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Gift & Estate Tax Valuation Pointers: The Importance of a Qualified Appraisal

By Melissa Goetz

The owners of a closely-held business may be interested in exploring gift and estate tax planning strategies and, as part of the planning, need to know the value of the business. Or, a decedent may have owned stock in a closely-held business at his or her death, and the business must be valued so an estate tax return can be filed. In cases such as these, there are a number of considerations that are required for a successful gift and estate tax valuation, including the following:

- **Qualified Appraiser:** It is important to find a qualified appraiser that can prepare a qualified valuation report. A qualified appraiser should not only offer verifiable education and experience in valuing the type of business that is the subject of the appraisal, but he or she should also regularly perform appraisals. The appraisal report should specifically outline the appraiser's qualifications, including background, experience, education, certification and any membership in professional appraisal associations.
- **Independent Appraiser:** The appraiser must be sufficiently independent, meaning that the appraiser should not have any interest in the business and should not be "beholden" to any party with an interest in the business.
- **Compliance with IRS Revenue Ruling 59-60:** A valuation for gift and estate tax purposes should contain specific information required by Internal Revenue Service ("IRS") Revenue Ruling 59-60, including, but not limited to, the nature and history of the business; the value of the stock and the financial condition of the business; the earning capacity of the company; whether or not the enterprise has goodwill or other intangible value; an economic outlook as well as specific conditions related to the industry in which the business operates; and the market price of the stock of companies engaged in the same or a similar line of business.

- **Defensible, Supportable Analysis:** A qualified gift and estate tax valuation report should be detailed and include a specific discussion of which approaches to value – for example, the income approach or the market approach – were used in the valuation of the closely-held entity; what assumptions were used; an explanation regarding any discount that was applied when estimating the fair market value of the business, including a discount for lack of marketability or discount for lack of control; as well as the date (or expected date) of the gift and/or the date on which the business was valued.
- **Adequate Disclosure:** When transferring wealth from one generation to the next via a gift, it is not only necessary for the value of the gift to be supported by a qualified appraisal, but it is also critical for the gift to be adequately disclosed on a gift tax return in order for the clock to start ticking on the statute of limitations.
- **Statute of Limitations:** Typically, a transfer that is adequately disclosed on a gift tax return is only subject to audit by the IRS during the statute of limitations period, which is three years after the transfer is reported. If, however, a transfer is not adequately disclosed, the statute of limitations does not begin to run, and the IRS is free to audit the transfer at any time; this may result in the taxpayer being required to pay additional tax and interest in the event of an audit. In order to avoid this gift tax nightmare, it is important for taxpayers to adequately disclose all transfers on a gift tax return in accordance with Treasury Regulations Section 301.6501. If a transfer is adequately reported, the statute of limitations will run its course, and the transfer cannot be revisited by the IRS after the three-year period expires.

Thoughtful gift and estate tax planning takes time and requires the expertise of a qualified appraiser working along with a client’s legal and accounting professionals. In order to protect the value claimed, it is necessary to have an accredited valuation filed along with all gift and estate tax returns.

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