How the IRS Will Value Your Business

The factors below should be considered when valuing any closely held business for any reason, including sales, transfers, gifts to your children or other family members, and stock options granted to key executives. These factors, taken as a whole, provide the basis for a comprehensive, defensible valuation. But they have added importance because they are the factors the IRS uses in valuing businesses. (For further explanation, see IRS Revenue Ruling 59-60.)

- Nature of the business being valued, e.g., manufacturer, distributor, independent representative, or service business.
- Economic outlook, in general, where the company operates.
- Condition and outlook of the specific industry in which the company operates.
- The net book value of the company (assets less liabilities) and the overall financial condition of the business.
- The historical and projected earnings of the company (particularly, its earnings potential over the next three to five years).
- •Whether the stock is voting or non-voting.
- The company's ability to pay dividends.
- The existence of goodwill or other intangible assets, such as licenses and patents.
- Prior sales, transfers, and gifts of shares to others (e.g., an employee, venture firm, or family members). If the sale or transfer was affected on an arm's-length basis, this will help establish the fair market value of the stock.
- The size of the block of stock being valued (e.g., minority or controlling block). If it's a minority position, a discount of 20% to 40% can be applied to the value.
- The value and price-earning's multiple of companies engaged in the same or similar lines of business whose shares are publicly traded in a *free* and *open* market, either on a stock exchange or over the counter.

The ruling further states that "all *available* financial data" and "other relevant factors affecting the fair market value of the stock" must also be considered.