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MERCER CAPITAL
VALUATION & ADVISORY SERVICES

VALUE MATTERS®

Gift, Estate, & Income Tax Valuation Insights Newsletter

Complex Governance Structures in Gift and Estate Tax Valuation

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EXECUTIVE SUMMARY

In valuations for gift or estate tax reporting purposes, the subject of the appraisal is not simply a percentage ownership interest, but the specific ownership interest being transferred, together with the legal and economic rights attached to it. Those rights, as defined by the governing documents, are the starting point for understanding the interest holder's ability to influence management, participate in cash flows, transfer the interest, and ultimately realize value. As a result, two ownership interests representing the same percentage of the same entity may have materially different values.

This distinction has become increasingly important as closely held entities adopt more complex governance and capital structures. Differences in voting rights, distribution rights, liquidation preferences, transfer restrictions, redemption provisions, and buy-sell provisions affect control, expected cash flows, liquidity, risk, and holding period. A well-supported valuation begins with a careful analysis of the rights associated with the subject interest and reflects those rights, to the extent they are legally enforceable and economically meaningful, throughout the valuation methods and any applicable discounts.[1]

Governing Documents Are the Starting Point

An interest can be one of several types, including a general or limited partnership interest, a managing or non-managing member interest, a voting or nonvoting unit, a preferred or common interest, a profits or carried interest, or other. In some ownership structures, the transferred interest may be several layers removed from the underlying operating company, real estate, portfolio investments, or other assets. The name of the interest is helpful but does not define its rights. These should be clearly defined in the governing documents, including:

See page 3 for details

[1] *In a gift or estate tax context, the governing documents are an essential starting point, but they are not always the end of the inquiry. Certain rights, restrictions, retained interests, buy-sell provisions, transfer limitations, liquidation restrictions, or similar arrangements may be subject to special transfer-tax rules that may affect how certain rights or restrictions are respected for valuation purposes. Accordingly, valuation professionals generally evaluate the economic effect of the rights reflected in the governing documents while relying on tax or legal counsel, where appropriate, for conclusions regarding enforceability, tax treatment, and whether particular rights or restrictions should be respected for valuation purposes.*

- **Governance Rights**. These may include voting rights, consent rights, veto rights, removal rights, manager appointment rights, or approval rights over major decisions. The holder may have no ability to direct day-to-day operations but may have the ability to approve or block certain actions. In other cases, the holder may have voting rights on paper but little practical influence due to ownership thresholds or control held by another party.

- **Economic Rights.** These include distribution rights, preferred returns, tax distributions, liquidation preferences, promote structures, catch-up provisions, capital call obligations, dilution provisions, clawbacks, and redemption rights. These rights determine how cash flows are shared and how value is allocated among owners. We discussed the valuation implications of these economically differentiated rights in the **June 2026 issue of Value Matters: *Complex Capital Structures in Transfer Tax Planning: A Valuation Perspective.***

- **Transfer and Exit Rights.** These outline how, and whether, the holder can sell or otherwise exit the interest. Most closely held entities restrict transfers. Rights of first refusal, buy-sell provisions, and permitted transferee limits may narrow the pool of possible buyers, depending on their terms, enforceability, and practical effect. Drag-along and tag-along rights, put rights, and call rights change the terms on which an owner can exit or be required to exit. All else equal, an interest that is hard to sell, with no clear path to liquidity, generally supports a lower value than one that can be transferred or redeemed on reasonable terms.

These rights should not be reviewed in isolation. They work together and are often related. A transfer restriction may matter more if the interest has no redemption right. A lack of voting control may matter less if the entity has a history of regular distributions. A preferred return may be valuable, but only if the entity is expected to generate sufficient cash flow. A veto right may affect control, but only if it applies to decisions that matter economically. In a transfer tax context, the analysis should also consider whether particular rights, restrictions, or retained interests are respected for valuation purposes under applicable tax rules, a determination that may require input from tax or legal counsel.

Valuation Depends on the Rights Being Transferred

In many assignments, the value of the enterprise is only one part of the analysis in valuing a specific ownership interest in that entity. The ownership interest may lack control, be difficult or entirely unable to be sold, have limited rights to distributions, be subject to capital calls and other factors that detract from the interest's pro rata share of enterprise value. It may have rights that make it more valuable than a typical common or minority interest, such as redemption rights or priority economic rights. The valuation should appropriately reflect those facts, subject to any applicable transfer tax rules that may affect how particular rights or restrictions are considered.

Tiered structures add another layer. The subject interest may be a holding company that owns an interest in another entity, which may own real estate, marketable securities, an operating business, or fund interests. In those situations, the rights and economics should be traced through each layer of ownership.

Discounts Should Reflect the Rights

The rights of the subject ownership interest may affect the valuation methods, the allocation of value among ownership classes, and any applicable discounts for lack of control or lack of marketability.

A discount for lack of control reflects the interest holder's limited ability to direct the business, including distribution policy, asset sales, or officers' compensation. An ownership interest with no voting rights, no consent rights, and no influence over distributions supports a different level of discount than an interest that carries meaningful consent rights or board input. The presence or absence of those rights, drawn from the governing documents, sets the baseline for this analysis.

A discount for lack of marketability reflects the difficulty in converting the interest to cash. Meaningful and enforceable transfer restrictions, a narrow buyer pool, no redemption right, and no foreseeable or expected liquidity event may point toward a larger discount. Regular distributions, a clear exit path, or tag-along rights point the other way. A well-supported appraisal should provide a clear bridge between the governing documents, the subject interest's rights, the valuation methods, and the discounts applied. A discount that is detached from the actual rights of the interest and not connected to the economics it is meant to measure can have real consequences, including IRS scrutiny and potential penalties.

Documentation and Timing Are Critical

The valuation analysis is affected by the governance rights of the subject interest, the determination of which requires a thorough understanding of the relevant legal and entity documents in effect as of the valuation date. These materials may include operating agreements, partnership agreements, amendments, side letters, assignment documents, capitalization schedules, capital account detail, buy-sell agreements, loan agreements, subscription documents, and any other agreements that affect the rights of the subject interest.

Incomplete documentation, inconsistent documents, or late changes to governing terms can create problems, require rework, and make the valuation conclusion more difficult to support if the transfer is later reviewed. Obtaining the relevant materials prevents rework and supports a conclusion that can be traced from the source documents to the concluded value. Involving a valuation professional before a planned transfer occurs can help identify valuation issues, documentation gaps, and rights or restrictions that may require further review by tax or legal counsel.

Final Considerations

For owners and advisors, the practical takeaway is straightforward. The economic reality of the subject interest is informed by the rights and restrictions in effect on the valuation date, including its governance, economic, transfer, and exit rights. Those rights should be evaluated for their practical economic effect and reflected in the valuation analysis where appropriate. Early coordination with a valuation professional before structuring transactions or finalizing documents helps identify potential issues before they occur and supports a defensible valuation.

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- Matthew R. Crow, CFA, ASA
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- Timothy K. Bronza, CPA, ASA
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Travis Harms presenting "Understanding Business Valuation"

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- Bryce Erickson, ASA, MRICS
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And we understand what the IRS considers important. From income tax planning to transfer tax planning and estate administration, a federal tax valuation plays a central role in positioning your, or your client's, business for success. That is why we take great care to ensure our federal tax valuations are substantiated and well-documented, enabling you to implement effective planning strategies with confidence.

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- Estate & Gift Tax Controversies – Valuation Consulting
- Gift Tax Planning & Reporting – IRC §2512
- Pre-Expatriation Planning & Reporting

Income Tax Transactions

- Allocation of Value, Determination of Professional Goodwill
- Charitable Contributions – Reg. §1.170A – 13(c)(2)
- Compensation in Kind – Reg. §1.61-2(d)(1)
- Compensation Planning – IRC §§83(b) and 409A
- Corporate Reorganizations
- C Corporation to S Conversion – IRC §1374
- Divestitures
- Expatriation Tax Reporting – IRC §877A
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- Net Operating Loss (NOL) Carryforwards – IRC §382
- Not-For-Profit – IRC §501(c)(3)
- Qualified Stock Purchases – IRC §§351, 352, and 338
- Valuation of Closely Held Securities Held by a Stock Bonus, Pension or Profit-Sharing Plan of an Employer – IRC §401(a)(28)(C)
- Worthless Securities – IRC §165

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