

THE STATE OF SOUTH CAROLINA

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In The Court of Appeals

Jun 29 2021

SC Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

Case No. 14-ALJ-17-0552-CC

Appellate Case No. 2021-000031

Lowe's Home Centers, LLC

Appellant,

v.

South Carolina Department of Revenue

Respondent.

**RECORD ON APPEAL
Volume 8 of 12**

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**CONTINUATION OF
JOINT EXHIBIT 48**

- Historical financial information (including annual and interim financial statements, financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding the following:
 - Advantageous or disadvantageous contracts
 - Contingent or off-balance-sheet assets or liabilities
 - Information on prior sales of company stock

.30

The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

Valuation Approaches and Methods

.31

In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (income-based) approach**
- **Asset (asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (market-based) approach**

.32

The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs .33–.41, but detailed guidance on specific valuation approaches and methods and

Income Approach. Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

- a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:
 - i. **Normalization** adjustments
 - ii. Nonrecurring revenue and expense items
 - iii. Taxes
 - iv. Capital structure and financing costs
 - v. Appropriate capital investments
 - vi. Noncash items
 - vii. Qualitative judgments for risks used to compute discount and capitalization rates
 - viii. Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)
- b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a, the valuation analyst should consider the following:
 - i. Forecast or projection assumptions
 - ii. Forecast or projected earnings or cash flows
 - iii. **Terminal value**
- c. For an intangible asset, the valuation analyst should also consider, when relevant, the following:
 - i. Remaining useful life
 - ii. Current and anticipated future use of the intangible asset
 - iii. Rights attributable to the intangible asset
 - iv. Position of intangible asset in its life cycle
 - v. Appropriate discount rate for the intangible asset
 - vi. Appropriate **capital or contributory asset charge**, if any
 - vii. Research and development or marketing expense needed to support the intangible asset in its existing state
 - viii. Allocation of income (for example, **incremental income, residual income**, or ...)

- x. Discounted multi-year excess earnings
- xi. Market royalties
- xii. Relief from royalty

Asset Approach and Cost Approach

.34

A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

.35

When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

Market Approach

.36

Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are as follows:

- Guideline public company method
- *Guideline company transactions method*
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are as follows:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)

earned by guideline companies)

- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

.37

In applying the methods listed in paragraph .36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider the following:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

.38

The valuation analyst should set forth in the report the rationale and support for the valuation methods used (see paragraph .47).

.39

Rules of Thumb. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

Valuation Adjustments

.40

During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

.41

When valuing a controlling ownership interest under the income approach, the value of any **non-operating assets**, **non-operating liabilities**, or **excess or deficient operating assets** should be

interest under the income approach, the value of any interest in liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the non-controlling interest. In the asset-based or cost approach, it may not be necessary to separately consider non-operating assets, non-operating liabilities, or excess or deficient operating assets.

Conclusion of Value

.42

In arriving at a conclusion of value, the valuation analyst should

- a. correlate and reconcile the results obtained under the different approaches and methods used.
- b. assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
- c. determine, based on items a and b, whether the conclusion of value should reflect
 - i. the results of one valuation approach and method, or
 - ii. a combination of the results of more than one valuation approach and method.

Subsequent Events

.43

The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (see paragraphs .52p, .71r, and .74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Documentation

valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include the following:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs .25–.30)
- Assumptions and limiting conditions (paragraph .18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph .19)
- Basis for using any *valuation assumption* during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph .43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph .39)
- Other documentation considered relevant to the engagement by the valuation analyst

.45

The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

Calculation Engagement

.46

In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a. Identity of the client
- b. Identity of the subject interest
- c. Whether or not a business interest has ownership control characteristics and its degree of marketability
- d. Purpose and intended use of the calculated value
- e. Intended users of the report and the limitations on its use

g. Applicable premise of value

h. Applicable standard of value

i. Sources of information used in the calculation engagement

j. Valuation approaches or valuation methods agreed upon with the client

k. Subsequent events, if applicable (see paragraph .43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs .44 and .45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

The Valuation Report

.47

A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (see paragraph .50).

.48

The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are as follows: either a detailed report or a summary report for a valuation engagement and a calculation report for a calculation engagement:

- a. *Valuation engagement—detailed report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .51).
- b. *Valuation engagement—summary report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71). For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.
- c. *Calculation engagement—calculation report.* This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (see paragraph .73).

.49

The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or

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A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this statement (see paragraphs .47–.49 and .51–.78). The developmental provisions of the statement (see paragraphs .21–.46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Interpretation No. 1 [VS sec. 9100 par. .01–.89]).

Detailed Report

.51

The *detailed report* is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement or financial information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments
- Non-operating assets, non-operating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendixes and exhibits

Udvalgte personer

This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

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Sources of Information

.53

This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest
- d. Financial information (paragraphs .54 and .56)
- e. Tax information (paragraph .55)
- f. Industry data
- g. Market data
- h. Economic data
- i. Other empirical information
- j. Relevant documents and other sources of information provided by or related to the entity

.54

If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements [SSAEs] [AT sec. 20–701]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

.55

The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (see paragraph .53e), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

.56

that were not the subject of an audit, review, compilation or examination of the SSAEs, the valuation report should do the following:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAEs (AT sec. 20–710) to the financial information and assumes no responsibility for that information

Analysis of the Subject Entity and Related Nonfinancial Information

.57

The valuation analyst should include a description of the relevant nonfinancial information listed and discussed in paragraph .27.

Financial Statement or Financial Information Analysis

.58

This section should include a description of the relevant information listed in paragraph .29. Such description may include the following:

- a. The rationale underlying any normalization or *control adjustments* to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

Valuation Approaches and Methods Considered

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This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph .31.

Valuation Approaches and Methods Used

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In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

.61

This section should also identify the following for each of the three approaches (if used):

- a. Income approach:

-
- b. Composition of the representative benefit stream

- Other factors as discussed in paragraph .33

b. Asset-based approach or cost approach:

- *Asset-based approach.* Any adjustments made by the valuation analyst to the relevant balance sheet data
- *Cost approach.* The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated

c. Market approach:

- For the guideline public company method:

- The selected guideline companies and the process used in their selection
- The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments

- For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection, if the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

.62

When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (see paragraph .39).

Valuation Adjustments

.63

This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (see paragraph .40).

.b4

When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related non-operating assets, non-operating liabilities, or excess or deficient operating assets and their effect on the valuation (see paragraph .41).

Representation of the Valuation Analyst

.65

Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph .18), and they are the personal analyses and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (see paragraph .49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.
- g. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.
- h. The valuation analyst and, if applicable, the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

Representations Regarding Information Provided to the Valuation Analyst

.66

It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of

Qualifications of the Valuation Analyst

.67

The report should contain information regarding the qualifications of the valuation analyst.

Conclusion of Value

.68

This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a. A valuation engagement was performed, including the subject interest and the valuation date.
- b. The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c. The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e. The scope of work or data available for analysis is explained, including any restrictions or limitations (see paragraph .19).
- f. A statement describing the conclusion of value, either a single amount or a range.
- g. The conclusion of value is subject to the assumptions and limiting conditions (see paragraph .18) and to the valuation analyst's representation (see paragraph .65).
- h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i. The date of the valuation report is included.
- j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

.69

The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of *insurance of the*

any other party to our report.
with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [value, either a single amount or a range]. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Appendix and Exhibits

.70

Appendix or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the detailed report.

Summary Report

.71

A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. The business interest's ownership control characteristics, if any, and its degree of marketability
- g. Valuation date

- j. Applicable premise of value
- k. Applicable standard of value
- l. Sources of information used in the valuation engagement
- m. Assumptions and limiting conditions of the valuation engagement (paragraph .18)
- n. The scope of work or data available for analysis including any restrictions or limitations (paragraph .19)
- o. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- p. If the work of a specialist was used in the valuation (paragraph .20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q. The valuation approaches and methods used
- r. Disclosure of subsequent events in certain circumstances (paragraph .43)
- s. Any application of the jurisdictional exception (paragraph .10)
- t. Representation of the valuation analyst (paragraph .65)
- u. The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v. A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs .68 and .69
- w. A statement that the valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the valuation report

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Appendixes or exhibits may be used for required information (see paragraph .70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendixes to the summary report.

Calculation Report

.73

As indicated in paragraph .48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph .65, but adapted for a calculation engagement.

The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph .22), any application of the jurisdictional exception (paragraph .10), and any assumptions and limiting conditions applicable to the engagement (paragraph .18). If the valuation analyst used the work of a specialist (paragraph .20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph .43).

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Appendixes or exhibits may be used for required information (paragraph .72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the calculation report.

.76

The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

- a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.
- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that
 - i. a calculation engagement does not include all of the procedures required for a valuation engagement, and

- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

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The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SSVS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as previously referred to, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [calculated value, either a single amount or a range]. This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

Effective Date

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This statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

Appendix A

Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

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The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value (or the calculated value) arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.

... that is based at least in part on the assumption

exchange, or diminution of the owners' participation would not be materially or significantly changed.

6. This report and the conclusion of value (or the calculated value) arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value (or the calculated value) are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The stated valuation represents the considered conclusion of value (or the calculated value) of [Valuation Firm], based on information furnished to them by [ABC Company] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value [or the calculated value], the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [Valuation Firm].
3. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [Valuation Firm] unless previous arrangements have been made in writing.
9. [Valuation Firm] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [Valuation Firm] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [Valuation Firm] has not determined independently whether [ABC Company] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [Valuation Firm]'s valuation takes no such liabilities into account, except as they have been reported to [Valuation Firm] by [ABC Company] or by an environmental consultant working for [ABC Company], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [Valuation Firm] has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.
11. [Valuation Firm] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [Sample wording for use if the jurisdictional exception is invoked.] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published environmental liability assessment standards.

and we shall have no responsibility for any

14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.
16. We have conducted interviews with the current management of [ABC Company] concerning the past, present, and prospective operating results of the company.
17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.

Appendix B

International Glossary of Business Valuation Terms in *

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To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the subsequently identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

- Adjusted Book Value Method**—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. (NOTE: In Canada on a going concern basis)
- Adjusted Net Asset Method**—see **Adjusted Book Value Method**.
- Appraisal**—see **Valuation**.
- Appraisal Approach**—see **Valuation Approach**.
- Appraisal Date**—see **Valuation Date**.
- Appraisal Method**—see **Valuation Method**.
- Appraisal Procedure**—see **Valuation Procedure**.
- Arbitrage Pricing Theory**—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.
- Asset (Asset-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.
- Beta**—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.
- Blockage Discount**—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.
- Book Value**—see **Net Book Value**.
- Business**—see **Business Enterprise**.
- Business Enterprise**—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.
- Business Risk**—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.
- Business Valuation**—the act or process of determining the value of a business enterprise or ownership interest therein.
- Capital Asset Pricing Model (CAPM)**—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.
- Capitalization**—a conversion of a single period of economic benefits into value.

single period into value.

Capitalization of Earnings Method—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control—the power to direct the management and policies of a business enterprise.

Control Premium—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control.

Cost Approach—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital—the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free—*we discourage the use of this term. See Invested Capital.*

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Effective Date—see **Valuation Date**.

Enterprise—see **Business Enterprise**.

Equity—the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "*price*" should be replaced with the term "*highest price*."}

Fairness Opinion—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow—*we discourage the use of this term. See Net Cash Flow.*

Going Concern—an ongoing operating business enterprise.

Going Concern Value—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

products, and similar factors that separately determine.

Goodwill Value—the value attributable to goodwill.

Guideline Public Company Method—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk—the degree of uncertainty as to the realization of expected returns.

Investment Value—the value to a particular investor based on individual investment requirements and expectations. (NOTE: in Canada, the term used is "Value to the Owner.")

Key Person Discount—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta—the beta reflecting a capital structure that includes debt.

Limited Appraisal—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

Liquidity—the ability to quickly convert property to cash or pay a liability.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

enterprise.

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity—the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital—the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability—the ability to quickly convert property to cash at minimal cost.

Marketability Discount—see **Discount for Lack of Marketability**.

Merger and Acquisition Method—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount—a discount for lack of control applicable to a minority interest.

Minority Interest—an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple—the inverse of the capitalization rate.

Net Book Value—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value—the value of the business enterprise's tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

Nonoperating Assets—assets not necessary to ongoing operations of the business enterprise.

Normalized earnings—excluding various adjustments for unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple—the price of a share of stock divided by its earnings per share.

Rate of Return—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets—see **Nonoperating Assets**.

Account Data—the data conclusions are transmitted to the client.

Replacement Cost New—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New—the current cost of an identical new property.

Required Rate of Return—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value—the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity—the amount, expressed as a percentage, earned on a company's common equity for a given period.

See Return on Invested Capital and Return on Equity.

Return on Invested Capital—the amount, expressed as a percentage, earned on a company's total capital for a given period.

is not available in the market on an investment free of default risk.

cost: Premium—a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb—a mathematical formula developed from the relationship between price and certain variables based on experience observation, hearsay, or a combination of these;

own.

Standard of Value—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Sustaining Capital Reinvestment—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value—See **Residual Value**.

Transaction Method—See **Merger and Acquisition Method**.

Unlevered Beta—the beta reflecting a capital structure without debt.

Unsystematic Risk—the risk specific to an individual security that can be avoided through diversification.

Valuation—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

Valuation Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method—within approaches, a specific way to determine value.

Valuation Procedure—the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Value to the Owner—see **Investment Value**.

Voting Control—*de jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC)—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

Appendix C

Glossary of Additional Terms

assumptions and underlying conditions. A valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

business ownership interest. A designated share in the ownership of a business (business enterprise).

calculated value. An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

calculation engagement. An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

capital or contributory asset charge. A fair return on an entity's *contributory* assets, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

capitalization of benefits method. A method within the income approach whereby expected future benefits (for example, earnings or cash flow) for a representative single period are converted to value through division by a capitalization rate.

comparable profits method. A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

comparable uncontrolled transaction method. A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

conclusion of value. An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.

control adjustment. A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners'

tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

excess operating assets. Operating assets in excess of those needed for the normal operation of a business.

fair value. In valuation applications, there are two commonly used definitions for fair value:

- (1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board *Accounting Standards Codification* glossary.
- (2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

guideline company transactions method. A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

hypothetical condition. That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

incremental income. Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income* or *cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

normalization. See *Normalized Earnings* in appendix B, "International Glossary of Business Valuation Terms." (see paragraph .81).

pre-adjustment value. The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

profit split income. With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income* or *cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

relief from royalty method. A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use.

Application of this method initially involves estimating the fair market value of the assets.

the owner of the intangible asset is exercising the right of ownership.

residual income. For an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after subtracting a capital charge on all of the entity's tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

security. A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

subject interest. A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

subsequent event. An event that occurs subsequent to the valuation date.

valuation analyst. For purposes of this statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

valuation assumptions. Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

valuation engagement. An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

valuation service. See **engagement to estimate value**.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC; Revised, January 2015, to reflect the revised Code of Professional Conduct.]

Footnotes (VS Section 100 — Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset):

¹ This statement includes two glossaries. Appendix B, "International Glossary of Business Valuation Terms" (par. .81), is a verbatim reproduction of the glossary jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers. Appendix C, "Glossary of Additional Terms" (par. .82), provides definitions for terms included in this statement but not defined in the jointly developed glossary. The terms defined in appendix B are in boldface type the first time they appear in this statement; the

third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1, "Scope of Applicable Services" (VS sec. 9100 par. .01–.89), and Statement for Standards on Tax Services No. 4, *Use of Estimates* (TS sec. 400).

¹⁰ Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at www.aicpa.org/InterestAreas/ForensicAndValuation/Membership/DownloadableDocuments/Int%20Glossary%20of%20BV%20Terms.pdf. Note that the phrase, "we discourage the use of this term," that appears herein is also reproduced verbatim.

VS Section 9100

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100

1. Scope of Applicable Services

Background

.01

The Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* [VS section 100] establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPAs continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

General Interpretation

.02

The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraphs 1 and 2 [VS section 100.01–.02]). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVS No. 1, paragraph 4 [VS section 100.04].

In determining whether a particular service is excluded, consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS No. 1, paragraph 5 [VS section 100.05])
- Use of values provided by the client or a third party (SSVS No. 1, paragraph 6 [VS section 100.06])
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS No. 1, paragraph 7 [VS section 100.07])
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an engagement to estimate value (SSVS No. 1, paragraph 8 [VS section 100.08])
- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS No. 1, paragraph 9(a) [VS section 100.09a])
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS No. 1, paragraph 9(b) [VS section 100.09b])
- Engagements meeting the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10])

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A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the clients needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

Specific Illustrations

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The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

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Conclusion. No, unless the computations are undertaken as part of an engagement to estimate value (SSVS No. 1, paragraphs 1, 2, and 8 [VS section 100.01, .02, and .08]).

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Illustration 2. Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

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Conclusion. The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (*Illustration 1*).

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Illustration 3. If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

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Conclusion. There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

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Illustration 4. Does the Statement include any exceptions relating to litigation or controversy proceedings?

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Conclusion. Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50]); however, there is no litigation or controversy

value is performed (*Illustration 1*).

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Illustration 5. Is the Statements reporting exemption for litigation or controversy proceedings (see SSVS No. 1, paragraph 50 [VS section 100.50]) the same as the "litigation exemption" in the AICPA attestation standards?

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Conclusion. No, the so-called "litigation exemption" is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner "has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party." (Interpretation No. 3, "Applicability of Attestation Standards to Litigation Services," of Chapter 1, "Attest Engagements," of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AT section 9101.34–.42]. However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statements exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]).

Illustrations Relating to Tax Engagements

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Illustration 6. When does the Statement apply to members who determine values related to tax reporting and planning engagements?

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Conclusion. The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). The application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

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required to be issued? To whom are those reports required to be provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

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Conclusion. The Statement requires the preparation of a written or oral valuation report (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]) that is communicated to the client (SSVS No. 1, paragraph 47 [VS section 100.47]) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS No. 1, paragraph 10 [VS section 100.10] and *Illustration 18*). There is also a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50] and *Illustration 4*).

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Illustration 8. Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

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Conclusion. Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS No. 1, paragraph 9(a) [VS section 100.09a]).

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Examples of services that do not rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS No. 1, paragraph . [VS section 100.06]); and (d) calculating cash "hold back" requirements for tax contingencies (SSVS No. 1, paragraphs 4 and 9(a) [VS section 100.01, .04, and .09a]).

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Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, or other contractual or market restrictions such that valuation approaches and methods are applied, and professional judgment is used to determine the fair value, fair market value, or other

market value of assets in a business to estimate application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

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Illustration 9. Does the "jurisdictional exception" (SSVS No. 1, paragraph 10 [VS section 100.10]) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

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Conclusion. No, the "jurisdictional exception" would not exempt the engagement from this Statement, even if the engagements sole purpose was to value a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

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Illustration 10. Is an interest in a publicly traded partnership whose shares are frequently traded considered a "security" under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a "security" under the Statement?

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Conclusion. Whether interest constitutes a "security" is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS No. 1, paragraphs 1 and 9(a) [VS section 100.01 and .09a]). An interest in a nonpublicly traded partnership, such as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS No. 1, paragraphs 1, 4, [VS section 100.01 and .04], and *Illustration 6*), unless the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b] applies (*Illustration 13e*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

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Conclusion. It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS No. 1, paragraph 1, [VS section 100.01] and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS No. 1, paragraph 9(b), [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the "estimated estate tax" or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statements on Standards for Tax Services [TSS sections 100–900] (*Illustration 10* at paragraph .27 of this Interpretation).

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Illustration 12. There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

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Illustration 12a. A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?

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Conclusion. This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]). This example is a debt-service analysis.

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Illustration 12b. There are compliance filings that require an estimate of the value of a company. For example, the "market value" of "intangible personal property," as defined by a states taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return: Is this a valuation engagement subject to the Statement?

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Conclusion. It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06]). In addition, the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS No. 1, paragraph 4 [VS section 100.04]).

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Illustration 12c. There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

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Conclusion. It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply

1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets' relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

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Illustration 12d. If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

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Conclusion. Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS No. 1, paragraphs 1–4 and 9(a) [VS section 100.01–.04 and .09a]).

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Illustration 12a. Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

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Conclusion. It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

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Illustration 12f. In circumstances in which the value of assets of a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

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Conclusion. It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06], and *Illustration 6*).

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Illustration 12g. A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

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Conclusion. No, none of the assets constitutes a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

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Illustration 12h. A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

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Conclusion. It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the

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Illustration 13. An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, "TI Corporation," whose shares are infrequently traded; (b) a large block of stock in "LB Corporation," a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) "CHB Corporation," a closely held business owned by the decedent and the decedent's family; and (e) a 5 percent interest in "RP," a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

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Illustration 13a. Does the Statement apply to shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently?

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Conclusion. It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS No. 1, paragraph 9(a) [VS section 100.09a]). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]) (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

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Illustration 13b. Does the Statement apply to a large block of stock in "LB Corporation," a publicly

Conclusion. The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate's stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company's shares. In such a case, the quoted market price of a share times the number of shares held by the estate may be considered to reflect the fair market value of the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

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Illustration 13c. Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

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Conclusion. The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs .49 and .51 of this Interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

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Illustration 13d. Does the Statement apply to "CHB Corporation," a closely held business owned by the decedent and the decedent's family?

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Conclusion. The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used

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Illustration 13e. Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

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Conclusion. The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP's general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member's requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS No. 1, paragraph 9(b) [VS section 100.09b]).

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Illustration 14. Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

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Conclusion. The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300], in providing appropriate due diligence with respect to the values provided to the member. It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

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Illustration 15. Would the answers to *Illustration 13* change if the values were provided by an outside

Conclusion. If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]; SSVS No. 1, paragraph 20, "Using the Work of Specialists in the Valuation Engagement," [VS section 100.20]). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300] in providing appropriate due diligence with respect to the values provided.

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Illustration 16. The client and the member agree that the member will value a partnership interest and then apply an "average" discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

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Conclusion. Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS No. 1, paragraph 21(b) [VS section 100.21b] and *Illustration 6*).

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Illustration 17. Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

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Conclusion. No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

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Conclusion. No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS No. 1, paragraph 1 [VS section 100.01] and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the IRS regulations require that the taxpayer reasonably calculate an arm's-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement, the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10]) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS No. 1, paragraphs 25–48 [VS section 100.25–.48]). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS No. 1, paragraphs 50–78 [VS section 100.50–.78]) and thus a valuation report would not be necessary.

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Illustration 19. In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTSs) [TS sections 100–900]?

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Conclusion. Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SSTS No. 1, *Tax Return Positions*, [TS section 100], for that valuation.

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Illustration 21. Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

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Conclusion. No, settlements of negotiations of value in exchange for a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS No. 1, paragraph 50 [VS section 100.50]).

Illustrations Relating to Other Engagements

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Illustration 20. Does determining the value of accounts receivable fall under the Statement?

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Conclusion. No, accounts receivable constitute **tangible assets** under the Statement (SSVS No. 1, Appendix B [VS section 100.81], and do not constitute a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

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Illustration 22. In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]?

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Conclusion. No, Chapter 1, "Attest Engagements," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended [AT section 101.01] states that the attestation standards apply when a practitioner is "engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party." If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs [AT sections 20–701] do not apply (SSARS 14 [AR section 120]).

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Illustration 23. Under a valuation engagement, a valuation analyst is free to select any and all

approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS No. 1, paragraph 21 [VS section 100.21]) Under SSVS No. 1, paragraph 18 [VS section 100.18], a restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

.77

Conclusion. Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

.78

Illustration 24. If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

.79

Conclusion. Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

.30

Illustration 25. Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

.31

Conclusion. No, SSVS No. 1, paragraph 7 [VS section 100.07] exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not

These illustrations assume the member has not been engaged to perform a business valuation.

.82

Illustration 26. When does the Statement apply to members who determine values related to personal financial planning engagements?

.83

Conclusion. The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

.84

Illustration 27. If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

.85

Conclusion. No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

.86

Illustration 28. A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

.87

Conclusion:

(a) If, in the process of determining the current value from which the member estimates future

industry knowledge with the client instead of applying professional judgment.

(b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

(c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

.88

Illustration 29. The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?

.89

Conclusion. No, the Statement does not apply because the member did not use professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.

Rev. Rul. 59-60, 1959-1 CB 237 -- IRC Sec. 2031 (Also Section 2512.) (Also Part II, Sections 811(k), 1005, Regulations 105, Section 81.10.)

Reference(s): Code Sec. 2031 Reg § 20.2031-2

In valuing the stock of closely held corporations, or the stock of corporations where market quotations are not available, all other available financial data, as well as all relevant factors affecting the fair market value must be considered for estate tax and gift tax purposes. No general formula may be given that is applicable to the many different valuation situations arising in the valuation of such stock. However, the general approach, methods, and factors which must be considered in valuing such securities are outlined.

Revenue Ruling 54-77, C.B. 1954-1, 187, superseded.

Full Text:

Section 1. Purpose.

The purpose of this Revenue Ruling is to outline and review in general the approach, methods and factors to be considered in valuing shares of the capital stock of closely held corporations for estate tax and gift tax purposes. The methods discussed herein will apply likewise to the valuation of corporate stocks on which market quotations are either unavailable or are of such scarcity that they do not reflect the fair market value.

Sec. 2. Background and Definitions.

.01 All valuations must be made in accordance with the applicable provisions of the Internal Revenue Code of 1954 and the Federal Estate Tax and Gift Tax Regulations. Sections 2031(a), 2032 and 2512(a) of the 1954 Code (sections 811 and 1005 of the 1939 Code) require that the property to be included in the gross estate, or made the subject of a gift, shall be taxed on the basis of the value of the property at the time of death of the decedent, the alternate date if so elected, or the date of gift.

.02 Section 20.2031-1(b) of the Estate Tax Regulations (section 81.10 of the Estate Tax Regulations 105) and section 25.2512-1 of the Gift Tax Regulations (section 86.19 of Gift Tax Regulations 108) define fair market value, in effect, as the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

.03 Closely held corporations are those corporations the shares of which are owned by a relatively limited number of stockholders. Often the entire stock issue is held by one family. The result of this situation is that little, if any, trading in the shares takes place. There is, therefore, no established market for the stock and such sales as occur at irregular intervals seldom reflect all of the elements of a representative transaction as defined by the term "fair market value."

Sec. 3. Approach to Valuation.

.01 A determination of fair market value, being a question of fact, will depend upon the circumstances in each case. No formula can be devised that will be generally applicable to the multitude of different valuation issues arising in estate and gift tax cases. Often, an appraiser will find wide differences of opinion as to the fair market value of a particular stock. In resolving such differences he should maintain a

reasonable attitude in recognition of the fact that valuation is not an exact science. A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance.

.02 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.

.03 Valuation of securities is, in essence, a prophecy as to the future and must be based on facts available at the required date of appraisal. As a generalization, the prices of stocks which are traded in a free and active market by informed persons best reflect the consensus of the investing public as to what the future holds for the corporations and industries represented. When a stock is closely held, is traded infrequently, or is traded in an erratic market, some other measure of value must be used. In many instances, the next best measure may be found in the prices at which the stocks of companies engaged in the same or a similar line of business are selling in a free and open market.

Sec. 4. Factors To Consider.

.01 It is advisable to emphasize that in the valuation of the stock of closely held corporations or the stock of corporations where market quotations are either lacking or too scarce to be recognized, all available financial data, as well as all relevant factors affecting the fair market value, should be considered. The following factors, although not all-inclusive are fundamental and require careful analysis in each case:

- (a) The nature of the business and the history of the enterprise from its inception.
- (b) The economic outlook in general and the condition and outlook of the specific industry in particular.
- (c) The book value of the stock and the financial condition of the business.
- (d) The earning capacity of the company.
- (e) The dividend-paying capacity.
- (f) Whether or not the enterprise has goodwill or other intangible value.
- (g) Sales of the stock and the size of the block of stock to be valued.
- (h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.

.02 The following is a brief discussion of each of the foregoing factors:

- (a) The history of a corporate enterprise will show its past stability or instability, its growth or lack of growth, the diversity or lack of diversity of its operations, and other facts needed to form an opinion of the degree of risk involved in the business. For an enterprise which changed its form of organization but carried on the same or closely similar operations of its predecessor, the history of the former enterprise should be considered. The detail to be considered should increase with approach to the required date of

appraisal, since recent events are of greatest help in predicting the future; but a study of gross and net income, and of dividends covering a long prior period, is highly desirable. The history to be studied should include, but need not be limited to, the nature of the business, its products or services, its operating and investment assets, capital structure, plant facilities, sales records and management, all of which should be considered as of the date of the appraisal, with due regard for recent significant changes. Events of the past that are unlikely to recur in the future should be discounted, since value has a close relation to future expectancy.

(b) A sound appraisal of a closely held stock must consider current and prospective economic conditions as of the date of appraisal, both in the national economy and in the industry or industries with which the corporation is allied. It is important to know that the company is more or less successful than its competitors in the same industry, or that it is maintaining a stable position with respect to competitors. Equal or even greater significance may attach to the ability of the industry with which the company is allied to compete with other industries. Prospective competition which has not been a factor in prior years should be given careful attention. For example, high profits due to the novelty of its product and the lack of competition often lead to increasing competition. The public's appraisal of the future prospects of competitive industries or of competitors within an industry may be indicated by price trends in the markets for commodities and for securities. The loss of the manager of a so-called "one-man" business may have a depressing effect upon the value of the stock of such business, particularly if there is a lack of trained personnel capable of succeeding to the management of the enterprise. In valuing the stock of this type of business, therefore, the effect of the loss of the manager on the future expectancy of the business, and the absence of management-succession potentialities are pertinent factors to be taken into consideration. On the other hand, there may be factors which offset, in whole or in part, the loss of the manager's services. For instance, the nature of the business and of its assets may be such that they will not be impaired by the loss of the manager. Furthermore, the loss may be adequately covered by life insurance, or competent management might be employed on the basis of the consideration paid for the former manager's services. These, or other offsetting factors, if found to exist, should be carefully weighed against the loss of the manager's services in valuing the stock of the enterprise.

(c) Balance sheets should be obtained, preferably in the form of comparative annual statements for two or more years immediately preceding the date of appraisal, together with a balance sheet at the end of the month preceding that date, if corporate accounting will permit. Any balance sheet descriptions that are not self-explanatory, and balance sheet items comprehending diverse assets or liabilities, should be clarified in essential detail by supporting supplemental schedules. These statements usually will disclose to the appraiser (1) liquid position (ratio of current assets to current liabilities); (2) gross and net book value of principal classes of fixed assets; (3) working capital; (4) long-term indebtedness; (5) capital structure; and (6) net worth. Consideration also should be given to any assets not essential to the operation of the business, such as investments in securities, real estate, etc. In general, such nonoperating assets will command a lower rate of return than do the operating assets, although in exceptional cases the reverse may be true. In computing the book value per share of stock, assets of the investment type should be revalued on the basis of their market price and the book value adjusted accordingly. Comparison of the company's balance sheets over several years may reveal, among other facts, such developments as the acquisition of additional production facilities or subsidiary companies, improvement in financial position, and details as to recapitalizations and other changes in the capital structure of the corporation. If the corporation has more than one class of stock outstanding, the charter or certificate of incorporation should be examined to ascertain the explicit rights and privileges of the various stock issues including: (1) voting powers, (2) preference as to dividends, and (3) preference as to assets in the event of liquidation.

(d) Detailed profit-and-loss statements should be obtained and considered for a representative period immediately prior to the required date of appraisal, preferably five or more years. Such statements should show (1) gross income by principal items; (2) principal deductions from gross income including major prior items of operating expenses, interest and other expense on each item of long-term debt, depreciation and depletion if such deductions are made, officers' salaries, in total if they appear to be reasonable or in detail if they seem to be excessive, contributions (whether or not deductible for tax purposes) that the nature of its business and its community position require the corporation to make, and taxes by principal items.

including income and excess profits taxes; (3) net income available for dividends; (4) rates and amounts of dividends paid on each class of stock; (5) remaining amount carried to surplus; and (6) adjustments to, and reconciliation with, surplus as stated on the balance sheet. With profit and loss statements of this character available, the appraiser should be able to separate recurrent from nonrecurrent items of income and expense, to distinguish between operating income and investment income, and to ascertain whether or not any line of business in which the company is engaged is operated consistently at a loss and might be abandoned with benefit to the company. The percentage of earnings retained for business expansion should be noted when dividend-paying capacity is considered. Potential future income is a major factor in many valuations of closely-held stocks, and all information concerning past income which will be helpful in predicting the future should be secured. Prior earnings records usually are the most reliable guide as to the future expectancy, but resort to arbitrary five-or-ten-year averages without regard to current trends or future prospects will not produce a realistic valuation. If, for instance, a record of progressively increasing or decreasing net income is found, then greater weight may be accorded the most recent years' profits in estimating earning power. It will be helpful, in judging risk and the extent to which a business is a marginal operator, to consider deductions from income and net income in terms of percentage of sales. Major categories of cost and expense to be so analyzed include the consumption of raw materials and supplies in the case of manufacturers, processors and fabricators; the cost of purchased merchandise in the case of merchants; utility services; insurance; taxes; depletion or depreciation; and interest.

(e) Primary consideration should be given to the dividend-paying capacity of the company rather than to dividends actually paid in the past. Recognition must be given to the necessity of retaining a reasonable portion of profits in a company to meet competition. Dividend-paying capacity is a factor that must be considered in an appraisal, but dividends actually paid in the past may not have any relation to dividend-paying capacity. Specifically, the dividends paid by a closely held family company may be measured by the income needs of the stockholders or by their desire to avoid taxes on dividend receipts, instead of by the ability of the company to pay dividends. Where an actual or effective controlling interest in a corporation is to be valued, the dividend factor is not a material element, since the payment of such dividends is discretionary with the controlling stockholders. The individual or group in control can substitute salaries and bonuses for dividends, thus reducing net income and understating the dividend-paying capacity of the company. It follows, therefore, that dividends are less reliable criteria of fair market value than other applicable factors.

(f) In the final analysis, goodwill is based upon earning capacity. The presence of goodwill and its value, therefore, rests upon the excess of net earnings over and above a fair return on the net tangible assets. While the element of goodwill may be based primarily on earnings, such factors as the prestige and renown of the business, the ownership of a trade or brand name, and a record of successful operation over a prolonged period in a particular locality, also may furnish support for the inclusion of intangible value. In some instances it may not be possible to make a separate appraisal of the tangible and intangible assets of the business. The enterprise has a value as an entity. Whatever intangible value there is, which is supportable by the facts, may be measured by the amount by which the appraised value of the tangible assets exceeds the net book value of such assets.

(g) Sales of stock of a closely held corporation should be carefully investigated to determine whether they represent transactions at arm's length. Forced or distress sales do not ordinarily reflect fair market value nor do isolated sales in small amounts necessarily control as the measure of value. This is especially true in the valuation of a controlling interest in a corporation. Since, in the case of closely held stocks, no prevailing market prices are available, there is no basis for making an adjustment for blockage. It follows, therefore, that such stocks should be valued upon a consideration of all the evidence affecting the fair market value. The size of the block of stock itself is a relevant factor to be considered. Although it is true that a minority interest in an unlisted corporation's stock is more difficult to sell than a similar block of listed stock, it is equally true that control of a corporation, either actual or in effect, representing as it does an added element of value, may justify a higher value for a specific block of stock.

(h) Section 2031(b) of the Code states, in effect, that in valuing unlisted securities the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange

should be taken into consideration along with all other factors. An important consideration is that the corporations to be used for comparisons have capital stocks which are actively traded by the public. In accordance with section 2031(b) of the Code, stocks listed on an exchange are to be considered first. However, if sufficient comparable companies whose stocks are listed on an exchange cannot be found, other comparable companies which have stocks actively traded in the over-the-counter market also may be used. The essential factor is that whether the stocks are sold on an exchange or over-the-counter there is evidence of an active, free public market for the stock as of the valuation date. In selecting corporations for comparative purposes, care should be taken to use only comparable companies. Although the only restrictive requirement as to comparable corporations specified in the statute is that their lines of business be the same or similar, yet it is obvious that consideration must be given to other relevant factors in order that the most valid comparison possible will be obtained. For illustration, a corporation having one or more issues of preferred stock, bonds or debentures in addition to its common stock should not be considered to be directly comparable to one having only common stock outstanding. In like manner, a company with a declining business and decreasing markets is not comparable to one with a record of current progress and market expansion.

Sec. 5. Weight To Be Accorded Various Factors.

The valuation of closely held corporate stock entails the consideration of all relevant factors as stated in section 4. Depending upon the circumstances in each case, certain factors may carry more weight than others because of the nature of the company's business. To illustrate:

- (a) Earnings may be the most important criterion of value in some cases whereas asset value will receive primary consideration in others. In general, the appraiser will accord primary consideration to earnings when valuing stocks of companies which sell products or services to the public; conversely, in the investment or holding type of company, the appraiser may accord the greatest weight to the assets underlying the security to be valued.
- (b) The value of the stock of a closely held investment or real estate holding company, whether or not family owned, is closely related to the value of the assets underlying the stock. For companies of this type the appraiser should determine the fair market values of the assets of the company. Operating expenses of such a company and the cost of liquidating it, if any, merit consideration when appraising the relative values of the stock and the underlying assets. The market values of the underlying assets give due weight to potential earnings and dividends of the particular items of property underlying the stock, capitalized at rates deemed proper by the investing public at the date of appraisal. A current appraisal by the investing public should be superior to the retrospective opinion of an individual. For these reasons, adjusted net worth should be accorded greater weight in valuing the stock of a closely held investment or real estate holding company, whether or not family owned, than any of the other customary yardsticks of appraisal, such as earnings and dividend paying capacity.

Sec. 6. Capitalization Rates.

In the application of certain fundamental valuation factors, such as earnings and dividends, it is necessary to capitalize the average or current results at some appropriate rate. A determination of the proper capitalization rate presents one of the most difficult problems in valuation. That there is no ready or simple solution will become apparent by a cursory check of the rates of return and dividend yields in terms of the selling prices of corporate shares listed on the major exchanges of the country. Wide variations will be found even for companies in the same industry. Moreover, the ratio will fluctuate from year to year depending upon economic conditions. Thus, no standard tables of capitalization rates applicable to closely held corporations can be formulated. Among the more important factors to be taken into consideration in deciding upon a capitalization rate in a particular case are: (1) the nature of the business; (2) the risk involved; and (3) the stability or irregularity of earnings.

Sec. 7. Average of Factors.

Because valuations cannot be made on the basis of a prescribed formula, there is no means whereby the various applicable factors in a particular case can be assigned mathematical weights in deriving the fair market value. For this reason, no useful purpose is served by taking an average of several factors (for example, book value, capitalized earnings and capitalized dividends) and basing the valuation on the result. Such a process excludes active consideration of other pertinent factors, and the end result cannot be supported by a realistic application of the significant facts in the case except by mere chance.

Sec. 8. Restrictive Agreements.

Frequently, in the valuation of closely held stock for estate and gift tax purposes, it will be found that the stock is subject to an agreement restricting its sale or transfer. Where shares of stock were acquired by a decedent subject to an option reserved by the issuing corporation to repurchase at a certain price, the option price is usually accepted as the fair market value for estate tax purposes. See Rev. Rul. 54-76, C.B. 1954-1, 194. However, in such case the option price is not determinative of fair market value for gift tax purposes. Where the option, or buy and sell agreement, is the result of voluntary action by the stockholders and is binding during the life as well as at the death of the stockholders, such agreement may or may not, depending upon the circumstances of each case, fix the value for estate tax purposes. However, such agreement is a factor to be considered, with other relevant factors, in determining fair market value. Where a stockholder is free to dispose of his shares during life and the option is to become effective only upon his death, the fair market value is not limited to the option price. It is always necessary to consider the relationship of the parties, the relative number of shares held by the decedent, and other material facts, to determine whether the agreement represents a bona fide business arrangement or is a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth. In this connection see Rev. Rul. 157 C.B. 1953-2, 255, and Rev. Rul. 189, C.B. 1953-2, 294.

Sec. 9. Effect on Other Documents.

Revenue Ruling 54-77, C.B. 1954-1, 187, is hereby superseded.



About The International Valuation Standards Council (IVSC)

The IVSC is an independent, not-for-profit, private sector organisation.

The objectives of the IVSC are to strengthen the worldwide valuation profession by:

- Developing high quality international standards and supporting their adoption and use;
- Facilitating collaboration and cooperation among its member organisations;
- Collaborating and cooperating with other international organisations; and
- Serving as the international voice for the valuation profession

In pursuit of these objectives the IVSC places paramount importance on protecting the public interest.

The IVSC Today

The IVSC is a not for profit organisation incorporated in the USA, with its operational headquarters in London. This organisation is mainly funded through membership subscriptions and sponsorship by valuation professional bodies, valuation providers and valuation users;

The organisation has three main bodies:

- a Board of Trustees responsible for the strategic direction and funding of the IVSC and for appointments to the Standards Board and Professional Board;
- a Standards Board with autonomy over its agenda and the creation and revision of valuation standards and supporting technical guidance;
- a Professional Board to promote the development of the profession around the world.

The IVSC is a membership organisation and is open to a wide range of stakeholders including professional institutes, valuation providers, standard setters, regulators of valuation services and academia. Members are provided with a forum for participation in the work of the IVSC which can advise the Boards on agenda priorities. The IVSC currently has 74 member bodies from 54 countries.

A number of leading global organisations share the belief that raising standards of international valuation practice benefits the capital markets, contributes to the growth of strong economies around the world and leads to improved confidence of investors and users of valuation services. These organisations provide financial sponsorship to the IVSC. A list of the IVSC's current sponsors can be found under "Associated Documents".

A Short History of the IVSC

Discussions between representatives of the UK and US valuation profession in the late 1970s led to the founding of the International Assets Valuation Standards Committee (IAVSC) in 1991. The Committee changed its name in 1994 to the International Valuation Standards Committee (IVSC). The Committee, which was founded with a membership of twenty organisations, had grown by 2007 to include member organisations from more than fifty countries.

As demand increased for valuation standards in different sectors and markets, it had become clear to the IVSC that its constitution and structure no longer could provide it with the legitimacy or resources required to meet these new challenges. In January 2007 the IVSC published proposals for a radical restructuring to transform the IVSC from a committee of representatives of its member valuation organisations into an independent body.

These proposals were accepted by the membership and following an interim period in which the new

Bases of Value Skeleton Outline

IVS Framework

Valuation and Judgement

Independence and Objectivity

Competence

Price, Cost and Value

Basis of Value / Standard of Value

1. A basis of value (sometimes called a standard of value) is a statement of the fundamental measurement assumptions of a valuation. A basis of value describes the nature of any value estimate. It is critical for any valuation to be performed using the basis of value that is appropriate to the purpose of the valuation, as a standard of value may influence or dictate an appraiser's selection of methods, inputs, and assumptions.

2. There are many different bases of value used in valuations, but they generally have certain common elements:

- a. Assumed Transaction
 - i. Hypothetical or actual transaction.....
 - ii. Purchase / sale / both
 - iii. May define a market for the transaction:
- b. Parties to Transaction
 - i. Hypothetical or real
 - ii. General or specific
 - iii. Motivations / duress
 - iv. Knowledge level

3. Definition Examples (Start with most international, move to more specific/local)

- a. Definitions from Prior IVS issuance (for Real Estate Valuation) The IVSC also believes the following are reasonable bases of value for appraisers to use when there is no specific basis of value required for the purpose of the valuation:
 1. Market Value
 2. Market Rent
 3. Fair Value (To refer to definitions shown below)
 4. Investment Value/Worth
 5. Synergistic Value
- b. Fair Value (IFRS and GAAP)

- i. For financial reporting purposes, over 130 countries require or permit the use of International Accounting Standards published by the International Accounting Standards Board (IASB).
- ii. IFRS 13 - The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- iii. The Financial Accounting Standards Board (FASB) in the United States uses the same definition of Fair Value (ASC 820)
- c. Fair Market Value (Organization for Economic Co-operation and Development)
 - i. The OECD, based in Paris, France, is made up of 34 member countries and has a mission to promote policies that will improve the economic and social well-being of people around the world.
 - ii. OECD Glossary: The price a willing buyer would pay a willing seller in a transaction on the open market².
- d. Fair Market Value (United States IRS)
 - i. Regulation §20.2031-1. "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."
- e. Fair Market Value (United States Department of Labor)
 - i. Insert "Proposed Regulation Relating to the Definition of Adequate Consideration" definition
- f. Fair Value (litigation)
 - i. Varies by jurisdiction but typically considers fairness of a transaction to two identified parties taking into account the respective advantages and disadvantages that each will gain from the transaction.
4. The Market (move existing section in IVS Framework under Basis of Value section and edit as necessary)
5. Market Participants (move existing section in IVS Framework under Basis of Value section and edit as necessary)
6. Entity Specific Factors (move existing section in IVS Framework under Basis of Value section and edit as necessary)
 3. Add discussion of which commonly-used bases of value would consider entity specific factors and which would not
7. Synergies (move existing section in IVS Framework under Basis of Value section and edit as necessary)
 3. Add discussion of which commonly-used bases of value would consider entity specific factors and which would not
8. Forced Sales (move existing section in IVS Framework under Basis of Value section and edit as necessary)

² <http://www.oecd.org/dataoecd/1/1/2006246.pdf>
³ <http://www.irs.gov/efile/faq-fair-market-value>

- a. Add discussion of which commonly-used bases of value would consider entity specific factors and which would not
- 9. Assumptions (move existing section in IVS Framework under Basis of Value section and edit as necessary)
- 10. Hypothetical Conditions / Special Value

Valuation Approaches

Market Approach

Income Approach

Cost Approach

Methods of Application

Valuation Inputs

Appendix: Examples

Basis for Conclusions

Appraising Machinery & Equipment: Levels of Trade

1105 4th Avenue,

Every different kind of equipment appraiser has been asked this question ---- 'I've got some equipment that I need to have appraised. I how much will it cost?' And every certified equipment appraiser should answer that question by asking for more information, because not only does the cost of an equipment appraisal depend on the location, volume and type equipment to be appraised, but just as importantly, always on what kind of appraisal is needed.

As we all know, the reasons for an equipment appraisal can be varied and multiple. Will the appraisal be used for collateral values in a loan, in an attempt to settle a loss claim with an insurance company, or to resolve a family law matter? Or will the equipment appraisal be used for due diligence, a tax appeal or charitable donation tax deduction?

The reason for the equipment appraisal points directly at the premise of value, or levels of trade, that will be most appropriate for that appraisal.

Because machinery and equipment appraisers deal with assets that, unlike real estate, can often be moved or sold in many different markets, or trade levels, the determination of level of trade is an important consideration in the machinery and equipment appraisal industry. Depending on the market, or the probable future use, equipment and machinery can have very different values. Consider the difference between the value of manufacturing equipment, for instance, sold for continued use in place at the plant, and that same equipment parcelled out and hauled away. In determining the level of trade for a particular equipment appraisal, then, we are determining the basic market place that one is presuming in the valuation, which guides the appraisal's bottom-line.

→ before an accredited equipment appraiser will quote a price for appraising equipment for agriculture, manufacturing, construction, factory or rolling stock — the equipment appraiser needs answers to these 2 questions.

What is the purpose of the appraisal? Or more directly put by our good friend Robert L. Kelly, "What are you going to do with it?" A clear answer to this first question leads directly to the next question:

Given the purpose of the equipment appraisal, which level of trade, or premise of value, will best meet the needs of the purpose of this appraisal?

Uniform standards or professional appraisal education for appraisers is critical in preparing an understandable and useful definition of value used in the equipment appraisal report is not just a good idea for compliance with USPAP, it is critical in preparing an understandable and useful equipment appraisal report.

We'll talk more about levels of trade in future posts. If you have any questions in the meantime, I hope you'll comment or tweet!

2004年10月26日
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Equipment Appraisal In Northern California

Jack Young, ASA, CPA

Jack Young is an Accredited Senior Appraiser (ASA) of the American Society of Appraisers specializing in machinery and equipment. He is a Certified Public Accountant and has a Master Personal Property Appraiser (MPPA) designation from the National Auctioneers Association. Jack serves as an Officer of the Northern California Chapter of the American Society of Appraisers. He values equipment and machinery throughout Northern California and beyond, including business assets, heavy equipment appraisal, farm equipment appraisal, construction equipment appraisal, medical equipment appraisal, restaurant equipment appraisal, retail equipment appraisal, factory equipment appraisal, trucking equipment appraisal, tolling stock appraisal, manufacturing plant equipment appraisal, mining and aggregate equipment, and small aircraft. NorCal Valuation Inc. provides qualified expert equipment appraisals for estate purposes, asset verification, collateralized lending, legal matters such as loss claim appraisals and expert witness testimony, business combination, buy/sell and due diligence appraisal, financial reporting valuation (SFAS 141R, SFAS 142, SFAS 144, SFAS 157) and family law matters. Whatever your equipment appraisal needs, call 530-795-5536 for consulting services and for an ASA USPAP equipment appraisal with the most appropriate appraisal approach for your specific appraisal needs.

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What's so Fair about Fair Market Value Equipment Appraisals?

February 26, 2014

Fair Market Value
In opinion expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, as of a specific date.

When you think about "Fair Market Value" in equipment appraisal reports, what do you think the "fair" part means? We had this discussion not long ago at an appraisal report writing class regarding the new USPAP regulations and the consensus was that the "fair" part of "fair market value" is redundant. Market Value, by definition, is impartial, honest and legitimate. Equipment appraisers, along with any one who sells, buys, insures equipment, or makes collateral loans based upon equipment value, make this assumption over and over again when going to the market to investigate values.

In fact, when we appraise equipment in the state of California, we insert specific language citing the "fairness" of the market recording the impact of CARB compliance on equipment valuation, stating that "all indications support the conclusion that the current market has, in fact, assimilated the economic obsolescence information regarding the CARB RRP."

Whether you and your equipment appraiser choose to use the streamlined term Market Value or the traditional Fair Market Value is a question of semantics. The definition of value is the definition of value. The definition of value is the definition of value.

reliable source, such as the appropriate ASA Discipline or the IRS.

Market Value for equipment valuations, according to the ASA MILS definition, is

In opinion expressed in terms of money, at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts, as of a specific date.

Pretty straightforward, yes? In some cases, you or your equipment appraiser may decide to hone in on Market Value by using one of the other 4 market value definitions available for specific circumstances, such as Market Value Installed or Market Value Removed, but as you might imagine, these are only necessary for situations such as factories, manufacturing lines, commercial kitchens, food processing lines or other such equipment scenarios where equipment is actually *installed*. For equipment such as CNC machines, fork lifts, transportation fleets, or other more mobile equipment, the standard Fair Market Value is generally the most appropriate when market value is needed.

For more information on determining when to use market value or other value definitions, search our website for levels of trade, or read our Equipment Appraisals Levels of Trade post.

Jack Young, ASA, CPA
NortVal Valuation Inc.

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STANDARD MEASURES OF VALUE:
TANGIBLE PERSONAL PROPERTY
APPRAISAL GUIDELINES

FLORIDA
DEPARTMENT OF REVENUE

14. INVENTORY

REFERENCE

SECTION 192.001
(11)(c), FLORIDA
STATUTES

DESCRIPTION

INVENTORY. Means only those chattels consisting of items commonly referred to as goods, wares, and merchandise (as well as inventory) which are held for sale or lease to customers in the ordinary course of business. Supplies and raw materials shall be considered to be inventory only to the extent that they are acquired for sale or lease to customers in the ordinary course of business or will physically become a part of merchandise intended for sale or lease to customers in the ordinary course of business. Partially finished products which when completed will be held for sale or lease to customers in the ordinary course of business shall be deemed items of inventory. All livestock shall be considered inventory. Items of inventory held for lease to customers in the ordinary course of business, rather than for sale, shall be deemed inventory only prior to the initial lease of such items. For the purposes of this section, fuels used in the production of electricity shall be considered inventory.

15. JUST VALUE

REFERENCE

FLORIDA ADMINISTRATIVE
CODE (12D-1.002(2)),
F.A.C.)

DESCRIPTION

JUST VALUE - JUST VALUATION, Actual Value and Value. The price at which a property, if offered for sale in the open market, with a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent, under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.

SUPREME COURT OF
FLORIDA, *WALTER V.
SCHULER*, 176 So.2d 81,
85-6 (Fla. 1965)

"that 'fair market value' and 'just valuation' should be declared 'legally synonymous'...in turn, may be established by the classic formula that this is the amount a 'purchaser willing but not obliged to buy, would pay to one willing but not obliged to sell.'"

16. LEASEHOLD

REFERENCE

PROPERTY APPRAISAL
AND ASSESSMENT
ADMINISTRATION,
International
Association of
Assessing Officers,
130 E. Randolph St.,
Suite 850, Chicago,
IL 60601, 1990, p. 649.

DESCRIPTION

LEASEHOLD. The interests in a property that are associated with the lessee (the tenant) as opposed to the lessor (the property owner).

17. LEASEHOLD IMPROVEMENTS

REFERENCE

ASSESSMENT OF
PERSONAL PROPERTY,
International
Association of
Assessing Officers,
130 E. Randolph St.,
Suite 850, Chicago,
IL 60601, 1996, p. A-4.

DESCRIPTION

LEASEHOLD IMPROVEMENTS. Items of personal property such as furniture and fixtures associated with a lessee (the tenant) that have been affixed to the real property owned by the lessor.

BLACK'S LAW
DICTIONARY,
5th Edition,
West Publishing
Co., 1990, p. 890.

LEASEHOLD IMPROVEMENTS. Improvements made by lessee to leased property such as a parking lot or driveway. The term is used in condemnation proceedings to determine the portion of the award to which the lessee is entitled.

18. MARKET VALUE

See JUST VALUE, page 16.

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< Regulations (<http://regulations.vlex.com>)

19 CFR 351.412 - Levels of trade; adjustment for difference in level of trade; constructed export price offset.

Updated to:

April 2013

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Title 19: Customs Duties

CHAPTER III: INTERNATIONAL TRADE
ADMINISTRATION, DEPARTMENT OF COMMERCE

PART 351: ANTIDUMPING AND COUNTERVAILING
DUTIES

Subpart D: Calculation of Export Price, Constructed Export
Price, Fair Value, and Normal Value

351.412 - Levels of trade; adjustment for difference in level of
trade; constructed export price offset.

(a) Introduction. In comparing United States sales with
foreign market sales, the Secretary may determine that sales
in the two markets were not made at the same level of trade,
and that the difference has an effect on the comparability of
the prices. The Secretary is authorized to adjust normal value to account for such a difference. (See section 773
(3)(7) of the Act.)

(b) Adjustment for difference in level of trade. The Secretary will adjust normal value for a difference in level of
trade if:

- (1) The Secretary calculates normal value at a different level of trade from the level of trade of the export price or
the constructed export price (whichever is applicable); and
- (2) The Secretary determines that the difference in level of trade has an effect on price comparability.

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Chapter III. International Trade Administration, Department of Commerce

Part 351. Antidumping and Countervailing Duties (Refs & Annos)

Subpart D. Calculation of Export Price, Constructed Export Price, Fair Value, and Normal Value

19 C.F.R. § 351.412

§ 351.412 Levels of trade; adjustment for difference in level of trade; constructed export price offset.

Currentness

(a) Introduction. In comparing United States sales with foreign market sales, the Secretary may determine that sales in the two markets were not made at the same level of trade, and that the difference has an effect on the comparability of the prices. The Secretary is authorized to adjust normal value to account for such a difference. (See section 773(a)(7) of the Act.)

(b) Adjustment for difference in level of trade. The Secretary will adjust normal value for a difference in level of trade if:

(1) The Secretary calculates normal value at a different level of trade from the level of trade of the export price or the constructed export price (whichever is applicable); and

(2) The Secretary determines that the difference in level of trade has an effect on price comparability.

(c) Identifying levels of trade and differences in levels of trade—

(1) Basis for identifying levels of trade. The Secretary will identify the level of trade based on:

(i) In the case of export price, the starting price;

(ii) In the case of constructed export price, the starting price, as adjusted under section 772(d) of the Act; and

(iii) In the case of normal value, the starting price or constructed value.

(2) Differences in levels of trade. The Secretary will determine that sales are made at different levels of trade if they are made at different marketing stages (or their equivalent). Substantial differences in selling activities are a necessary, but not sufficient, condition for determining that there is a difference in the stage of marketing. Some overlap in selling activities will not preclude a determination that two sales are at different stages of marketing.

(d) Effect on price comparability—

11 In general, the Secretary will determine that a difference in level of trade has an effect on price comparability only if it is established to the satisfaction of the Secretary that there is a pattern of consistent price differences between sales in the market in which normal value is determined:

(i) At the level of trade of the export price or constructed export price (whichever is appropriate); and

(ii) At the level of trade at which normal value is determined.

(2) Relevant sales. Where possible, the Secretary will make the determination under paragraph (d)(1) of this section on the basis of sales of the foreign like product by the producer or exporter. Where this is not possible, the Secretary may use sales of different or broader product lines, sales by other companies, or any other reasonable basis.

(e) Amount of adjustment. The Secretary normally will calculate the amount of a level of trade adjustment by:

(1) Calculating the weighted-averages of the prices of sales at the two levels of trade identified in paragraph (d), after making any other adjustments to those prices appropriate under section 773(a)(6) of the Act and this subpart;

(2) Calculating the average of the percentage differences between those weighted-average prices; and

(3) Applying the percentage difference to normal value, where it is at a different level of trade from the export price or constructed export price (whichever is applicable), after making any other adjustments to normal value appropriate under section 773(a)(6) of the Act and this subpart.

(f) Constructed export price offset—

(1) In general. The Secretary will grant a constructed export price offset only where:

(i) Normal value is compared to constructed export price;

(ii) Normal value is determined at a more advanced level of trade than the level of trade of the constructed export price; and

(iii) Despite the fact that a person has cooperated to the best of its ability, the data available do not provide an appropriate basis to determine under paragraph (d) of this section whether the difference in level of trade affects price comparability.

(2) Amount of the offset. The amount of the constructed export price offset will be the amount of indirect selling expenses included in normal value, up to the amount of indirect selling expenses deducted in determining constructed export price. In making the constructed export price offset, "indirect selling expenses" means selling expenses, other than direct selling expenses or assumed selling expenses (see § 351.410), that the seller would include in its normal value.

(3) Where data permit determination of affect on price comparability. Where available data permit the Secretary to determine under paragraph (d) of this section whether the difference in level of trade affects price comparability, the Secretary will not grant a constructed export price offset. In such cases, if the Secretary determines that price comparability has been affected, the Secretary will make a level of trade adjustment. If the Secretary determines that price comparability has not been affected, the Secretary will not grant either a level of trade adjustment or a constructed export price offset.

SOURCE: 62 FR 27379, May 19, 1997; 78 FR 62418, Oct. 22, 2013, unless otherwise noted.

AUTHORITY: 5 U.S.C. 301; 19 U.S.C. 1202 note; 19 U.S.C. 1303 note; 19 U.S.C. 1671 et seq.; and 19 U.S.C. 1538.

Notes of Decisions (98)

Current through Oct. 8, 2015; 80 FR 60808.

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SUMMARY OF STATEMENT NO. 157

FAIR VALUE MEASUREMENTS

Summary

This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice.

Reason for Issuing This Statement

Prior to this Statement, there were different definitions of fair value and limited guidance for applying those definitions in GAAP. Moreover, that guidance was dispersed among the many accounting pronouncements that require fair value measurements. Differences in that guidance created inconsistencies that added to the complexity in applying GAAP. In developing this Statement, the Board considered the need for increased consistency and comparability in fair value measurements and for expanded disclosures about fair value measurements.

Differences between This Statement and Current Practice

The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements.

The definition of fair value retains the exchange price notion in earlier definitions of fair value. This Statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).

This Statement emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, this Statement establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The notion of unobservable inputs is intended to allow for situations in which there is little, if any, market activity for the asset or liability at the measurement date. In those situations, the reporting entity need not undertake all possible efforts

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to obtain information about market participant assumptions, however, the reporting entity must not ignore information about market participant assumptions that is reasonably available without undue cost and effort.

This Statement clarifies that market participant assumptions include assumptions about risk, for example, the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and/or the risk inherent in the inputs to the valuation technique. A fair value measurement should include an adjustment for risk if market participants would include one in pricing the related asset or liability, even if the adjustment is difficult to determine. Therefore, a measurement (for example, a "mark-to-model" measurement) that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one in pricing the related asset or liability.

This Statement clarifies that market participant assumptions also include assumptions about the effect of a restriction on the sale or use of an asset. A fair value measurement for a restricted asset should consider the effect of the restriction if market participants would consider the effect of the restriction in pricing the asset. That guidance applies for stock with restrictions on sale that terminate within one year that is measured at fair value under FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

This Statement clarifies that a fair value measurement for a liability reflects its nonperformance risk (the risk that the obligation will not be fulfilled). Because nonperformance risk includes the reporting entity's credit risk, the reporting entity should consider the effect of its credit risk (credit standing) on the fair value of the liability in all periods in which the liability is measured at fair value under other accounting pronouncements, including FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

This Statement affirms the requirement of other FASB Statements that the fair value of a position in a financial instrument (including a block) that trades in an active market should be measured as the product of the quoted price for the individual instrument times the quantity held (within Level 1 of the fair value hierarchy). The quoted price should not be adjusted because of the size of the position relative to trading volume (blockage factor). This Statement extends that requirement to broker-dealers and investment companies within the scope of the AICPA Audit and Accounting Guides for those industries.

This Statement expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value and for recurring fair value measurements using significant unobservable inputs (within Level 3 of the fair value hierarchy), the effect of the measurements on earnings (or changes in net assets) for the period. This Statement encourages entities to combine the fair value information disclosed under this Statement with the fair value information disclosed under other accounting pronouncements, including FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable.

The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under Statement 133 at initial recognition and in all subsequent periods. Therefore, this Statement nullifies the guidance in footnote 3 of EITF Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*.^{*} This Statement also amends Statement 133 to remove the similar guidance to that in Issue 02-3, which was added by FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*.

How the Conclusions in This Statement Relate to the FASB's Conceptual Framework

The framework for measuring fair value considers the concepts in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*. Concepts Statement 2 emphasizes that providing comparable information enables users of financial statements to identify similarities in and

Statement No. 6, *Elements of Financial Statements*, in the context of market participants. A fair value measurement reflects current market participant assumptions about the future inflows associated with an asset (future economic benefits) and the future outflows associated with a liability (future sacrifices of economic benefits).

This Statement incorporates aspects of the guidance in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, as clarified and/or reconsidered in this Statement. This Statement does not revise Concepts Statement 7. The Board will consider the need to revise Concepts Statement 7 in its conceptual framework project.

The expanded disclosures about the use of fair value to measure assets and liabilities should provide users of financial statements (present and potential investors, creditors, and others) with information that is useful in making investment, credit, and similar decisions—the first objective of financial reporting in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*.

How the Changes in This Statement Improve Financial Reporting

A single definition of fair value, together with a framework for measuring fair value, should result in increased consistency and comparability in fair value measurements.

The expanded disclosures about the use of fair value to measure assets and liabilities should provide users of financial statements with better information about the extent to which fair value is used to measure recognized assets and liabilities, the inputs used to develop the measurements, and the effect of certain of the measurements on earnings (or changes in net assets) for the period.

The amendments made by this Statement advance the Board's initiatives to simplify and codify the accounting literature, eliminating differences that have added to the complexity in GAAP.

Costs and Benefits of Applying This Statement

The framework for measuring fair value builds on current practice and requirements. However, some entities will need to make systems and other changes to comply with the requirements of this Statement. Some entities also might incur incremental costs in applying the requirements of this Statement. However, the benefits from increased consistency and comparability in fair value measurements and expanded disclosures about those measurements should be ongoing.

The Effective Date of This Statement

This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year.

The provisions of this Statement should be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except as follows. The provisions of this Statement should be applied retrospectively to the following financial instruments as of the beginning of the fiscal year in which this Statement is initially applied (a limited form of retrospective application):

1. A position in a financial instrument that trades in an active market held by a broker-dealer or investment company within the scope of the AICPA Audit and Accounting Guides for those industries that was measured at fair value using a blockage factor prior to initial application of this Statement
2. A financial instrument that was measured at fair value at initial recognition under Statement 133 using the transaction price in accordance with the guidance in footnote 3 of Issue 02-3 prior to initial application of this Statement

3. A hybrid financial instrument that was measured at fair value at initial application of this Statement 133 using the transaction price in accordance with the guidance in Statement 133 (added by Statement 153) prior to initial application of this Statement.

The transition adjustment, measured as the difference between the carrying amounts and the fair values of those financial instruments at the date this Statement is initially applied, should be recognized as a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for the fiscal year in which this Statement is initially applied.

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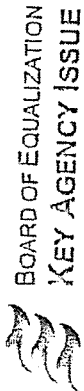
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Issue Paper Number 99-050

- ☐ Board Meeting
☐ Business Taxes Committee
☐ Customer Services Committee
☐ Legislative Committee
☒ Property Tax Committee
☐ Technology & Administration Committee
☐ Other

PROPERTY TAX RULE 10

TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

I. Issue

Should the Board authorize publication of proposed amendments to Title 18, California Code of Regulations, Property Tax Rule 10?

II. Staff Recommendation

Staff recommends that proposed amendments to Property Tax Rule 10 as shown on Attachment A, "SBE Staff Version," be authorized for publication and submitted to the Office of Administrative Law for publication in the California Regulatory Notice Register. *[Assessors concur with staff.]*

III. Other Alternative(s) Considered

1. Adopt, and authorize for publication, Industry's proposed amendments to Property Tax Rule 10 as shown on Attachment B, "Industry Version" (deletions and modifications to staff's proposed amendments are shown on the attached matrix, Attachment C). Submit the revised rule to the Office of Administrative Law for publication in the California Regulatory Notice Register.

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the authority to prescribe rules and regulations to govern local boards of equalization when equalizing and assessors when assessing. Accordingly, staff was directed to review and revise Property Tax Rule 10 (Section 10, Title 18, of the California Code of Regulations). Consistent with this direction, the staff of the Property Taxes Department and Legal Division drafted proposed amendments to Property Tax Rule 10, and disseminated a draft of the rule to interested parties (February 25, 1999, Letter to Assessors (LTA) 99/17).

After requesting and receiving comments from interested parties regarding the proposed revision, a second draft of the rule was prepared and disseminated. On June 22, 1999, staff held a meeting in Sacramento with interested parties to attempt to reach agreement on the issues and language of the proposed revisions. Following that meeting four areas of disagreement remained, and the issues were scheduled to be heard at the September meeting of the Property Taxes Committee. Due to ongoing discussions and concern about the issues, however, the discussion of Rule 10 and related issues was rescheduled to the Committee's calendar in November.

Staff was directed by management to continue working with interested parties until October 6, 1999 in an effort to resolve issues and wording differences related to the rule. At that time this issue paper was drafted, finalized, and submitted to the Property Tax Committee for discussion at its November meeting.

There are two areas of disagreement remaining regarding Rule 10 which are set forth below in the form of questions:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?
2. In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that proposed amendments to Property Tax Rule 10 as shown on Attachment A, "SBE Staff Version," be authorized for publication and submitted to the Office of Administrative Law for publication in the California Regulatory Notice Register.

Rule 10 provides guidance in applying the trade level principle. The proposed language of Rule 10 is consistent with the statutory and constitutional requirements that all property be assessed at fair market value. Section 110(a) of the Revenue and Taxation Code defines "fair market value" or full cash value as the "amount of cash or its equivalent which property would bring if exposed for sale in the open market under conditions in which neither buyer or seller could take advantage of the exigencies of the other." The Constitution requires that all taxable property must be assessed at "fair market value" (Article XIII, § 1(a)). The trade level concept ensures that property is valued at fair

similar property that may be acquired through different means (i.e. self-constructed or leased versus property purchased by a consumer). Without a trade level adjustment property may be valued above or below its fair market value.

Under staff's proposed Rule 10, all property must be assessed at the proper level of trade based on its location and use on the lien date. An appraiser must recognize that property normally increases in value as it progresses through production and distribution channels to the consumer, whether or not the cost or value added is booked in accounting records. The trade level concept, as described in staff's proposed version of Rule 10 (Attachment A), is applicable when book cost does not provide adequate information for making a fair market value appraisal. It is most frequently applied to leased equipment and self-constructed equipment.

3. Pros of the Staff Recommendation

Staff's recommendation addresses the two questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

Yes. Staff and county assessors believe that general trade level principles are applicable to all types of taxable property, both real and personal for the following fundamental reasons: (1) the need to meet the constitutional requirement of fair market value as defined in section 110; and (2) the need to recognize the principle of fairness and equity in the assessment of property that has been enunciated by the courts in a number of cases. In *Xerox Corp. v. County of Orange* (1977) 66 Cal.App.3d 746, the court said at page 755:

"...the trade level concept is useful in assessing the leased property for two reasons; namely, it establishes the trade level at which the property is to be appraised and it focuses on the elements that help establish the market price."

"...the trade level theory produces equity between taxpayers by assuring that the taxpayer consumer who owns his equipment will pay the same tax on identical equipment, as the taxpayer who leases the equipment to the ultimate consumer. The market value of the property is the same if the property is held by the ultimate consumer regardless of who pays the tax."

(See also *Beckman Instruments, Inc. v. County of Orange* (1977) 53 Cal.App.3d 767 at 782 and *Cell-O Corp. v. County of Alameda* (1973) 32 Cal.App.3d 135 at 141.)

General trade level principles can apply to any type of property, and are similar to the stage of production principle as discussed in Assessors' Handbook Section 501 (AH 501), *Basic Appraisal* (September 1997, p. 12-13). If applying a trade level adjustment to a fixture results in fair market value and equity between taxpayers, then it is an appropriate adjustment whether or not it is specifically identified in a Board rule. Excluding fixtures from the rule does not mean that trade level theory does not apply to fixtures but it may cause difficulty in applying trade level adjustments when appraising personal property affixed to real property (fixtures). Since fixtures are real property, changing the title of the rule to "Trade Level" would be necessary if staff's version is adopted.

Currently, confusion exists as to the rule's application to fixtures. For example, if a trade level

for an identical printing press affixed to real property (fixture)? Staff believes the rule should be revised to eliminate this confusion and promote uniformity of assessment practices. If fixtures are not specifically included in the rule, the rule may lack "clarity" as required by Government Code section 11349.1 when reviewed by the Office of Administrative Law (OAL).

2. In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?

The full economic cost should not include non-property items unless they are separately purchased. The costs of non-property items are appropriate adjustments to the calculation of retail trade level factors *only* when such costs are separately stated. For example, Industry uses warranty as an example of non-property. If an extended warranty were purchased it would be appropriate to make an adjustment for this item (as listed on the sales contract). If, however, the warranty is not listed separately but merely the warranty required by law or otherwise "typically" included with the product (i.e., not separately stated and priced), no adjustment is appropriate.

Staff's proposed language does not discuss "non-property items" and is consistent with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*. In AH 504, "non-property items" are discussed under the heading "Discounts/Adjustments". AH 504, at page 59, states:

"Adjustment may be appropriate when non-property items have been included in a purchase contract. Extended service plans and warranties, supplies, other purchased assets or business services may have been included in the purchase contract. An adjustment may be appropriate for the fair market value of these assets."

"Non-property items" in this context is used to define or describe items, which may be included in the purchase price, other than the specific property being valued. Each "non-property item" listed in this text would generally be a separately listed item on the sales contract. "Non-property items" is only meant to be used in the context of the discussion in AH 504. The term should not be utilized without explanation, or taken out of context and applied to non-property items not separately stated in a sales contract.

(Additional arguments for staff's position can be found in Alternative 1, Cons of the Alternative)

Note: Footnote 118 in AH 504, as mentioned by industry in Alternative 1, Pros of the Alternative, is based on current Rule 10. This footnote would be deleted if staff's version were adopted.

C. Cons of the Staff Recommendation

1. Industry does not believe the inclusion of fixtures in Rule 10 is appropriate. Industry cites a recent unpublished court case which refers to trade level in support of their position. Industry believes that leaving Rule 10 silent as to fixtures would not preclude the use of trade level in valuing fixtures but that the rule would cause confusion if fixtures were included. (See also Alternative 1, Pros of the Alternative.)

The letter referenced by Industry from senior staff counsel James M. Williams discussed the application of Rule 10 (as it was at that time) as applied to fixtures in relation to that particular

2. Industry believes that non-property items, whether or not separately stated, should not be included in the trade level adjustment. In industry's view, staff's language does not give adequate guidance for adjusting full economic cost to exclude all non-taxable property, resulting in the overvaluation of some property.

(Additional arguments for Industry's position can be found in Alternative 1, Pros of the Alternative.)

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See Attached Revenue Estimate

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Board should authorize publication of amendments to the Rule at its November 1999 meeting.

V1. Alternative 1

A. Description of the Alternative

The Board could adopt Industry's proposed amendments to Property Tax Rule 10. Attachment B shows Industry's proposed revisions to the current Rule 10.

Differences between staff's proposed Rule 10 and Industry's proposed Rule 10 are arrayed on the attached matrix (Attachment C). Industry's version (Attachment B) of Rule 10 differs from staff's version (Attachment A) in two respects: (1) industry deletes staff's references to fixtures, and (2) industry includes adjustments for non-property items while staff's version is silent.

B. Pros of the Alternative

Industry's recommendation addresses the two questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

No. Industry does not think that the inclusion of personal property that has been affixed to real property in Rule 10 is appropriate.

[The following text was submitted by the California Taxpayers' Association (Cal-Tax)]

Assets with a fixture classification are typically acquired at "arm's length" and should not be trade leveled. Fair market value for fixtures can be determined without applying trade level. Many taxpayers have experienced problems in some counties, where assessors incorrectly apply trade level adjustments to fixtures. The staff's proposed language would reinforce that practice. Fixtures are not now included in Rule 10, and industry believes it would be incorrect to add them to the new rule.

The stated purpose of updating Rule 10 is to conform the rule to current law, and hopefully to provide clarity for taxpayers and assessors. By including fixtures in Rule 10, we are concerned that neither conformity nor clarity will be served and that county assessors will apply trade level adjustment that are inappropriate and could be illegal. Moreover, recent court cases have held that fixtures are real property, not tangible personal property. It would appear to present a confusing, if not conflicting, situation to include fixtures in a rule pertaining to tangible personal property.

Including fixtures in Rule 10 would also be inconsistent with AH 504 Footnote 118 on page 60 of the handbook. Footnote 118 in the Trade Level section directs readers that fixtures should be assessed at the appropriate stage of production rather than trade level, as described on page 13 in AH 501. By removing the last sentence of paragraph (a) in the proposed Rule 10, the conflict with AH 504 and AH 501 would disappear.

The only valid reason for originally including fixtures in Rule 10 appeared to be justification for using trade level to value propane tanks under Rule 10. Now that Rule 153 is being proposed for the valuation of propane tanks, reference to fixtures in Rule 10 is unnecessary and creates confusion and inconsistency. Leaving Rule 10 silent as to fixtures does not absolutely preclude the use of trade level, but readers would not be unnecessarily confused by its inclusion.

[The following text was submitted by the Western Propane Gas Association.]

The SBOE has previously researched the issue of whether "fixtures" can be taxed under Rule 10 and it has concluded that they cannot. On May 4, 1992 senior staff counsel James M. Williams wrote the letter to the County or San Luis Obispo which stated " ...if the tanks have already been classified as improvements, then Rule 10 is not applicable because by its own explicit term it controls only the appraisal of tangible personal property."

The history of this issue only highlights the need for a separate Rule 153. At that time of Mr. Williams above referenced letter the local assessor was initially treating propane tanks as

property". Subsequently Rule 124 was changed so that the tanks would be classified as "fixtures". While this was happening, the case of *J.W. Platz, et al. v County of San Luis Obispo* was running its course through the Court of Appeals. As staff is well aware, this case focused solely on the issue of whether Property Tax Rule 10(d) or Rule 10(e) controlled the assessment of Plaintiff's propane storage tanks. During the final hearing of this case, the County of San Luis Obispo took the position that the entire case was moot because Rule 124 had changed to include tanks as "fixtures" and that therefore Rule 10 no longer applied. As you can see, this position is entirely inconsistent with the CAA's current position.

Notwithstanding the above, and notwithstanding the fact that Rule 124 now classifies the tanks as fixtures, the Industry has been willing to allow specific reference within Rule 10 which deals with the proper evaluation of propane tanks. The Industry has taken this position because it does not really care under which Rule specific reference to the handling of propane tanks is found, so long as there is a specific reference. As the staff will recall, it was staff's request of the industry that it consider dropping its proposal that specific reference to propane tanks be found within Rule 10, in exchange for a new rule (153) which would make specific reference to propane tanks. As staff can now clearly see, the CAA wishes to undermine these efforts by deleting specific reference to propane tanks in Rule 10, and by eliminating Rule 153 entirely.

In conclusion, the CAA makes repeated reference to the case of *Xerox Corp. v. County of Orange* (1977) 66 Cal.App.3d, 746. The Industry would like to remind staff that this case is of absolutely no value in trying to determine the property valuation of propane storage tanks. In the case of *Platz et al., v County of San Luis Obispo*, the court of Appeals specifically noted that this case, along with others relied on by the assessor "...indicate that the 'trade level' theory should be applied to leased equipment. But, where it is necessary to determine which method of valuation under the 'trade level' theory is to be applied, they are not instructive." The Industry does not have any problem with the concept of trade level adjustment per se, only the County Assessor's improper application of it to propane storage tanks.

2. **In the determination of a trade level factor, should the full economic cost include an allowance for non-property items?**

Yes, there should be a trade level adjustment for non-property items.

[The following text was submitted by the California Taxpayers' Association (Cal-Tax). Text was not submitted by the Western Propane Gas Association regarding this topic.]

There should be a trade level adjustment for non-property items as already agreed to in the development of AH 504. This would encompass warranties or other non-property items included in the transaction as an appropriate deduction.

To omit the non-property items would put Rule 10 at variance with AH 504, which states on page 59 of the handbook:

"Adjustment may be appropriate when non-property items have been included in a purchase contract. Extended service plans and warranties, supplies, other purchased assets or business services may have been included in the purchase contract. An adjustment may be appropriate for the fair market value of these assets. The effect on the purchase price for any included financing should also be considered."

Table 4B Discounts/Adjustments on the same page of the AH 504, then lists those items for which an adjustment is allowed for assessment purposes and includes:

- Quantity discount
- Cash discount
- Non-property items
- Seller rebates

Rule 10 would be incomplete if non-property items were not added to the list of allowable adjustments as well as inconsistent with the language agreed to and adopted in the AH 504 just last year.

In addition, precedent already exists in statute for allowing adjustments for the value of non-property items under Revenue and Taxation Code Sec. 998, pertaining to timeshares:

"The full value of a timeshare estate or a timeshare use subject to tax under this division shall be determined by finding the real property value of the interest involved and shall not include the value of any nonreal property items, including, but not limited to, vacation exchange rights, vacation conveniences and services, and club memberships."

As in the above example, the inclusion of non-property item adjustment in Rule 10 would only apply to self-consumed and leased property because of their unique situation. It would not open up the issue of deductions for non-property items included in a purchase for other non-similarly situated property. And the burden will be on the manufacturer/user or lessor to show evidence of the non-property item value.

C. Cons of the Alternative

1. General trade level principles can apply to any type of property. If applying a trade level adjustment to a fixture results in fair market value and equity between taxpayers, then it is an appropriate adjustment whether or not it is specifically identified in a Board rule. Thus, excluding fixtures from the rule does not mean that the trade level theory does not apply to fixtures; including fixtures in the rule would clarify that trade level may apply to fixtures.

Industry, both the California Taxpayers' Association (Cal-Tax) and the Western Propane Gas Association, appear to agree that the trade level concept applies to fixtures. They wish, however, to remain silent as to fixtures in Rule 10 to avoid its improper application. Industry states:

"Leaving Rule 10 silent as to fixtures does not absolutely preclude the use of trade level, but readers would not be unnecessarily confused by its inclusion."
(Cal-Tax, see Alternative 1, Pros)

"The Industry does not have any problem with the concept of trade level adjustment per se, only the County Assessors' improper application of it to propane storage tanks."
(Western Propane Gas Association, see Alternative 1, Pros)

This, in staff's view, is inappropriate. The rule should expressly state that trade level applies to fixtures, for purposes of clarity.

(See also Staff Recommendation, Pros of the Staff Recommendation)

2. The term "non-property items" is ambiguous as to what it includes, and may lead to assessment of property at less than fair market value. The term must be defined, as was done in AH 504, in order to be applied appropriately. Cautionary statements such as "the burden will be on the manufacturer/user or lessor to show evidence of the non-property item value" (see Cal-Tax text under Alternative 1, Pros) and a definition of the term would also be necessary in Rule 10.

The meaning of "non-property items" can only be determined from the statutes by excluding the things defined as property in section 103. This is not the way the term is being used in AH 504. Cal-Tax uses the term "non-property items" out of context and cites section 998 as precedent for using the term. However, section 998 uses the term "nonreal property", which has a completely different meaning. ("Real property" is specifically defined in the Revenue and Taxation Code (section 104). "Property" is defined broadly as "all matters and things, real, personal, and mixed, capable of private ownership" (section 103).)

Once defined, adjustments for non-property items are appropriate only when such costs are separately stated; i.e., they can be purchased separately from the product. The full economic cost of property, therefore, should not include an adjustment for non-property items unless separately stated and/or purchased. Industry uses *warranty* as an example of a "non-property item" for which an adjustment to full economic cost is necessary. Staff disagrees with a warranty adjustment to full economic cost unless it is separately stated, such as an extended warranty. Staff's proposed language, excluding non-property items such as warranties, as an adjustment to the trade level factor, is consistent with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*. The wording in this section of the handbook regarding warranty adjustments was presented to the Board in the form of a formal issue paper. (See issue number 08-076 December 1998.)

Board approved staff's wording that specifically did not include "warranty" as an adjustment in the determination of the trade level factor.

Further, in this instance, warranty adjustments are not appropriate unless separately stated since assessed value must be based on the value to a "typical" consumer of similar property. "Typical" consumers do not purchase property without warranties. This is true, in part, because certain warranties are required by law. These required warranties of merchantability and fitness may not be limited, modified, or disclaimed by the seller unless the property is sold "as is" or "with all faults" and the buyer is conspicuously and clearly informed as such in writing. Thus a purchase of property without warranty is not representative of a "typical" buyer. Allowing such an adjustment for self-consumed property gives the manufacturer an unfair advantage unless other customers are allowed to purchase the products similarly (i.e., there are two price lists: one with warranty and one without). It is in conflict with section 110 of the Revenue and Taxation Code ("...the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor the seller could take advantage of the exigencies of the other....") and the constitution which requires all taxable property be assessed at "fair market value" (California Constitution, article XIII § 1 (a)). Since warranties are the only non-property items specifically identified by industry in "Pros of the Alternative", it is the only item addressed by staff in this issue paper. Staff is unable to address non-property items in general without specific information as to what is included in the term.

However, if the trade level adjustment is being determined for self-consumed property, other adjustments may be necessary to account for differences in the self-constructed equipment and equipment sold to the manufacturer's customers. As stated and discussed in AH 504, such discounts and/or appropriate retail selling prices for internally used equipment can be determined through (1) analysis of sales transactions or (2) use of a gross margin mark up method. When actual sales data is available, the first method is preferred. (See AH 504, December 1999, p. 64.)

[The following text was submitted by the California Assessors' Association (CAA).]

The deduction from full economic cost for "non-property items" is unclear and opens the door for assesses to assert that warranties should be excluded in the cost approach. Companies that are the end users of equipment that they manufacture should be assessed at the same trade level as any other consumer of the product. Generally, other consumers cannot elect to give up the warranty on the product and pay a lower price for the product.

(See also Staff Recommendation, Pros of the Staff Recommendation.)

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See attached Revenue Estimate

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Board should authorize publication of amendments to the Rule at its November 1999 meeting.

Prepared by: Property Taxes Department; Policy, Planning, and Standards Division

Current as of: October 21, 1999

ATTACHMENT A

"SBE STAFF AND CAA VERSION"

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.
Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein. Trade level adjustments shall also be considered when appraising personal property affixed to real property.

(b) ~~Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property; such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the best situs.~~

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level if exposed for sale on the open market. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost, installation costs, sales or use taxes, and additions for market supported entrepreneurial services (with appropriate allowances for trade, quantity, or cash discounts).

(c) ~~Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs.~~

1 Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by
2 recent purchases by the assessee or other recent market transactions.
3
4 (c) Tangible personal property leased, rented, or loaned for a period of six months or less,
5 having a tax situs at the place where the lessor normally keeps the property as provided in
6 regulation 204, shall be valued at the amount of cash or its equivalent for which it would
7 transfer to other lessors or retailers of like property. The value may be estimated by
8 reference to the price at which the lessor could be expected to sell the property at fair
9 market value to other lessors or retailers of like property. If that price is unknown, then
10 the value may be estimated by reference to one or more of the following indicators of
11 value: (1) the lessor's full economic cost of the property with a reasonable allowance for
12 depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the
13 manufacturer; or (3) in accordance with subdivision (b).
14
15 (d) Tangible personal property in the hands of a retail merchant who holds it for sale,
16 lease, or rental shall be valued at the amount for which it would transfer to other retailers
17 of like property; and tangible personal property in the hands of a wholesale merchant who
18 holds it for sale, lease, or rental shall be valued at the amount for which it would transfer
19 to other wholesalers of like property. This value shall be estimated (1) by reference to
20 the property's cost to the merchant, including freight in and deducting trade, quantity, and
21 cash discounts, with reasonable allowance based on proper substantiation for damaged,
22 shopworn, out-of-style, used, or overage stock; or (2) by reference to the price at which
23 the merchant is expected to sell the property less his experienced gross profit.
24
25 (e) Tangible personal property leased, rented, or loaned for an extended but unspecified
26 period or leased for a term of more than six months, having tax situs at the lessee's situs
27 as provided in regulation 204, shall be valued by estimating the cash price or its
28 equivalent for which the property could be sold at fair market value to an outside
29 customer operating at the same level of trade as the lessee. If that price is unknown, then
30 the value may be estimated by reference to one or more of the following indicators of
31 value: (1) the lessee's full economic cost of the property with a reasonable allowance for
32 depreciation, or (2) in accordance with subdivision (b).
33
34 (f) Tangible personal property in the hands of a person who holds it for consumption
35 shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When,
36 however, such property is leased or rented for a period of less than six months so that its
37 tax situs, as provided in section 204 of this chapter, is at the place where the lessor
38 normally keeps the property, it shall be valued in accordance with the last sentence of
39 subdivision (d).
40
41 (g) Tangible personal property acquired from internal sources for self-consumption or
42 use, shall be valued by estimating the cash price or its equivalent for which the property
43 could be sold at fair market value to an outside customer using the property at the same
44 trade level, (with appropriate allowances for trade, quantity, or cash discounts). If that
45 price is unknown, then the value may be estimated by reference to one or more of the
46

following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional and/or intercompany profits, interest on borrowed or owner supplied funds, sales or use tax, installation, and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, and depreciation), or (2) in accordance with subdivision (b). The quantity discount allowed a manufacturer, when it is its own largest customer, should be at least as large as that allowed its largest wholesale or retail customer.

(A) ~~When tangible personal property is in the hands of a person engaged in two or more of the functions of producer, manufacturer or processor, wholesaler, retailer, or consumer, the level of trade at which the property is held shall be determined by reference to its form, location, quantity, acquisition source, and probable purchasers or lessees. A person is operating at two or more levels when the property consists of raw materials, semi-manufacturers, or finished goods which were acquired from sources within a business entity (other than component parts meeting the tests of the following sentence) and the property is held (1) for consumption by the business entity or (2) for processing and/or marketing in competition with similar products marketed by other business entities that have purchased like raw materials, semi-manufacturers, or finished goods at the same stage of production from external sources. Component parts held at the manufacturing processing level, however, shall not be considered to be at a higher level than that at which they are manufactured when they have been manufactured by a business entity specifically and exclusively for (1) incorporation by the entity in its finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

~~When it is concluded that the person holding tangible personal property is operating at more than one trade level, property at the higher trade level or levels acquired from internal sources shall be valued (1) by estimating what the property, in its condition and location on the lien date, would have cost had it been acquired in an arm's length transaction from an outside supplier, (2) by reference to the cash price at which the property could be sold in an arm's length transaction to an outside customer less a reasonable gross profit, or (3) if held at the consumer level, in accordance with subdivision (e).~~

~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter the trade level. The trade level of such property will be determined in accordance with subdivision (f).~~

(f) Tangible personal property in the hands of a person engaged in the function of a manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade. The property shall be valued based on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).

History: Adopted June 21, 1967, effective July 23, 1967.

Amended February 18, 1970, effective March 26, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended April 19, 1971, effective May 22, 1971.

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ATTACHMENT B

"INDUSTRY VERSION"

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.
Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein.

~~(a) Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property, such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the tax situs.~~

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level if exposed for sale on the open market. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost, installation costs, sales or use taxes, and additions for market supported entrepreneurial services (with appropriate allowances for trade, quantity, or cash discounts; and non-property items).

~~(b) Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs. Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by recent purchases by the assessee or other recent market transactions.~~

(c) Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property. The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation; (2) the cost indicated in subdivision (c) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).

(i) ~~Tangible personal property in the hands of a retail merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other retailers of like property; and tangible personal property in the hands of a wholesale merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other wholesalers of like property. This value shall be estimated (1) by reference to the property's cost to the merchant, including freight in and deducting trade, quantity, and cash discounts, with reasonable allowance based on proper substantiation for damaged, shopworn, out-of-style, used, or overage stock, or (2) by reference to the price at which the merchant is expected to sell the property less his experienced gross profit.~~

(d) Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade as the lessee. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessee's full economic cost of the property with a reasonable allowance for depreciation, or (2) in accordance with subdivision (b).

(j) ~~Tangible personal property in the hands of a person who holds it for consumption shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When, however, such property is leased or rented for a period of less than six months so that its tax situs, as provided in section 204 of this chapter is at the place where the lessor normally keeps the property, it shall be valued in accordance with the last sentence of subdivision (d).~~

(e) Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer using the property at the same trade level, (with appropriate allowances for trade, quantity, or cash discounts). If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including

1 labor, materials, overhead, interdivisional and/or intercompany profits, interest on
2 borrowed or owner supplied funds, sales or use tax, installation, and other costs incurred
3 in bringing the property to a finished state, with appropriate allowances for trade,
4 quantity, or cash discounts; depreciation, and non-property items), or (2) in accordance
5 with subdivision (b). The quantity discount allowed a manufacturer, when it is its own
6 largest customer, should be at least as large as that allowed its largest wholesale or retail
7 customer.

8
9 ~~(4) When tangible personal property is in the hands of a person engaged in two or more~~
10 ~~of the functions of producer, manufacturer or processor, wholesaler, retailer, or~~
11 ~~consumer, the level of trade at which the property is held shall be determined by~~
12 ~~reference to its form, location, quantity, acquisition source, and probably purchasers or~~
13 ~~lessees. A person is operating at two or more levels when the property consists of raw~~
14 ~~materials, semi-manufactures, or finished goods which were acquired from sources~~
15 ~~within a business entity (other than component parts meeting the tests of the following~~
16 ~~sentence) and the property is held (1) for consumption by the business entity or (2) for~~
17 ~~processing and/or marketing in competition with similar products marketed by other~~
18 ~~business entities that have purchased like raw materials, semi-manufactures, or finished~~
19 ~~goods at the same stage of production from external sources. Component parts held at~~
20 ~~the manufacturing processing level, however, shall not be considered to be at a higher~~
21 ~~level than that at which they are manufactured when they have been manufactured by a~~
22 ~~business entity specifically and exclusively for (1) incorporation by the entity in its~~
23 ~~finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

24
25 ~~When it is concluded that the person holding tangible personal property is operating at~~
26 ~~more than one trade level, property at the higher trade level or levels acquired from~~
27 ~~internal sources shall be valued (1) by estimating what the property, in its condition and~~
28 ~~location on the lien date, would have cost had it been acquired in an arm's length~~
29 ~~transaction from an outside supplier, (2) by reference to the cash price at which the~~
30 ~~property could be sold in an arm's length transaction to an outside customer less a~~
31 ~~reasonable gross profit, or (3) if held at the consumer level, in accordance with~~
32 ~~subdivision (e).~~

33
34 ~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter~~
35 ~~the trade level. The trade level of such property will be determined in accordance with~~
36 ~~subdivision (f).~~

37
38 ~~(f) Tangible personal property in the hands of a person engaged in the function of a~~
39 ~~manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the~~
40 ~~cash price or its equivalent for which the property could be sold at fair market value to an~~
41 ~~outside customer operating at the same level of trade. The property shall be valued based~~
42 ~~on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).~~

43
44
45 *History:* Adopted June 21, 1967, effective July 23, 1967.

46 Amended February 18, 1970, effective March 26, 1970.

Amended January 6, 1971, effective February 18, 1971.
Amended April 19, 1971, effective May 22, 1971.

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ATTACHMENT C
 RULE 10 ISSUE PAPER MATRIX

Wording Differences Between Staff and Assessors (Attachment A) and Industry (Attachment B)

Item	Paragraph	Source	Position
1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?			
1(a)	Title	SBE Staff & CAA	Change title of Rule 10. Trade Level for ~~Tangible-Permanent-Property~~
1(b)	Paragraph (a), last sentence	SBE Staff & CAA	Add following sentence: Trade level adjustments shall also be considered when appraising personal property affixed to real property.
2. In the determination of a trade level factor, should the full economic cost include an allowance for warranties?			
2(a)	Paragraph (b), last sentence	Industry	Addition to SBE staff & CAA version: ... (with appropriate allowances for trade, quantity, or cash discounts, and non-property items).
2(b)	Paragraph (c), second sentence	Industry	Addition to SBE staff & CAA version: ... with appropriate allowances for trade, quantity, or cash discounts, depreciation, and non-property items)



BOARD OF EQUALIZATION
REVENUE ESTIMATE

ISSUE #99-050
Property Tax Rule 10, Trade Level for Tangible Personal Property

Proposal

Board staff has proposed amendments for Property Tax Rule 10, Trade Level for Tangible Personal Property.

Background, Methodology, and Assumptions

Under the trade level concept, property is assessed based on how it is situated on the lien date. Trade level adjustments ensure that property is valued at market value and are most frequently applicable to leased equipment and to equipment that is self-constructed and self-consumed by the manufacturer.

The two areas of disagreement between the staff proposal and the alternative offered by industry are the adjustment for non-property items and the deletion of references to trade level adjustments for fixtures. The version of Rule 10 proposed by industry includes an allowance for non-property items and would most affect valuations in the computer hardware manufacturing industry.

Staff estimates that the statewide total for personal property and fixtures values for computer hardware manufacturers is less than \$10 billion and that up to one-half of this, \$5 billion, is self-constructed and self-consumed equipment that will be affected by the trade level adjustments. It is estimated that the allowance for non-property items proposed by industry would result in a reduction in the range of one to ten percent. Statewide, the annual maximum reduction in assessed value under the alternative proposal is then:

$$\$5 \text{ billion} \times (1\% \text{ to } 10\%) = \$50 \text{ million to } \$500 \text{ million.}$$

Another unresolved item is the reference to fixtures; it is deleted in the industry's version of Rule 10. This deletion should not have a revenue effect since the application of the trade level principle is inherent in arriving at fair market value. Rule 10 only gives clarification of the application of the trade level principle. The assessors should continue to apply trade level adjustments to fixtures with or without the explicit reference.

Revenue Summary

There is no revenue change for the staff recommendation. Under the industry proposal, the decrease in property taxes at the basic one percent property tax rate is between \$500,000 and \$5 million $((\$50 \text{ million to } \$500 \text{ million}) \times 1 \text{ percent})$ annually.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Statistics Section, Agency Planning and Research Division. The estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division, and by Mr. Richard C. Johnson, Deputy Director, Property Taxes Department. For additional information, please contact Ms. Lee at 445-0840.

Current as of October 28, 1999.

value added

Definitions (3)

1. Accounting

2. Economics

3. Marketing

1. Accounting: Alternative term for gross income.
2. Economics: Difference between the total sales revenue of an industry and the total cost of components, materials, and services purchased from other firms within a reporting period (usually one year). It is the industry's contribution to the gross domestic product (GDP) and is the basis on which value added tax (VAT) is computed. See also economic value added.
3. Marketing: Creation of a competitive advantage by bundling, combining, or packaging features and benefits that result in greater customer acceptance.

Need Startup Funds?

As much as \$125k at low rates for those with a high credit score!

Use value added in a sentence

- I needed to determine the **value added** before we moved forward in our business because that would determine the difference.

10 people found this helpful

- You should always try to add in the **value added** to any sort of deal so that you know the true price of what you get.

5 people found this helpful

- Europe recently changed how they calculated the **value added** tax, causing confusion among independent authors in the pricing of their books.

2 people found this helpful

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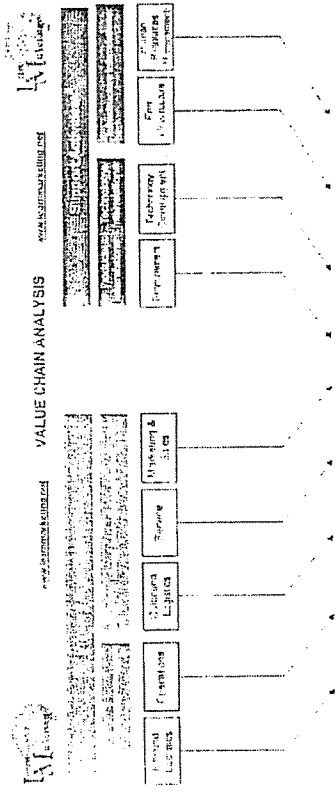
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VALUE CHAIN ANALYSIS

[Previous](#) [Value Chain](#) [Marketing Mix](#) [Marketing Concept](#) [Retail Marketing](#)

Introduction

Michael Porter introduced the value chain analysis concept in his 1985 book 'The Competitive Advantage'. Porter suggested that activities within an organisation add value to the service and products that the organisation produces, and all these activities should be run at optimum level if the organisation is to gain any real competitive advantage. If they are run efficiently the value obtained should exceed the costs of running them i.e. customers should return to the organisation and transact freely and willingly. Michael Porter suggested that the organisation is split into 'primary activities' and 'support activities'.



MARGIN MARGIN MARGIN MARGIN MARGIN

Primary Activities

Inbound logistics : Refers to goods being obtained from the organisation's suppliers and to be used for producing the end product.

Operations : Raw materials and goods are manufactured into the final product. Value is added to the product at this stage as it moves through the production line.

Outbound logistics : Once the products have been manufactured they are ready to be distributed to distribution centres, wholesalers, retailers or customers. Distribution of finished goods is known as outbound logistics.

Marketing and Sales: Marketing must make sure that the product is targeted towards the correct customer group. The marketing mix is used to establish an effective strategy. Any competitive advantage is clearly communicated to the target group through the promotional mix.

Services: After the product/service has been sold what support services does the organisation offer customers? This may come in the form of after sales training, guarantees and warranties.

With the above activities, any or a combination of them are essential if the firm are to develop the competitive advantage.

B-to-B

Marketing

Uncover the media channels that will optimize your B-to-B marketing

e's Companies Inc. (LOW)

	30-Jan-15	Pct.	31-Jan-14	Pct.	1-Feb-13	
Revenue	56,223,000	100.00%	53,417,000	100.00%	50,521,000	1
Profit	36,665,000	65.21%	34,941,000	65.41%	33,194,000	1
Operating Expenses	19,558,000	34.79%	18,476,000	34.59%	17,327,000	
Operating Expenses, General and Administrative	13,281,000	23.62%	12,865,000	24.08%	12,244,000	2
Operating Expenses	1,485,000	2.64%	1,462,000	2.74%	1,523,000	
Operating Income or Loss	14,766,000	26.26%	14,327,000	26.82%	13,767,000	2
Income before Interest and Taxes from Cont. Oper.	4,792,000	8.52%	4,149,000	7.77%	3,560,000	
Tax Expense	4,276,000	7.61%	3,673,000	6.88%	3,137,000	
Income from Continuing Operations	1,578,000	2.81%	1,387,000	2.60%	1,178,000	
	2,698,000	4.80%	2,286,000	4.28%	1,959,000	

<http://finance.yahoo.com/q/is?s=LOW&annual>

From: Hennie van Bulck <hennie@ftc-i.net>
Sent: Monday, October 12, 2015 2:15 PM
To: Nicole Wooten
Subject: RE: Decisions
Attachments: Documents Consulted.pdf; Lowes_2011_Annual_Report.pdf; 2011 Lowes_Form10K.pdf; 2011 lowes_10_year (1).pdf

Nikki,
Attached are the 2011 annual reports and an updated list of documents consulted.
Hennie

-----Original Message-----
From: Nicole Wooten [mailto:Nicole.Wooten@dor.sc.gov]
Sent: Thursday, October 8, 2015 1:33 PM
To: Hennie van Bulck <hennie@ftc-i.net>
Subject: RE: Decisions

Hennie,

Yes, I received the document and was able to access it. Thank you, I will forward to Lowe's counsel for review.

Thanks again,
Nikki

-----Original Message-----
From: Hennie van Bulck [mailto:hennie@ftc-i.net]
Sent: Thursday, October 08, 2015 12:46 PM
To: Nicole Wooten
Subject: RE: Decisions

Nikki,

Attached is the report and information you asked for, yesterday. The file is PW protected.
The PW is the docket number including the hyphens.
Please acknowledge receipt and your ability to open the file with a quick email reply.

Thanks!
Hennie

-----Original Message-----
From: Nicole Wooten [mailto:Nicole.Wooten@dor.sc.gov]
Sent: Wednesday, October 7, 2015 2:52 PM
To: hennie@ftc-i.net
Subject: Decisions

Hennie,

Nicole (Nikki) M. Wooten
Counsel for Litigation
803-898-1826
Nicole.Wooten@dor.sc.gov

South Carolina Department of Revenue
Office of General Counsel
300A Outlet Pointe Blvd. (29210)
Post Office Box 12265
Columbia, SC 29211-9979
www.dor.sc.gov

Documents Consulted

1. Conclusion and Report
2. Correspondence and emails with SCDR
3. Engagement documents
 - o Curriculum Vitae
 - o Notice of Deposition dated September 2, 2015
 - o Engagement Letter dated August 24, 2015
 - o Confidentiality Agreement dated August 21, 2015
4. Case background and parties involved
 - o Email from Ken Smith RE Mr Crider - Court Cases Log dated August 17, 2015
 - o Agency Information Sheet and Notice of Appearance dated December 12, 2014
 - o Request for Contested Case Hearing Form dated November 21, 2014
 - o Department Determination Letter dated October 24, 2014
 - o Supplement to Protest Of Proposed Assessment dated August 2, 2013
 - o Protest Of Proposed Assessment dated December 21, 2012
 - o Crider, Bouye, Elliott & Goodwin LLC website
 - o Jones Day website
5. SC Sales Tax Law and Regulations
 - o Regulation §117-309.17
 - o South Carolina Sales-Tax Manual Chapter 16
 - o SC Code Regs. 117-314 Construction
 - o SC Code Regs. 117-324 Dual Business
 - o SC Code SECTION 12-36-90 "Gross proceeds of sales"
 - o SC Code SECTION 12-36-110 Sale at retail; retail sale.
 - o SC Code SECTION 12-36-910
 - o Board Of Tax Appeals State of Kansas Docket No. 2014-34-DT dated June 29, 2015
 - o 253 SC 14 Supreme Court of South Carolina Colonial Stores Incorporated vs South Carolina Tax Commission dated 30, 1969
6. Depositions
 - o Charles Crider dated October 1, 2015
 - o John P McCormack dated June 30, 2015
 - o Craig Price dated July 21, 2015
 - o Paulette Crawford dated June 30, 2015
7. Subject company information
 - o Lowe's Companies, Inc. 2014 and 2011 Annual Report
 - o Lowe's Companies, Inc. US SEC Form 10-K for The fiscal year ended January 30, 2015 and 2011 10-K
 - o Summary financial information (source: finance.yahoo.com)
 - o 10 -year Financial Information
8. Industry information
 - o NAISC Codes
 - o US Census Industry Snapshot (SC)
 - o US Census 2013 County Business Patterns (NAICS)

9. Valuation standards

- Uniform Standards of Professional Appraisal Practice. (2014-2015 Edition)
 - AICPA Statement on Standards for Valuation Services No 1
 - IRS Revenue Ruling 59-60
 - IRS Publication 561
10. Research on applicable standards of value
- Bases of Value Skeleton Outline (International Valuation Standards Council)
 - Equipment Valuation: Levels of Trade (Norcal Valuation)
 - Equipment Appraisals: What's so Fair about Their Market Value (Norcal Valuation)
 - Standard Measures of Value: Tangible Personal Property Appraisal Guidelines (Florida Department of revenue)
 - 19 CFR 351.412 - Levels of Trade; Adjustments for the Difference in Level of Trade; Constructed Export Price Offset.
 - Summary of statement number 157: Fair Value Measurements (FASB)
 - Property Tax Rule 10 Trade Level for Tangible Personal Property – Issue Paper Number 99-050 State of California Board of Equalization

Valuation Principles

Definition of Assignment (incl. clients and other intended users)

Description of legal interest (incl. type of property; assets or securities, real, personal, intangible)

Ownership characteristics
Control vs. Lack of Control (including restrictions, encumbrances, etc.)
Degree of Marketability

Purpose of Valuation

Purpose of Appraisal (incl. intended uses)
Statutory, regulatory, and case precedent

Standard of Value
Fair Market Value
Investment Value
Intrinsic Value
Fair Value
Premise of value: Going-concern; Liquidation

Applicable standards
e.g. USPAP, SSVS No.1

Approaches (Techniques)
Income approach
Market (Sales comparisons)
Asset-based, incl. cost approach

Assumptions, limiting conditions, scope limitations

Considerations:
Uses, markets and levels of trade, economic conditions