Likely



States where the difference in poll numbers between Biden and Trump is less than 5 percentage points are classified as 'toss-up' states.

Source: <https://ig.ft.com/us-election-2020>; as of October 26, 2020

# Valuation Opportunity?



# Fair Market Value

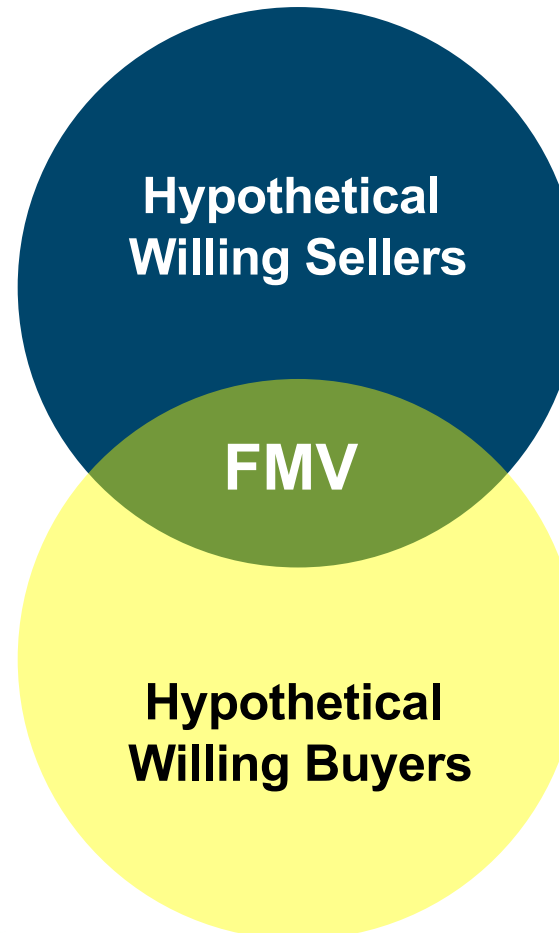
Value is a function of cash flow ( $CF$ ), risk ( $r$ ), and growth ( $g$ )

Both are able and willing to trade

Both fully (reasonably) informed

Both have financial capacity

Neither acting under compulsion



Hypothetical willing sellers

Engage in a (hypothetical) transaction for the interest for “money or money’s worth” (cash equivalent)

On the valuation date

Hypothetical willing buyers

# Revenue Ruling 59-60

---

“ The fair market value of specific shares of stock will vary as general economic conditions change from "normal" to "boom" or "depression," that is, according to the degree of optimism or pessimism with which the investing public regards the future at the required date of appraisal. Uncertainty as to the stability or continuity of the future income from a property decreases its value by increasing the risk of loss of earnings and value in the future. The value of shares of stock of a company with very uncertain future prospects is highly speculative. The appraiser must exercise his judgment as to the degree of risk attaching to the business of the corporation which issued the stock, but that judgment must be related to all of the other factors affecting value.



# Value Drivers

---

## Cash Flow

Stock prices are based on the future, not the past. Historical earnings and cash flows can provide important perspective, but investors are much more focused on what's visible through the windshield than what is in the rearview mirror.

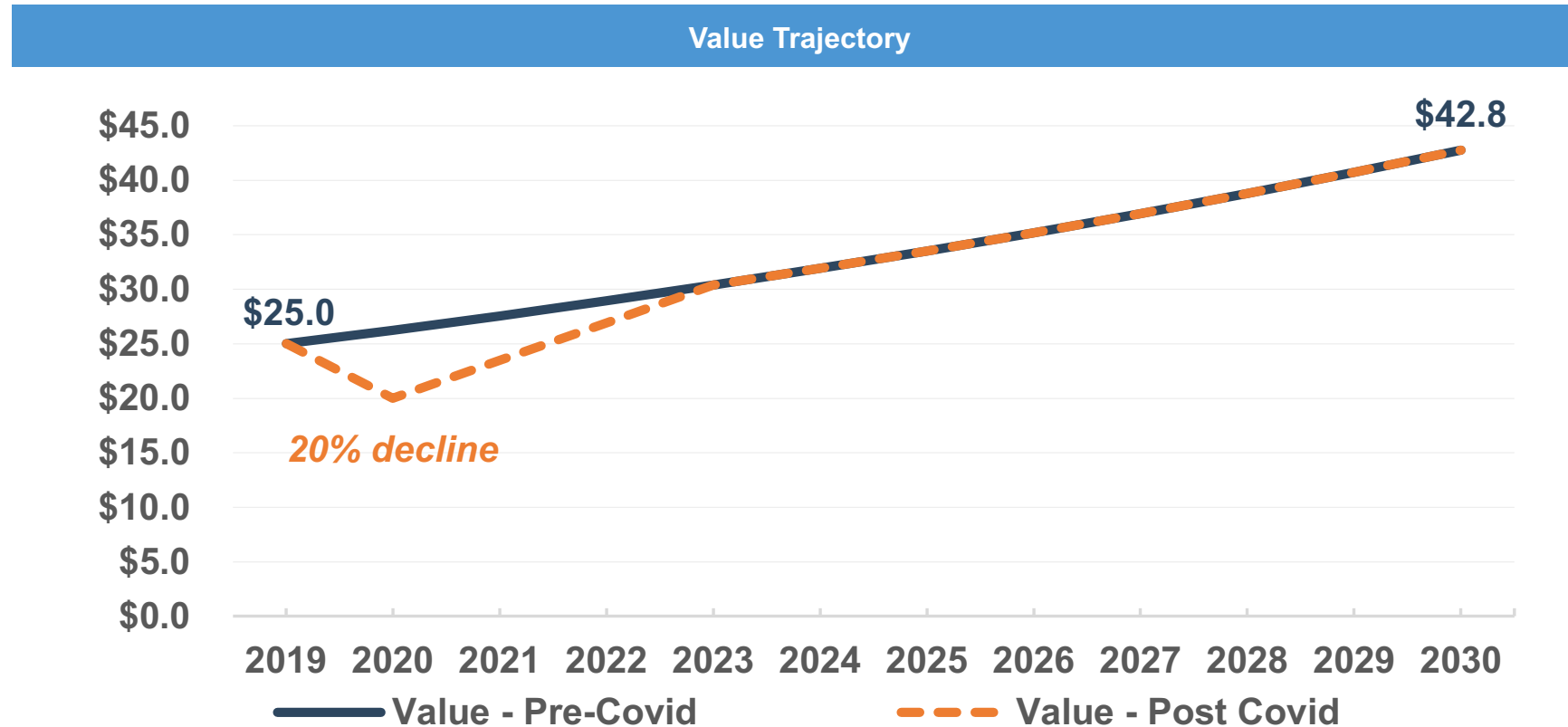
## Risk

When fog or other conditions reduce visibility, smart drivers slow down. Investors do the same thing. The pandemic has increased uncertainty regarding future performance for many businesses. When risk goes up, stock prices come down.

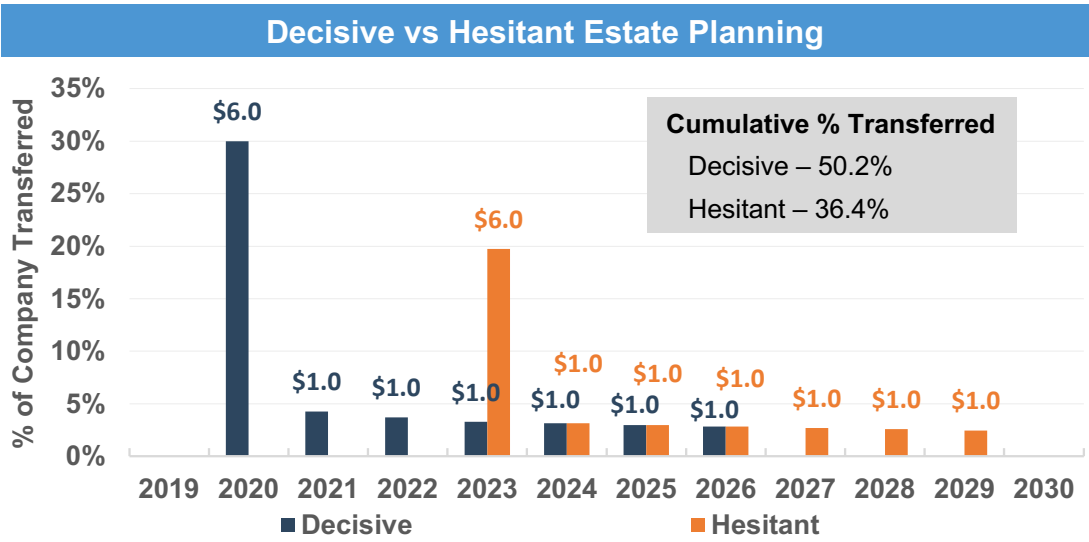
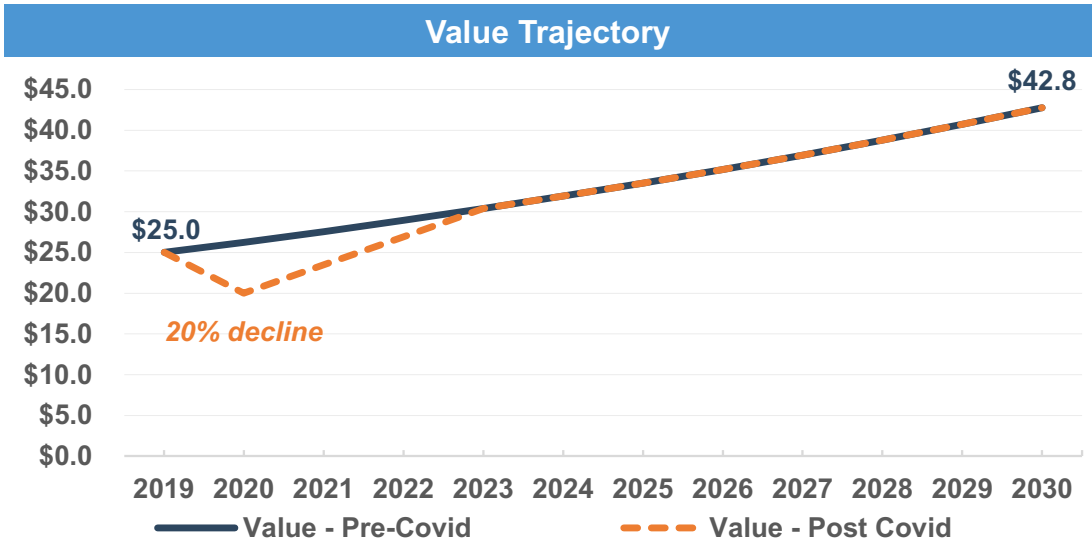
## Growth

Theories abound – and change daily – as to whether the economic recovery will look like a “V”, “U”, “W”, or a “K” (or some other letter). To the extent investors expect the negative effect of the pandemic to weigh on future performance, business values are lower.

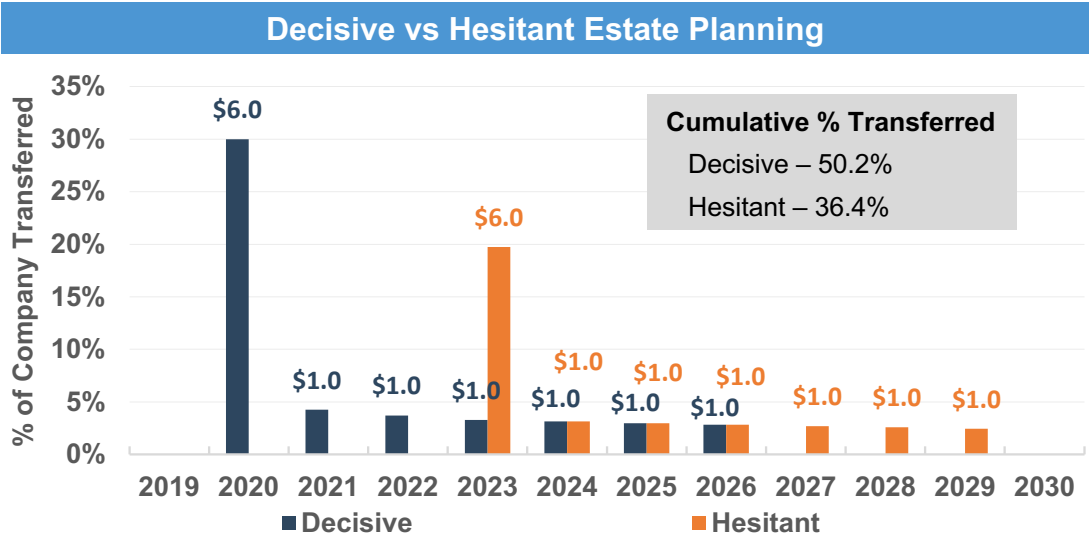
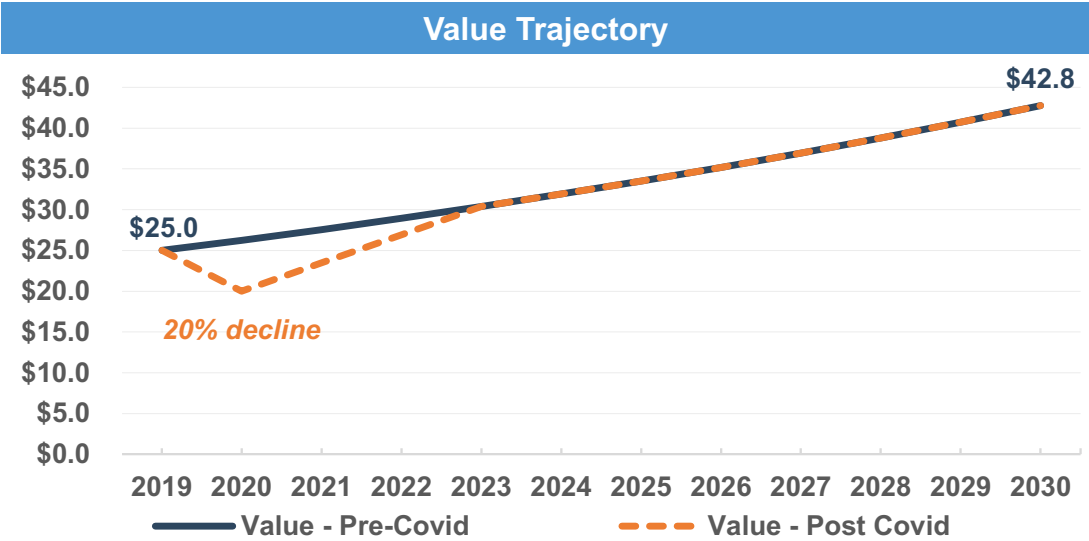
# Decisive vs. Hesitant Planning



# Decisive vs. Hesitant Planning



# Decisive vs. Hesitant Planning

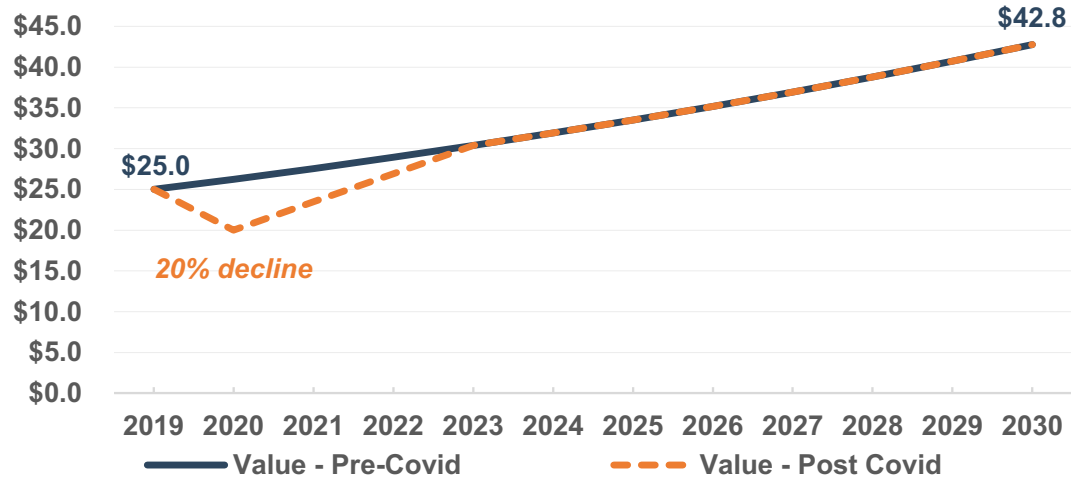


Difference in Estate Tax Burden in 2030

	Decisive	Hesitant
<i>\$ in Millions</i>		
As-if-Freely-Traded Value	\$42.8	\$42.8
Retained Ownership	49.8%	63.6%
As-if-Freely-Traded Value of Retained Interest	\$21.3	\$27.2
Marketability Discount	25.0%	0.0%
Fair Market Value of Interest	\$16.0	\$27.2
Estate Tax Rate	40.0%	40.0%
Estate Tax Burden	\$6.4	\$10.9
<b>Difference in Estate Tax Burden</b>		<b>\$4.5</b>

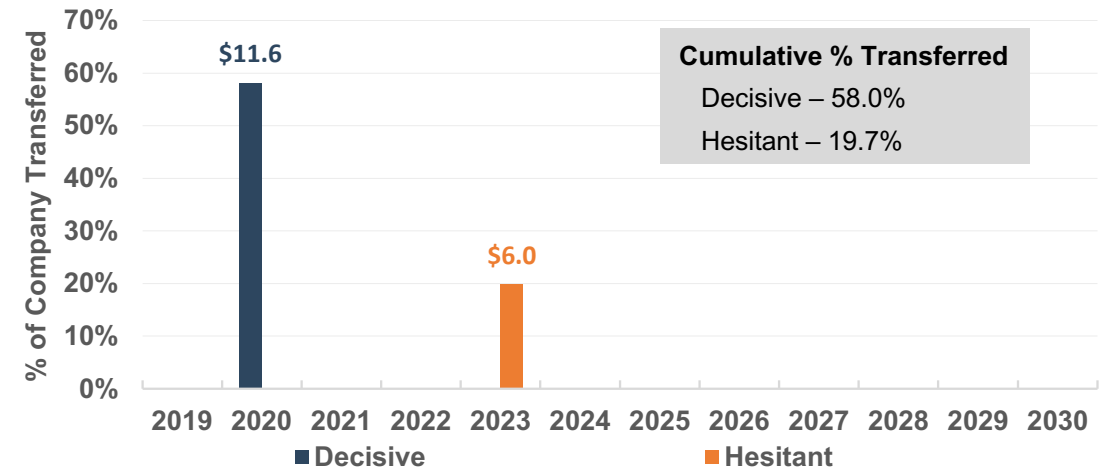
# Decisive vs. Hesitant Planning – Assuming Unified Tax Credit Decreases

Value Trajectory



Combined impact of taking advantage of lower valuations and high estate tax exemptions is significant

Decisive vs Hesitant Estate Planning

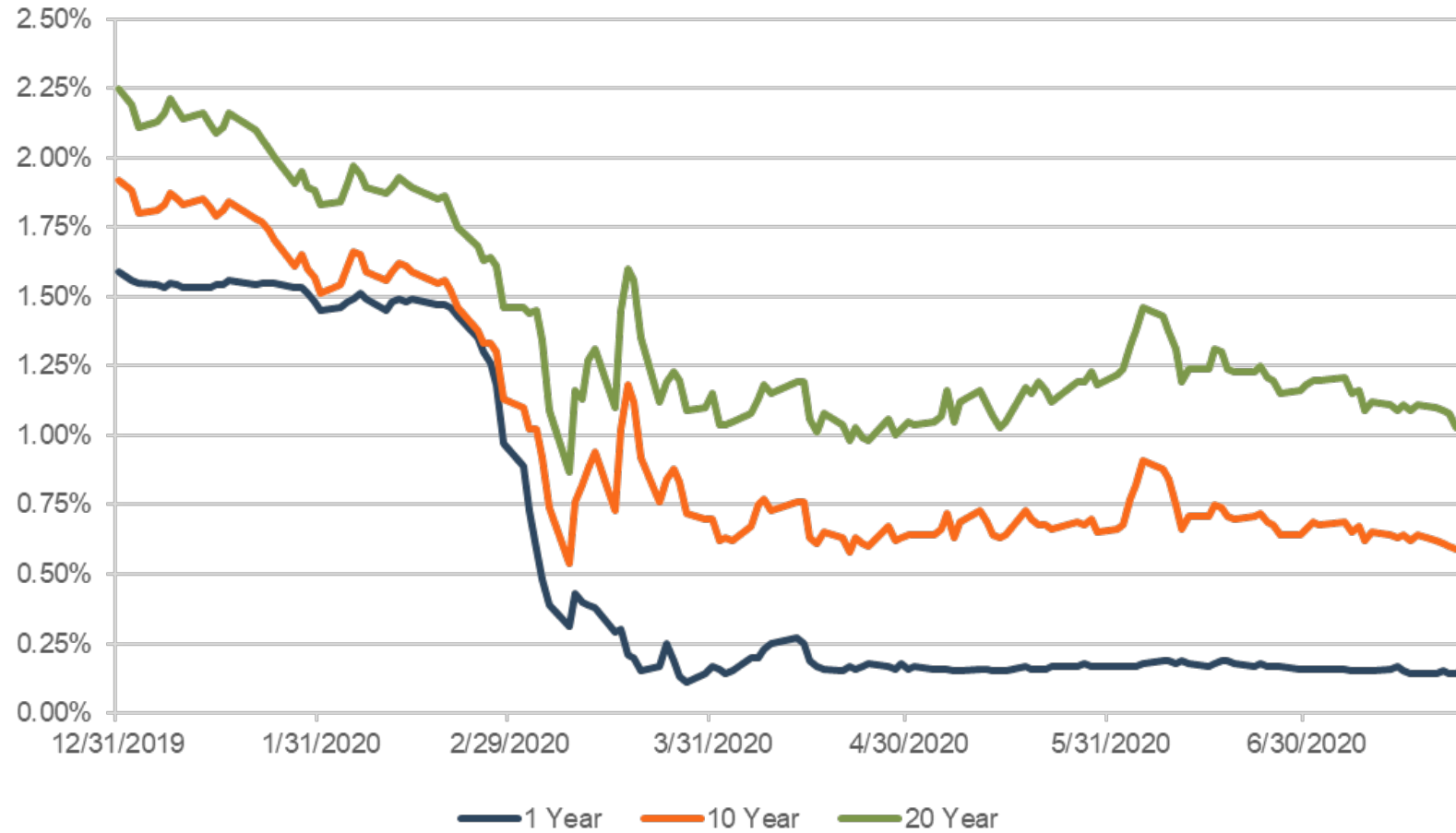


Difference in Estate Tax Burden in 2030

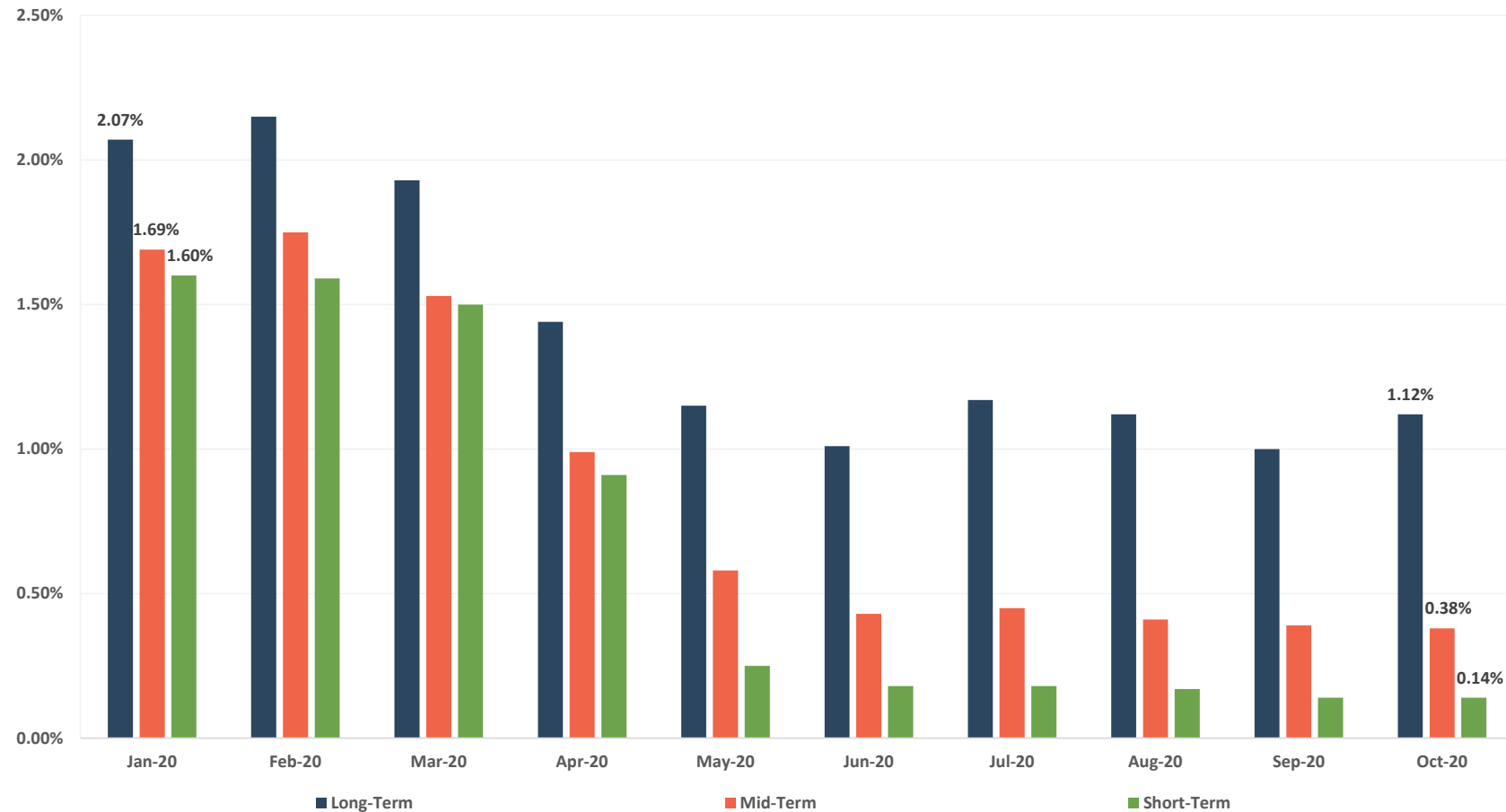
\$ in Millions	Decisive	Hesitant
As-if-Freely-Traded Value	\$42.8	\$42.8
Retained Ownership	42.0%	80.3%
As-if-Freely-Traded Value of Retained Interest	\$18.0	\$34.3
Marketability Discount	25.0%	0.0%
Fair Market Value of Interest	\$13.5	\$34.3
Estate Tax Rate	40.0%	40.0%
Estate Tax Burden	\$5.4	\$13.7

**Difference in Estate Tax Burden** **\$8.3**

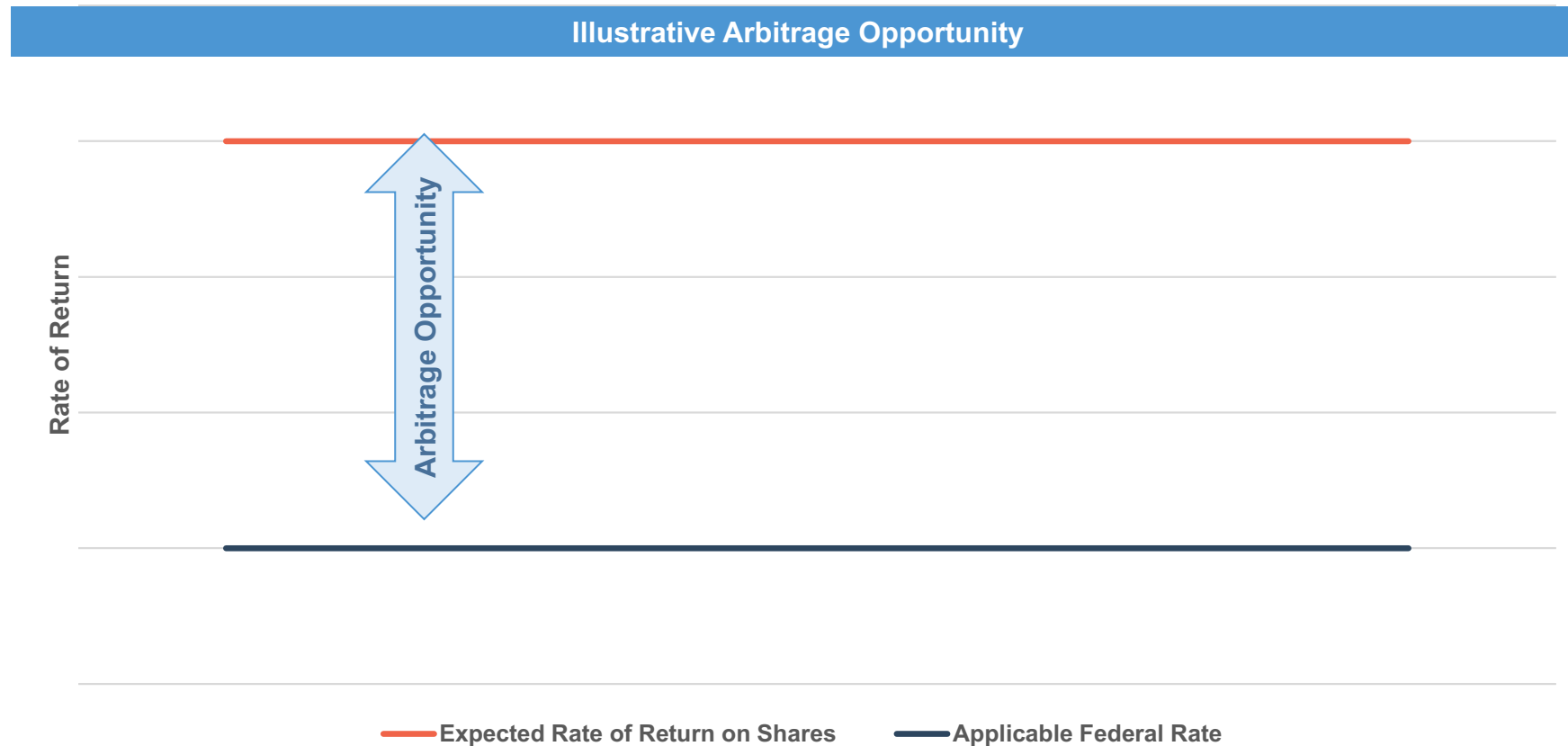
# Interest Rates



# Applicable Federal Rates (AFR)



# Lower Interest Rates





# Pre COVID-19 Example

## Illustrative Value Transfer – Pre-COVID-19

### Scenario Assumptions

\$ Amount Sold	\$10,000,000
Initial Value per Share	\$100
Shares Sold	100,000
Expected Annual Appreciation	8.0%
Applicable Federal Rate	1.75%

*Feb mid-term rate*

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Beginning Loan Balance	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000
AFR	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%
Annual Interest Payment	\$175,000	\$175,000	\$175,000	\$175,000	\$175,000	\$175,000	\$175,000	\$175,000
Ending Share Value	\$108	\$117	\$126	\$136	\$147	\$159	\$171	\$185
Shares Sold to Fund Interest	1,620	1,500	1,389	1,286	1,191	1,103	1,021	945
Shares Sold to Repay Principal								54,027
Net Shares Retained by Purchaser	35,916							
Ending Share Value	\$185							
<b>Net Value Transferred</b>	<b>\$6,647,892</b>							

# Post-COVID-19 Example

## Illustrative Value Transfer – Post-COVID-19

### Scenario Assumptions

\$ Amount Sold	\$10,000,000	
Initial Value per Share	\$80	
Shares Sold	125,000	
Expected Annual Appreciation	10.0%	Higher appreciation from depressed level
Applicable Federal Rate	0.38%	Oct mid-term rate

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Beginning Loan Balance	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000
AFR	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%
Annual Interest Payment	\$38,000	\$38,000	\$38,000	\$38,000	\$38,000	\$38,000	\$38,000	\$38,000
Ending Share Value	\$88	\$97	\$106	\$117	\$129	\$142	\$156	\$171
Shares Sold to Fund Interest	432	393	357	324	295	268	244	222
Shares Sold to Repay Principal								58,313
Net Shares Retained by Purchaser	64,152							
Ending Share Value	\$171							
<b>Net Value Transferred</b>	<b>\$11,001,324</b>							

# Other Considerations

---

- Saving tax is only one consideration
- Don't wait until it is too late (*Moore v Commissioner*)

<https://mercercapital.com/family-business-director/when-is-it-too-late-to-plan/>

- Measure twice and cut one

# Questions?

---

**Brooks K. Hamner, CFA, ASA**

901.322.9714

hamnerb@mercercapital.com

**Zachary W. Milam, CFA**

901.322.9705

milamz@mercercapital.com

[www.mercercapital.com](http://www.mercercapital.com)

WHITEPAPER

## Valuing RIAs



Understanding the value of an investment management business requires some appreciation for what is simple and what is complex. On one level, a business with almost no balance sheet, a recurring revenue stream, and an expense base that mainly consists of personnel costs could not be more straightforward. At the same time, investment management firms exist in a narrow space between client allocations and the capital markets, and depend on revenue streams that rarely carry contractual obligations and valuable staff members who often are not subject to employment agreements. In essence, RIAs may be both highly profitable and prospectively ephemeral. Balancing the particular risks and opportunities of a given investment management firm is fundamental to developing a valuation.

# Contact

---



**Brooks K. Hamner, CFA, ASA**  
Vice President  
901.322.9714  
hamnerb@mercercapital.com

Brooks is a vice president at Mercer Capital and is a senior member of the firm's Investment Management Industry team. The team provides RIAs, independent trust companies, traditional and alternative asset managers, wealth management firms, broker-dealers, and investment consultants with valuation services related to corporate planning and reorganization, litigated matters, transactions, employee stock ownership plans, and tax issues as well as valuations of intangible assets, options, and assets subject to specific contractual restrictions. Brooks also consults with investment management clients in the process of buying other RIAs or selling their business.

As a senior member of the firm's Investment Management Industry team, Brooks publishes research related to the investment management industry and is a regular contributor to Mercer Capital's blog regarding the investment management community, *RIA Valuation Insights*.



**Zachary W. Milam, CFA**  
Senior Financial Analyst  
901.322.9705  
milamz@mercercapital.com

Zach is a senior financial analyst with Mercer Capital. Zach has valuation experience in engagements related to corporate planning and reorganizations, financial reporting, fairness opinions, litigation support, employee stock ownership plans, and estate and gift tax planning and compliance matters.

As a member of the firm's Investment Management Industry team, Zach publishes research related to the investment management industry and is a regular contributor to Mercer Capital's blog, *RIA Valuation Insights*.

# About Mercer Capital

---

**Mercer Capital provides investment managers, wealth managers, independent trust companies, and financial institutions with business valuation and financial advisory services related to corporate disputes, litigated matters, and financial reporting requirements. Mercer Capital also provides transaction advisory and consulting-related services.**

Mercer Capital provides a comprehensive suite of valuation and financial advisory services to meet your needs. Experience includes:

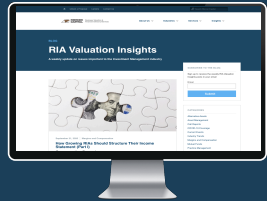
- Valuing start up managers with as little as \$50 million in AUM to established industry leaders managing over \$400 billion
- Negotiating transactions involving investment managers from sell-side, buy-side, and mutually retained perspectives
- Providing expert witness testimony for purposes of marital dissolution and shareholder disputes
- Providing financial statement reporting services related to purchase price allocation and goodwill impairment testing
- Assisting RIAs and other asset managers with annual ESOP valuations, fairness opinions, and appraisals for gift and estate tax compliance



# Mercer Capital's Investment Management Industry Resources

## WEEKLY BLOG

### RIA Valuation Insights



Visit Mercer Capital's blog, *RIA Valuation Insights*, for a weekly update on issues important to the Investment Management Industry.

To visit the blog or to subscribe, click [HERE](#)

## QUARTERLY NEWSLETTER

### VALUE FOCUS: Investment Management



This newsletter focuses on the following asset management industry segments: Mutual Fund Companies, Traditional Asset Managers, Alternative Asset Managers, and Trust Companies.

To view the current issue and the archives or to subscribe, click [HERE](#)

## WHITEPAPER

### Buy-Sell Agreements for Wealth Management Firms



This whitepaper will equip RIA owners to understand the consequences of their buy-sell agreements before a controversy arises, and to make informed decisions about the drafting or re-drafting of the agreement that promote the financial health and sustainability of their firm.

To read the whitepaper, click [HERE](#)



**MERCER  
CAPITAL**

[www.mercercapital.com](http://www.mercercapital.com)