INTERNAL REVENUE SERVICE BUSINESS VALUATION GUIDELINES

1. INTRODUCTION

The Engineering Program Handbook (IRM 4.3.16) states that accomplishment of the objective of the IRS Engineering Program requires on-going risk analysis, quality factual development and communication with taxpayers in an effort to resolve issues.

The purpose of this document is to provide guidelines applicable to IRS Valuation Engineers, Appraisers, Valuation Specialists and others engaged in valuation practice (hereinafter referredto as "Valuators,") relating to the development, resolution and reporting of issues involving business valuations and similar valuation issues. Valuators must be able to reasonably justify any departure from these guidelines. This document incorporates by reference, the Code of Conduct, applicable to all IRS employees, and all provisions of IRM 4.3.16 relevant to the development, resolution and reporting of such valuation issues.

2. DEVELOPMENT STANDARDS

2.1. Planning.

- 2.1.1. The first step in a quality examination is the pre-examination planning process and cost/benefit or risk analysis. See Section 1.7 of IRM 4.3.16.
- 2.1.2. Valuators will adequately plan and their managers will supervise the staff involved in the valuation process.
- Quality planning is a continual process throughout the valuation assignment.

2.2. Identifying.

- 2.2.1. In developing a valuation conclusion, valuators must define the assignment and determine the scope of work necessary by identifying the following:
 - 2.2.1.1. Subject to be valued;
 - 2.2.1.2. Interest to be valued;
 - 2.2.1.3. Effective date of valuation:
 - 2.2.1.4. Purpose of valuation;
 - 2.2.1.5. Use of valuation;
 - 2.2.1.6. Standard of value;
 - 2.2.1.7. Premise or level of value;
 - 2.2.1.8. Assumptions;
 - 2.2.1.9. Limiting conditions;
 - 2.2.1.10. Scope limitations;
 - 2.2.1.11. Restrictions, agreements and other factors that may influence value:
 - 2.2.1.12. Sources of information.

2.3. Analyzing.

- 2.3.1. In developing a valuation conclusion, valuators must obtain and analyze all relevant information necessary to accomplish the assignment, including:
 - 2.3.1.1. The nature of the business and the history of the enterprise from its inception.
 - 2.3.1.2. The economic outlook in general and the condition and outlook of the specific industry in particular.

- 2.3.1.3. The book value of the stock or interest and the financial condition of the business.
- 2.3.1.4. The earning capacity of the company.
- 2.3.1.5. The dividend-paying capacity.
- 2.3.1.6. Whether or not the enterprise has goodwill or other intangible value.
- 2.3.1.7. Sales of the stock or interest and the size of the block of stock to be valued.
- 2.3.1.8. The market price of stocks or interests of corporations or entities engaged in the same or a similar line of business having their stocks or interests actively traded in a free and open market, either on an exchange or over-the-counter.
- 2.3.1.9. Other information deemed to be relevant
- 2.3.2. Valuation methods are commonly categorized into the asset-based approach, the market approach and the income approach. Professional judgment must be used to select the method(s) to consider and the methodology that best indicates the value of the business interest.
- 2.3.3. Historical financial statements should be analyzed and, if necessary, adjusted to reflect the appropriate asset value, income, cash flows and/or benefit stream, as applicable, to be consistent with the valuation methodologies selected by the valuator.
- 2.3.4. The valuator should select the appropriate benefit stream, such as pretax or after-tax income and/or cash flows, and select appropriate projection models to be consistent with the valuation methodologies selected.
- 2.3.5. The valuator will decide upon the appropriate discount and/or capitalization rate after taking into consideration all relevant factors, such as:
 - 2.3.5.1. The nature of the business.
 - 2.3.5.2. The risk involved.
 - 2.3.5.3. The stability or irregularity of earnings.
 - 2.3.5.4. Other relevant factors.
- 2.3.6. As appropriate for the assignment, and if not considered in the process of determining and weighing the indications of value provided by other procedures, the valuator should separately consider the following factors in reaching a final conclusion of value:
 - Marketability, or lack thereof, considering the nature of the business, business ownership interest or security, the effect of relevant contractual and legal restrictions, and the condition of the markets;

- 2.3.6.2. Ability of the appraised interest to control the operation, sale, or liquidation of the relevant business;
- 2.3.6.3. Other levels of value considerations, such as the impact of strategic or synergistic contributions to value; and
- 2.3.6.4. Such other factors which, in the opinion of the valuator, are appropriate for consideration.

2.4. Workpapers.

- 2.4.1. Workpapers must document the steps taken, techniques used, and provide the evidence to support the facts and conclusions in the final report. The workpapers must be organized and kept current throughout the examination, establishing a clear and concise audit trail.
- 2.4.2. Valuators will follow the mandatory workpaper auditing standards. They will ensure that workpapers are:
 - 2.4.2.1. Logically organized;
 - 2.4.2.2. Prepared to include a list or table of contents;
 - 2.4.2.3. Indexed;
 - 2.4.2.4. Bound or fastened (not loose);
 - 2.4.2.5. Labeled (i.e. valuator, date, taxpayer and year);
 - 2.4.2.6. Neat and legible; and
 - 2.4.2.7. Stored on properly labeled and secured diskettes.
- 2.4.3. Valuators will maintain a detailed case activity record (Form 9984) which:
 - 2.4.3.1. Identifies actions taken and indicates time charged;
 - 2.4.3.2. Identifies contacts including name, phone number, subject, commitments, etc.; and
 - 2.4.3.3. Documents delays in the examination.
- 2.4.4. The case activity record, along with the supporting workpapers, should justify time spent is commensurate with work performed.

2.5. Reviewing.

- 2.5.1. In reviewing a business valuation and reporting the results of that review, a valuator must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken.
- 2.5.2. In reviewing a business valuation, a valuator must:

- Identify the taxpayer and intended use of the valuator's opinions and conclusions, and the purpose of the review assignment;
- 2.5.2.2. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review;
- 2.5.2.3. Identify the extent of the review process conducted;
- 2.5.2.4. Form an opinion as to the completeness of the report under review within the scope of work applicable in the review assignment;
- 2.5.2.5. Form an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data;
- 2.5.2.6. Form an opinion as to the appropriateness of the valuation methods and techniques used and develop the reasons for any disagreement; and
- 2.5.2.7. Form an opinion as to whether the analyses, opinions and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.
- 2.5.3. In reviewing a business valuation, a valuator must consider jurisprudential valuation standards in relevant court decisions, such as the "relevant and reliable" standards for expert witness testimony.
- 2.5.4. In reviewing a business valuation, a valuator should utilize a checklist, similar to the example attached to these guidelines, modifying as necessary to suit the specific assignment.

3. RESOLUTION STANDARDS

3.1. Objective.

- 3.1.1. The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the valuator will facilitate resolution of issues without litigation.
- 3.1.2. The valuator will determine who has authority to resolve issues within the taxpayer's organization and will discuss issues with the examiner or case manager prior to presenting findings to the taxpayer.
- 3.1.3. Managers of valuators will be involved in resolving issues.

3.2. Arriving at Conclusions.

- 3.2.1. Once the valuator has all the information to be considered in resolving the issue, the valuator will use his/her professional judgment in considering this information to arrive at a conclusion.
- 3.2.2. Valuators seldom have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, must decide when they have enough, or substantially enough information to make a proper determination. The sooner this point is reached, the more timely the case can be completed and the less burden will be placed on the taxpayer.
- 3.2.3. The valuator will arrive at a definite conclusion by a balanced an impartial evaluation of all of the available evidence.
- 3.2.4. Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy and conflicts of interest.

4. REPORTING STANDARDS

4.1. Overview.

- 4.1.1. Valuation reports should contain all the information necessary to ensure a clear understanding of the valuation analyses and demonstrate how the conclusions were reached.
- 4.1.2. The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.

4.2. Report Contents.

- 4.2.1. The type of report prepared depends on the needs of each case. See 1.7.7.1 of IRM 4.3.16.
- 4.2.2. Valuation reports should be well written, communicate the results and identify the information relied upon in the valuation process. The wording used in the report should effectively communicate important thoughts, methods and reasoning, as well as identify the supporting documentation in a simple and concise manner, so that the user of the report can replicate the process followed by the valuator.
- 4.2.3. Subject to the type of report being written, valuation reports should generally contain sufficient information relating to the items in Sections 1.2 and 1.3, above, to ensure consistency and quality of valuation reports issued by IRS valuators.

4.3. Statement.

4.3.1. Each written valuation report must contain a signed statement that is similar in content to the following:

I am the person who has primary responsibility for the opinion of value contained in this report and attest that, to the best of my knowledge and belief:

- The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, impartial, unbiased professional analyses, opinions and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.

- My compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this report.
- My analyses, opinions and conclusions were developed, and this report has been prepared in conformity with the applicable Internal Revenue Service Valuation Standards

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