

# **ESTATE PLANNING COUNCIL OF ST. LOUIS**

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## **AN UPDATE ON 50 YEAR'S WORTH OF VALUATION ISSUES: ON FAIR MARKET VALUE FOR BUSINESS AND OTHER INTERESTS**

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# AN UPDATE ON 50 YEAR'S WORTH OF VALUATION ISSUES

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## **EXECUTIVE SUMMARY – VALUATION IN THE COURTS**

2019 marks the 50<sup>th</sup> anniversary of the issuance of Revenue Ruling 59-60.<sup>1</sup> 2019 is also the 50<sup>th</sup> anniversary of the founding of the firm that employs me, Willamette Management Associates.

Members of our firm have been involved in a number of significant court cases over the years and today I will review and update you on more recent court cases during 2017-2018 and relate them to ongoing valuation issues that are frequently seen during disputes between taxpayers and their advisors and the Internal Revenue Service (IRS). These issues also come up in other areas of litigation involving private business interests.

The appraiser/valuation analyst plays a critical role in litigation. Valuations from an independent, professional appraiser should be obtained early in the litigation planning process.

### **THE FEDERAL COURTS**

The taxpayer generally has the burden of adequately disclosing credible evidence in order to establish the taxpayer's valuation position. Without a well-documented, complete, and thorough appraisal report, the taxpayer has no basis to dispute what may be an unrealistic IRS valuation claim upon audit.

The burden of proof shifts to the IRS, however, if the taxpayer satisfies the following conditions:

1. The taxpayer must comply with the substantiation and recordkeeping requirements of the Internal Revenue Code and regulations;
2. The taxpayer must cooperate with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews; and
3. Taxpayers other than individuals must have a net worth of less than \$7 million. (I.R.C. §7491)

The existence of a credible valuation report from a qualified appraiser can often prevent a valuation challenge. The Service must make a cost-benefit analysis to determine whether it has a strong case against the taxpayer. A good report makes it more likely that the Service will have to expend more resources to assert its case, and will have a more difficult time trying to show that the taxpayer's position is somehow wrong. With a good report, the chances are higher that the Service will not challenge the valuation.

And if the Service does challenge the valuation report, the burden falls on the IRS to prove its case by retaining its own expert. The courts are now tending to go with the "preponderance of evidence" so that neither party has a clear-cut burden of proof.

### **FEDERAL COURT VALUATION ISSUES FROM THE IRS PERSPECTIVE**

#### **Family "Holding Companies" – Investment Management Entities**

Discussion of standard IRS responses to this issue.

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<sup>1</sup> Copy attached.

### **S-Corps and Other Pass-Through Entities**

Discussion of standard IRS responses to this issue.

### **Built-in Gains Effects on the Value of Company Interests**

Discussion of standard IRS responses to this issue.

### **Buy-Sell Agreements**

Discussion of standard IRS responses to this issue.

### **Valuation of Intra-Family Notes with AFR Interest Rates**

Standard IRS responses to this issue.

### **Valuation of Split-dollar Intergenerational Life Insurance Contract Advances**

The IRS challenges the taxpayers' position on this issue.

### **The Impact of Subsequent Events**

Standard IRS responses to this issue.

### **Strict Compliance for Disclosure and Reporting Rules**

The IRS (and the Courts) will use lack of compliance with reporting and disclosure rules to attack the validity of valuations

## **THE STATE COURTS**

The typical types of valuation cases seen at the state court level are:

- Fair value for dissenters' rights proceedings
- Shareholder oppression matters
- Damages disputes
- Equitable division of business interests in divorce

(Presentation time: 10 minutes – accumulated total: 10 minutes)

## **ADEQUATE DISCLOSURE AND THE QUALIFIED APPRAISER AND QUALIFIED APPRAISAL**

### **ADEQUATE DISCLOSURE RULES**

The name of the game in gift and estate planning is “adequate disclosure.” The IRS’s rules set forth in Treasury Regulations Section 301.6501(c)-1(f)(3), published December 3, 1999, apply to all gifts made after August 5, 1997. The following requirements apply:

With Respect to the Person(s) who Prepares the Report:

1. The person must be an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.
2. The appraiser is qualified to make appraisals of the type of property being valued.
3. The appraiser is not the donor, donee, or any employee of either, or a member of the family of any of these parties.

The Appraisal Report must contain the following information:

1. The date of the appraisal.
2. The date of the transfer.
3. The purpose of the appraisal.
4. A description of the property.
5. A description of the appraisal process employed, including the valuation method(s) utilized.
6. A description of the assumptions utilized.
7. A description of any hypothetical conditions considered.
8. Descriptions of any restrictions or other limiting conditions present.
9. The information considered in determining the value; including all financial information in sufficient detail to allow the reader to replicate the appraisal analysis and valuation.
10. The reasoning that supports the analysis, opinions and conclusions.
11. Any specific comparative transactions utilized in the valuation analysis.
12. The fair market value of 100 percent of the entity determined without regard to any discounts in valuing the entity or the assets owned by the entity, unless this information is not relevant or material in determining the value of the interest.

### **QUALIFIED APPRAISER**

A credible, qualified appraiser is essential when valuing difficult and complex entities. It becomes more difficult for the IRS to make the decision to challenge a valuation if a well-respected, independent analyst writes the report. And if the IRS does dispute the report, the analyst is prepared to defend it.

An experienced and qualified appraiser not only knows the various methods used to value closely held businesses but is also aware of the following areas that can add complexity to the situation:

- Current IRS rulings and Court judgments;
- Applicable issues such as the impact of a buy-sell agreement;
- Effects of state laws on asset transfers;
- Litigation procedures and rules of discoverability;
- Data on discounts for lack of marketability, blockage, and minority interests;
- Current financial market conditions.

Besides extensive knowledge and experience, the estate planner should look for an appraiser who holds the right credentials. There are four professional associations in the U.S. and one in Canada offering education and professional credentials in the appraisal of private business interests.

The oldest association is the **American Society of Appraisers**, which offers the **ASA** (Accredited Senior Appraiser) designation. Other relevant organizations are:

- National Association of Certified Valuation Analysts (NACVA) – **CBA, CVA**
- American Institute of Certified Public Accountants (Accredited in Business Valuation – **ABV**)
- Canadian Institute of Chartered Business Valuators (CICBV) – **CBV**
- Royal Institution of Chartered Surveyors (RICS) - **MRICS**

Another relevant accrediting organization is the CFA Institute. Its focus is primarily publicly traded securities rather than private businesses and intangible assets, but it does include certain types of “private equity” in its training programs. It awards the Chartered Financial Analyst (**CFA**) professional designation.

Another more recent organization is the Chartered Alternative Investment Analyst Association, which awards the Chartered Alternative Investment Analyst (**CAIA**) designation.

Having one or several of these designations gives the analyst creditability before the eyes of the Service and the Court. Note that merely having a CPA or an advanced business degree is not evidence of valuation competence.

Specific previous industry experience is helpful but not critical. The valuation expert should be able to identify the areas for which in-depth due diligence is needed and for which industry research, including consulting with an industry expert, will be essential.

The most widely cited and recognized set of professional standards for appraisals is the *Uniform Standards of Professional Appraisal Practice (USPAP)*, published by The Appraisal Foundation. USPAP is updated periodically. It covers appraisals for all disciplines, including real estate, personal property, and appraisal of businesses, business interests, and intangible assets.

The AICPA has its own set of standards titled *Statement on Standards for Valuation Services (SSVS)*. All CPA-members must follow SSVS when representing that they are performing a formal appraisal. Beginning in 2018, the ABV credential was made available to non-CPAs who are members of the AICPA.

The IRS issued final regulations regarding substantiation and reporting requirements for cash and noncash charitable contribution deductions that are effective as of July 30, 2018 (with full compliance by January 1, 2019). The qualified appraisal must be attached to any tax return claiming a noncash charitable contribution of more than \$500,000. The education and experience requirements under the final regulations say that an appraiser must have: (a) successfully completed professional or college level course work in valuing the type of property donated and have at least two years’ experience in valuing the type of property donated, or (b) earned a recognized professional appraiser designation in the type of property donated.

## **QUALIFIED APPRAISAL**

The IRS provided some guidance on what constitutes a “qualified” appraisal report. IRS commentaries in newly issued regulations have indicated that a report that follows the substance and principles of a USPAP-



compliant report will generally be regarded as a qualified report. The adequate disclosure rules discussed above also provide help on what is acceptable.

(Presentation time: 10 minutes – accumulated total: 20 minutes)

## **FEDERAL COURT CASES - IRS**

### **ESTATE OF WILLIAM CECIL V. COMMISSIONER, CAUSE NOS. 14639-14 AND 14640-14 (TRIAL HELD FEBRUARY 2016)**

- Estate planning participants are awaiting the outcome of this trial on the issue of “tax affecting” the earnings of an S corporation for estate tax valuation purposes.
- Both the IRS’ and the taxpayer’s experts used a variation of the SEAM-style analysis that recognized the impact of tax affecting
- The previous significant S corporation valuation case was Estate of Louise Paxton Gallagher, TCM 2011-148

### **ESTATE OF POWELL V. COMMISSIONER, 148 T.C. NO. (MAY 18, 2017)**

- Most significant case in FLPs since Bongard (2005)
- Attack on FLP via Section 2036(a)(2) – the LP “in conjunction with” all other family owners could dissolve the partnership at any time (the transaction also fails under Section 2038)
- No discounts on the transfer of the LP and its assets
- Observers characterized deal as overly aggressive death bed planning using powers of attorney
- This is a different result from the previous case in which the IRS asserted Section 2036 – in Mirowski (2008) the entity was upheld, Section 2036 did not apply, and discounts were allowed

### **ESTATE OF CAHILL V. COMMISSIONER, T.C. MEMO 2018-84 (JUNE 18, 2018)**

- Another perhaps overly aggressive case in which the actions were taken under a power of attorney for a 90-year-old senior generation family member
- Split dollar life insurance agreement between revocable and irrevocable trusts resulted in a \$10 million “advance” (i.e., like a zero interest note) being valued at \$183,700 for estate tax purposes, due to the long-term nature of the contract’s repayment provisions and unlikelihood of an early termination
- This case was on the initial motions to apply/not apply Sections 2036, 2038, and 2703 to this transaction – and the court ruled they would apply
- The Tax Court cited the Powell case
- The advance was not a bona fide note
- Two other intergenerational split dollar life insurance cases are pending: Estate of Morrisette and Estate of Levine

**CHET S. HUFFMAN ET AL V. COMMISSIONER, DOCKET NOS. 3255-16, 3256-16, 3261-16 AND 3526-16 (TRIAL HELD MAY 21-29, 2018)**

- Gift tax case involving a somewhat unusual buy-sell agreement
- The 1993 buy-sell allowed the son to buy out his parents for no less than \$5 million, when their controlling interests in the company were then worth a total of just under \$200,000
- When the parents were eventually bought out by the son in 2007, the IRS claimed a gift was made because the company was worth far more than \$5 million by then
- The IRS and the taxpayer disagreed over whether the buy-sell met the test under Section 2703(b) that:
  - It is a bona fide business arrangement;
  - It is not a device the transfer property to family members for less than full and adequate consideration;
  - It has terms that are comparable to similar arrangements entered into by persons in an arm's-length transaction
  - Would the parents have gotten a rate of return equal to that demanded by arm's-length investors
  - Were the acquiring company's projections relevant for determining a 2007 gift value when the company was subsequently bought in 2008

**ESTELLE C. GRAINGER V. COMMISSIONER, T. C. MEMO 2018-114 (JULY 30, 2018)**

- Charitable gift case which includes almost every way possible to mess up a charitable gift deduction claim
- Bad valuation method
- No independent qualified appraisal
- Forms 8283 filled out incorrectly
- No contemporaneous written acknowledgement from the charity
- Taxpayer represented herself in the proceeding

**BELAIR WOODS LLC ET AL V. COMMISSIONER, T. C. MEMO 2018-159 (SEPTEMBER 20, 2018)**

- This charitable gift case had an independent appraisal, but the taxpayers failed to properly fill out the portion of Form 8283 that includes information about the cost basis of the contributed property

## **FEDERAL COURT CASES – OTHER**

### **PEREZ V. FIRST BANKERS TRUST SERVS., 2017 U.S. DIST. LEXIS 52117 (MARCH 31, 2017)**

- The Court held the institutional trustee liable for overpaying for the stock purchased by the ESOP for a New Jersey construction company
- Reliance on valuation experts without making “an honest, objective effort” to review the report
- Insufficient effort to question the assumptions and methods of the appraiser
- The trustee and the DOL settled the case for an amount rumored to be about \$8 million

### **ACOSTA V. VINOSKEY, 2018 U.S. DIST. LEXIS 64094 (APRIL 17, 2018)**

- This and the following two cases are part of an ongoing series of ESOP litigation in which the DOL has been aggressively going after ESOP trustees when subsequent problems suggest to the DOL that the trustee overpaid for stock in the ESOP
- The DOL alleged that the noninstitutional trustee: (1) allowed the ESOP to pay more than adequate consideration, (2) allowed the share value to decrease, (3) used an attorney who had a conflict of interest (having a longstanding relationship with the selling owners), (4) did not allow sufficient time to complete its work thoroughly, and (5) did not engage in any meaningful negotiations.
- In this case, the ESOP trustee’s attorneys were partly successful in a Daubert motion in getting part of the DOL’s expert’s damages testimony excluded
- The trustee claimed the DOL’s expert: (1) was unqualified and (2) his calculation methodology was unreliable
- Expert had no professional designation and was unaware of the standards of practice in the ESOP community, including ERISA fiduciary standards
- The court ultimately accepted the DOL appraiser as qualified, mostly because of his experience
- The court did not accept part of the DOL expert’s damages analysis, the guideline public company method, because it only utilized one “comparable”
- However, the claim for damages from overpayment could stand
- The court threw out entirely the expert’s “novel” damages calculations regarding how the ESOP share value decreased
- Without viable damages evidence for this aspect of the case, the stock value decrease claim was unsustainable and was excluded
- The overpayment claim damages evidence was allowed, but would be subject to challenge during the trial

**BRUNDLE V. WILMINGTON TRUST, N.A., U. S. COURT OF APPEALS, FOURTH CIRCUIT, NO. 17-2224 (JULY 23, 2018)**

- This is the on-going appeal of the original Brundle v. Wilmington Trust, N.A., U.S. District Court, Eastern District of Virginia (No. 1:15-cv-01494-LMB-IDD), March 13, 2017 and June 23, 2017
- The Court hit Wilmington Trust with a judgement of approximately \$29 million for paying too much for the stock purchased in an ESOP transaction for Constellis Group, Inc., a Virginia-based private security firm
- The appeal is focused on three primary issues:
- Whether the court's judgement is correct that the appraiser (and trustee) blindly accepted management's projections and the trustee did insufficient review and gave "uncritical deference" to the appraiser's opinion
- Whether it was appropriate that the ESOP paid a control premium, even though it did not achieve effective control over the company as it could not appoint a majority of the board members
- Whether the district court correctly held that Wilmington's liability for the ESOP's losses caused by purchasing employer stock at an excessive price may not be offset by the amount the ESOP received when it subsequently sold the stock in an independent transaction
- Two Amicus Curiae briefs have been submitted – one by the American Society of Appraisers (for Wilmington) and one by the Department of Labor (for Brundle)

## **STATE COURT CASES – FAIR VALUE FOR DISSENTERS**

### **IN RE PETSMART, INC., 2017 DEL. CHANCERY LEXIS 89 (MAY 26, 2017)**

- The Delaware Court of Chancery concluded that the deal price was fair value
- Because the sales process was “close to perfection” in producing a reliable indicator
- In contrast, the court found that the other side’s expert’s discounted cash flow projections had “indicators of unreliability”

### **DCF GLOBAL CORP. V. MUIRFIELD VALUE PARTNERS, L.P., 2017 DEL. CHANCERY LEXIS 324 (AUGUST 1, 2017)**

- The Delaware Supreme Court reversed and remanded the Chancery Court’s valuation originally based on (1) a discounted cash flow analysis method, (2) a guideline public company method, (3) the deal price – all equally weighted
- The company went through a two year “robust” and “arm’s-length” sale process that involved at least 35 financial bidders and three strategic bidders
- The company urged the court to adopt a bright-line rule that the deal price is the best evidence of fair value if the sale is the product of a robust, conflict-free process
- The Supreme Court refused to do this, because the law states that the courts must consider “all relevant factors”
- But it found that the trial court should have placed most or all the weight on the deal price
- The lower court was also criticized for adopting a high out-years and terminal growth rate in its discounted cash flows, because the company’s payday lending industry had gone through a great deal regulatory turmoil and future growth could not be as good as historical growth rates

### **DELL, INC. V. MAGNETAR GLOBAL EVENT DRIVEN MASTER FUND LTD., 2017 DEL. CHANCERY LEXIS 518 (DECEMBER 17, 2017)**

- The Delaware Supreme Court struck down the Chancery Court’s 2016 opinion in the Dell case and remanded the case for further deliberation
- Initially, the trial court developed its own discounted cash flow method analysis to conclude the original deal was underpriced
- This was because the trial experts’ opinions (also based mainly on discounted cash flow analysis) diverged by a mere \$28 billion
- The trial court disregarded the deal price entirely
- The bidding process was deemed to be reasonably fair and those in charge “did many praiseworthy things”

- The fact that no strategic buyer was interested suggested that the deal price (and fair value) would be lower
- The Supreme Court found that the trial court had no justifiable reason to ignore the deal price
- It also criticized several the trial court's discounted cash flow method assumptions, including its treatment of complex tax issues

**VERITION PARTNERS MASTER FUND LTD. V. ARUBA NETWORKS, INC., 2018 DEL. CHANCERY LEXIS 52 (FEBRUARY 1, 2018)**

- The Court of Chancery decided that the market for Aruba's shares exhibited "attributes" associated with the efficient markets hypothesis
- "[t]he issue in an appraisal is not whether a negotiator has extracted the highest possible bid. Rather, the key inquiry is whether the dissenters got fair value and were not exploited."
- "By awarding fair value based on the unaffected market price, this decision is not interpreting Dell and DFC to hold that market price is now the standard for fair value. Rather, Aruba's unaffected market price provides the best evidence of its going concern value."
- The bidding process was deemed reasonable and the buyer, HP, was a strategic buyer
- The unaffected (by deal synergies) market price is therefore the best indicator of fair value

**IN RE AOL INC., 2018 DEL. CHANCERY LEXIS 63 (FEBRUARY 23, 2018)**

- The Court of Chancery decided that a discounted cash flow analysis method was a better indicator of fair value than the deal price
- The trial court adjusted its discounted cash flow analysis for several elements and principally relied on the respondent's expert's version of this analysis
- Circumstances in the process of the sale of AOL made reliance on the deal price as fair value not advisable

**BLUE BLADE CAPITAL OPPORTUNITIES, LLC ET AL V. NORCRAFT, DEL. CHANCERY, C.A. NO. 11184-CVS (JULY 27, 2018)**

- The merger deal price was not an indicator of fair value in this case the Court decided, despite the decisions in DFC, Dell and Aruba (discussed above)
- The court decided there were significant flaws in the sale process
- No pre-signing market check, and the company was focused on a single buyer
- The company's lead negotiator was conflicted, negotiating his own future employment and compensation terms

- The go-shop provision had so many original deal protection measures that it was “ineffective as a price discovery tool”
- Prior to the offer, the company’s stock was thinly traded
- The court used various components from the competing experts’ discounted cash flow analyses, depending on what it thought was the most credible
- The court considered the \$25.50 per share deal price, which was only \$0.66 lower than the discounted cash flow method value

**ATHLON SPORTS COMMUNICATIONS, INC. V. DUGGAN, 2018 TENNESSEE SUPREME COURT  
LEXIS 310 (JUNE 8, 2018)**

- In a follow-on to the earlier appeal of this fair value case in Tennessee, that state’s Supreme Court ruled that more modern valuation methods deserved consideration
- Tennessee had traditionally used the “Delaware Block Method” (DBM) and the appellate court in this case found that DBM was the precedent
- “we see no reason to restrict trial courts to using only the DBM in determining fair value”
- The parties’ experts had considered discounted cash flow methods as part of their analysis
- The Supreme Court remanded the case for further revaluation



## **STATE COURT CASES – OTHER**

### **SLUTSKY V. SLUTSKY, 2017 NEW JERSEY LEXIS 120 (AUGUST 8, 2017)**

- The Appeals Court reversed the trial court's findings due to (1) the court's failure to support its conclusions and (2) the inconsistencies in its findings
- The owner-spouse had an equity interest in a large law firm
- Although the law firm had goodwill, the spouse as a minority partner had no separate goodwill from that of the firm
- The Appeals Court asked for the case to be reassigned to a new judge

### **CARNEY V. CARNEY, 2017 PENNSYLVANIA SUPER. LEXIS 509 (JULY 11, 2017)**

- The value of the husband's auto transport business was the issue
- The husband's expert used an income-based approach
- The wife's expert used a net asset-based approach
- The Appeals Court decided that, if the net asset-based approach was selected by the trial court, the court also had to include the effect of selling expenses and taxes related to the sale of the assets
- Tax and expense factors must be considered in the analysis, although such "ramifications need not be immediate and certain" regardless of "whether a sale was likely or not"
- Remanded for further analysis and a hearing

### **IN RE MARRIAGE OF BROESDER, 2017 MONTANA LEXIS 568 (SEPTEMBER 12, 2017)**

- The Montana Supreme Court decided that the family-owned ranching company in which both husband and wife had stock should be valued with an adjustment for the tax consequences of liquidation
- Although the trial court's final judgement did not specifically require the liquidation of the ranch, it "would appear to be a necessity to satisfy the judgement," making a taxable event an "eventuality"
- Equitable division of a marital estate also includes equitable division of tax liabilities

### **ROHLING V. ROHLING, 2018 ALABAMA CIV. APPEALS LEXIS 94 (JUNE 1, 2018)**

- Appeals Court supports trial court's decision to accept and use a calculation report rather than demand an appraisal report

- A calculation report is not inherently “unreliable”
- The trial court properly considered the limitations of a calculation engagement when considering the weight to assign the expert’s testimony

(Presentation time: 25 minutes – accumulated total: 45 minutes)

## HOW TO READ AND REVIEW A VALUATION REPORT

### CHECKLIST FOR REPORT REVIEW

The following checklist is taken from *Valuing a Business* (Fifth Edition), Chapter 22 and sets forth the key areas to look for in any appraisal of a business interest.

The critical question to keep in mind while reading a valuation report is – “Why?”

The appraiser’s report should lead the reader through a logical path of analysis to a conclusion of value. The reasoning in the report should be supported by and based on accepted theoretical viewpoints and by empirical data. The report should explain in sufficient detail why the appraiser is relying on or selecting certain facts, assumptions, or theories as the basis for the valuation analysis.

- Identification of the subject property
- Identification of the client
- Relevant dates
- Definition of value
- Purpose of the valuation
- Ownership characteristics of the subject interest
  - Degree of control
  - Degree of marketability
- Economic outlook
- Industry outlook
- Company history and outlook
- Sources of information
- Financial statement analysis
- Valuation methodologies
  - Asset-based approach
  - Income-based approach
  - Market-based approach
- Are the data used appropriate to the valuation date?
- Valuation synthesis and conclusions
- Analyst’s qualifications and potential conflicts
- Appraisal certification
- Statement of contingent and limiting conditions
- Overall evaluation
  
- Conceptual problems
- Technical problems
- Calculation errors
- Typographical or inconsistency problems
- Problems with missing items

### SOME QUESTIONS TO ASK

Aside from establishing the appropriate credentials for the appraiser, a few basic questions to ask any prospective appraiser include:

- How many valuations did you (or your firm) do over the last two years?
- Have you previously valued the subject interest? How many previous engagements are similar to the subject interest in my client's case?
- What valuation credentials (or designations) do you hold? Are your credentials up to date?
- What types of training in valuation have you received? What courses have you taken?
- What articles or books have you written, and what speaking engagements have you made on valuation?
- What methods do you typically use in a case like this one?
- What procedural reporting guidelines do you follow in a case like this one?
- Have you ever had a formal complaint filed against you regarding your valuation activities?
- What sets you (or your firm) apart from other valuation practitioners?

(Presentation time: 10 minutes – accumulated total: 55 minutes)

## FINAL NOTES - VALUATION ISSUES FROM THE COURT'S PERSPECTIVE

### SOME FINAL NOTES – VALUATION IN THE COURTS 2017-2018

- Expert (*Daubert*) challenges are now a common tactic
- Courts do their own valuation calculations, especially the discounted cash flow method
- Motions challenges for rehearing or revisions of the court's or prevailing expert's valuation calculations

### SUPREME COURT CASES

The cases below confirmed once and for all that the judges' role as gatekeeper applies to *all* expert evidence and testimony, not just "scientific" testimony. Federal Rule of Evidence 704 requires the court to exclude any expert evidence that is not both "reliable" and "relevant."

*Daubert v. Merrell Pharmaceuticals, Inc.*; <sup>2</sup>

*General Electric Company et al. v. Robert K. Joiner et ux.* <sup>3</sup>

*Kumho Tire Company, Ltd., et al., v. Patrick Carmichael, etc., et al.* <sup>4</sup>

In *Daubert*, the Court specified four tests by which to judge experts and their testimony:

- **Testing**—Can the theory or technique be tested, or has it been tested?
- **Peer reviews**—Has the theory been subjected to peer review or publication, which aids in determining flaws in the method?
- **Error rates**—Are there established standards to control the use of the technique?
- **Acceptability**—Is the technique generally accepted in the relevant technical community? <sup>5</sup>

### A JUDGE'S VIEW ON FAIR MARKET VALUE AND VALUATION REPORTS

- Each valuation case is unique. <sup>6</sup> Although guidance can be obtained from earlier cases, one case is rarely on point with another, and a significant differentiation of the facts can usually be made.
- In valuation there are no absolutes. There are only general guidelines to which individual judgments must be applied.
- There is no irrefutable "right" answer.
- Experts will and do differ.

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<sup>2</sup>*Daubert v. Merrell Pharmaceuticals, Inc.*, 509 U.S. 572 (1993).

<sup>3</sup> *General Electric Company et al. v. Robert K. Joiner et ux.*, 66 U.S.L.W. 4036 (U.S. Dec. 15, 1997).

<sup>4</sup> *Kumho Tire Company, Ltd., et al., v. Patrick Carmichael, etc., et al.* 1999 WL 152455 (U.S.).

<sup>5</sup> Robert F. Reilly, "Supreme Court Applies *Daubert*-type Screening to All Experts' Work," *Shannon Pratt's Business Valuation Update*, July 1999, pp. 1, 3.

<sup>6</sup> Excerpted from a two-part report, "Judge Laro's Views on 'Fair Market Value,'" The Honorable David Laro, Tax Court Judge, *Judges & Lawyers Business Valuation Update*, May 1999, p. 1–3; and "Judge Laro's Views on Discounts & Valuation Reports," The Honorable David Laro, Tax Court Judge, *Judges & Lawyers Business Valuation Update*, June 1999, p. 1–4. The full text of Judge Laro's presentation is on *BVLibrary.com*.

- There are available methods which are generally recognized and accepted by the appraisal profession and the courts.
- A marketability discount may inhere in the value of an interest in a corporation regardless of the interest holder's percentage ownership of the ownership stock.
- In a recent survey 65.2 percent of the Tax Court's decisions did not coincide with the conclusions of any of the expert witnesses.
- At trial, two principal inquiries are always before the court.
  - Is the expert qualified?
  - Is the evidence to be admitted relevant and helpful?
- Always read the opinions on valuation that were written by the judge handling the case.
- Read and understand the recent opinions of the Court written by other judges on a related topic.
- Make known clearly the qualifications of the expert.
- Make special efforts to make sure that the expert's data is highly relevant and empirical in nature.
- Make sure the expert prepares a very cogent and credible valuation report.
- If the appraisal reflects real world values and supports its conclusions with relevant empirical data about real world situations, it likely will be accepted.

(Presentation time: 5 minutes – accumulated total: 60 minutes)

## PRESENTER'S BIOGRAPHY

**Curtis R. Kimball, CFA, ASA** - Mr. Kimball is a managing director of Willamette Management Associates, a nationally prominent valuation and financial advisory firm for over forty years. He acts as WMA's national director for wealth management valuations including estate, gift, buy-sell agreement, trust, fiduciary liability, marital, and charitable issues. He works out of WMA's Atlanta regional office. He holds a Chartered Financial Analyst (CFA) designation from the CFA Institute and an Accredited Senior Appraiser (ASA) designation in business valuation from the American Society of Appraisers. He has been valuing companies and interests in companies, intangible assets, and other investments for a variety of purposes for over thirty-five years and was formerly with Wachovia Bank and, later, the Citizens & Southern Trust Company prior to joining WMA in 1988. He graduated with a B.A. in Economics from Duke University and an M.B.A. from Emory University. He is a reviewer or contributing author to several standard reference works on private business valuation including: *Valuing a Business*, *Valuing Small Businesses and Professional Practices*, *Financial Valuation: Businesses and Business Interests (1997 Update)*, *Business Valuation Discounts and Premiums* and others.

Mr. Kimball has appeared as an expert witness on valuation issues in U.S. District Court, U.S. Tax Court, U.S. Court of Federal Claims, U.S. Bankruptcy Court, and other venues over 70 times. His expert witness appearances include the U. S. Tax Court cases: *Estate of Anna Mirowski* (Mirowski Family Ventures, LLC), *Estate of Georgina T. Gimbel* (Reliance Steel and Aluminum Company), *Estate of H. A. True, Jr. and Jean D. True et al v. Commissioner* (True Ranches and True Oil Company), and *Estate of Harriet Mellinger v. Commissioner* (Frederick's of Hollywood).

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