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REVENUE RULING 59-60: IS IT STILL VALID OR JUST DUSTY WITH AGE?

By: George B. Hawkins, ASA, CFA

Revenue Ruling 59-60; its words echo as if coming from Moses himself, with valuation practitioners throughout the country kneeling before the shrine of the entombed wisdom therein. Is it heresy today to question this pronouncement, or have fundamental advancements in the state of valuation art caused these original words to become obsolete?

Revenue Ruling 59-60 issued in 1959, was the result of a need by the Internal Revenue Service to set forth fundamental issues that should be considered when valuing a closely-held business for tax related purposes. Contrary to what many think, the Ruling is not a “how to” primer on valuation, but, rather, a superb discussion of many general factors to be considered when valuing a closely-held business for tax related purposes. For its purpose, the Ruling is a brilliant, concentrated statement of the essence of many issues that should enter into a business appraisal, and in that sense, is really a timeless piece of wisdom.

However, there are some shortcomings with the Ruling, mostly a function of the long passage of time since it was issued, which include:

- It was written in 1959 when business appraisal was virtually non-existent as a profession;
- Business valuation techniques and corporate finance knowledge have exploded since 1959. Much of the research into factors impacting securities returns, the “capital asset pricing model” (CAPM), “arbitrage pricing theory” (APT), discounted cash flow valuation techniques (DCF), and other quantum advances in the field have occurred in recent years and are continuing at a rapid pace;
- Many subsequent tax cases have provided additional insight into highly specific valuation situations not covered in a general statement like Revenue Ruling 59-60. Reliance on just the Ruling could result in major valuation missteps. For an example, see the article in this issue on valuing medical practices; although the ruling still applies, the tax ramifications are much more highly complex than indicated by the Ruling;
- It is all too often cited in valuations for purposes other than estate and gift tax as the authority when it is really a 1959 statement of position for tax purposes by the IRS. Valuation standards may vary by the purpose and intended use of the appraisal, and may be impacted by state laws, ERISA and other factors that may actually contradict some aspects of the Ruling. Witness the divorcing attorney whose practice goodwill may not be salable, yet, in many states, the fact that it is not marketable does not mean that it does not have value for divorce purposes; and,
- It does not tell how to value a company. An inexperienced reader might assume that the mention in the Ruling of the need to consider the book value of the stock suggests it is a valuation measure, when most valuation
practitioners would generally agree that book value is an accounting concept, not a valuation measure, and rarely, except by random chance, equals the fair market value. Or, the Ruling says the valuation should consider the use of comparable public companies in the “same or similar line of business.” What does “same or similar” mean? How broadly should it be viewed? Some tax cases suggest it may a much broader meaning than might conceivably be imagined.

Where does that leave the tax or estate-planning attorney? As always, pull out the Ruling periodically as a reminder of some very sound wisdom regarding valuation. But maintain your regimen to stay on top of rapidly changing valuation case law, statements of position by the IRS and techniques in business valuation. Become familiar with the required “Business Valuation Standards” of the American Society of Appraisers, which set forth very specific criteria for what should be contained in a business appraisal, methods to be considered and other important factors.

Finally, do not blindly accept the business appraisal submitted to you or your client without carefully reading the entire analysis, placing yourself in the mindset of a potential buyer. Look to see that the things you would consider important if parting with your own money are discussed and if there is reasonable support for the answers. Seek out the use of ASA accredited business appraisers who can keep you and your clients informed on the latest state of the art and whose goal is to provide thorough, detailed reports, backed by objective analysis of the wide array of factors impacting value.

George B. Hawkins is co-author of the CCH Business Valuation Guide and a Managing Director of Banister Financial, Inc., a business valuation firm in Charlotte, North Carolina. He can be reached at ghawkins@businessvalue.com or 704-334-4932.

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